

15 September 2020

Basic Materials | Mining

Adaro Energy (ADRO IJ)

Better ASP Control, Recovery To Kick Off In 2021

Trading Buy (Maintained)

Target Price (Return): IDR1,360 (+13%)
Price: IDR1,200
Market Cap: USD2,535m
Avg Daily Turnover (IDR/USD) 76,043m/5.23m

- **Maintain TRADING BUY, IDR1,360 TP, 13% upside with c.8% FY21F yield.** Further risks related to COVID-19 have dampened global coal demand, impacting benchmark prices even further. As such, we cut Adaro Energy's FY20-21F earnings by 13% and 6%. Nevertheless, support from its business diversification strategy and its commendable cost efficiency should hedge the risk on a softening ASP, and keep margins stable in the long run. Asia will remain its key market. We also expect coal prices to recover from 2021 onwards.
- **Recovery in prices will likely begin next year,** boosted by the anticipation of better control over the COVID-19 infection rate – which in turn, should encourage economic activity. YTD, the benchmark price of coal has fallen by 25% (Newcastle average: USD59.00/tonne, -29% YoY). We expect the Newcastle price average to be at c.USD55.00/tonne by end-FY20 (-30% YoY) before rising next year (FY21F: c.USD60.00/tonne). This should come from a dip in supply, since coal producers like Indonesia (which accounts for c.18% of global coal exports) and Australia (c.38%) will be going through the rainy season (September to March). Our FY20 estimate for ADRO's coal production is at 53m tonnes (-17% YoY).
- **Demand from domestic and regional markets is more stable.** In 1H20, ADRO's sales have depended more on stable demand from its domestic market and orders from neighbouring countries (Thailand, Vietnam, and Malaysia). This also offsets the policy risks from China and India. In the future, it intends to focus more on power plant clients in South-East Asia.
- **Advantages in cost efficiency.** Despite the fall in the benchmark price, the discount gap to ADRO's ASP has progressively narrowed (discounts to the FY18-19 price levels are at 43% and 32%). This should ease the pain from the ASP decline (FY20F: USD40.00/tonne, -25% YoY). Also, the large negotiable portion (c.95% adjusted monthly) of its fuel costs and abundant reserves of low-sulphur and ash coal content gives ADRO flexibility in getting fairer fuel prices and having a more flexible strip ratio (FY20F: 4.3x, vs FY19's 4.6x), which may stabilise GPM. On expenses, synergy with its subsidiaries (c.85% ownership in mining, services and logistics companies) should engender lesser operational risks and better cost control.
- **Support from diversified businesses.** Other support would also come from its joint ventures. ADRO's business is diversified towards power plant investments and coking coal extraction (Figure 9). Currently, ADRO is running a feasibility study on acquiring a stake in Paiton Energy (in East Java, 4,170MW capacity).
- **Reasonable short-term play.** Although the outlook for the coal industry remains uncertain for the next 2-3 years, we conservatively expect to see a recovery in 2021 (ADRO's FY21F volume: 56m tonnes, +6% YoY; ASP: USD43.00/tonne, +7% YoY). The stock is a reasonable short-term play. Our TP is close to its 3-year forward-rolling P/E mean, at 9.4x.

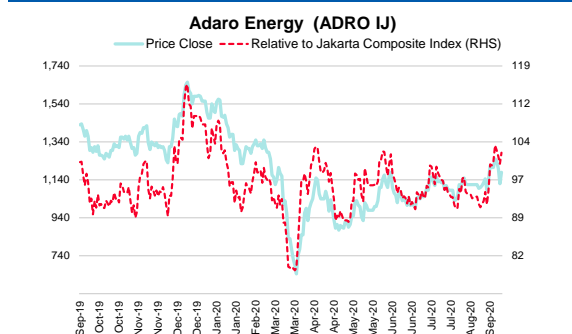
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(24.1)	2.6	10.3	22.3	(19.7)
Relative	(3.7)	6.0	7.0	25.0	1.7
52-wk Price low/high (IDR)				645 – 1,655	



Source: Bloomberg

Previous reports on Adaro Energy:

[Further Cost Efficiencies Conducted](#)
[Volatile Coal Price, But Undemanding Value](#)
[1Q20 Above Expectations; U/G To Trading BUY](#)
[Conference Call Key Takeaways; Stay NEUTRAL](#)
[Weak Earnings On Lower Coal Prices](#)
[JV Income Boosts 3Q19, Above Expectations](#)
[Indonesia Coal: End of An Era; Sell Now, Buy Later](#)
[IDX-RHB Summit KTA: Weakness Up Ahead](#)
[2Q19 Results Beat On Strong Volumes; BUY](#)
[1Q19 Results Beat; Reiterate BUY](#)
[4Q18 Operational Results Above; Stay BUY](#)

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (USDm)	3,620	3,457	2,458	2,750	2,992
Recurring net profit (USDm)	418	404	275	321	351
Recurring net profit growth (%)	(13.6)	(3.2)	(32.0)	16.9	9.2
Recurring P/E (x)	6.07	6.27	9.22	7.89	7.22
P/B (x)	0.7	0.7	0.7	0.7	0.6
P/CF (x)	2.24	3.53	3.86	3.85	3.65
Dividend Yield (%)	7.9	10.9	9.9	8.0	9.3
EV/EBITDA (x)	2.18	2.50	2.38	1.94	1.32
Return on average equity (%)	11.7	11.0	7.4	8.4	8.9
Net debt to equity (%)	11.7	9.5	2.0	net cash	net cash

Source: Company data, RHB

Financial Exhibits

Asia	Financial summary (USD)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Indonesia	Recurring EPS	0.01	0.01	0.01	0.01	0.01
Basic Materials	DPS	0.01	0.01	0.01	0.01	0.01
Adaro Energy	BV/PS	0.11	0.12	0.12	0.12	0.13
ADRO IJ	Return on average equity (%)	11.7	11.0	7.4	8.4	8.9
Trading Buy						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Valuation basis	Recurring P/E (x)	6.07	6.27	9.22	7.89	7.22
P/E of c.9x, which is around the mean of its 3-year band	P/B (x)	0.7	0.7	0.7	0.7	0.6
	FCF Yield (%)	26.6	45.4	20.5	21.0	22.8
Key drivers	Dividend Yield (%)	7.9	10.9	9.9	8.0	9.3
i. Increase in coal sales volume;	EV/EBITDA (x)	2.18	2.50	2.38	1.94	1.32
ii. Increase in coal prices;	EV/EBIT (x)	3.06	3.24	4.86	3.57	2.38
iii. A drop in oil prices.						
	Income statement (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Key risks	Total turnover	3,620	3,457	2,458	2,750	2,992
i. Economic downturn;	Gross profit	1,210	965	598	664	716
ii. Decrease in coal prices;	EBITDA	1,429	951	865	853	908
iii. Increase in oil prices.	Depreciation and amortisation	(412)	(219)	(442)	(391)	(403)
	Operating profit	1,016	732	423	462	505
Company Profile	Net interest	(41)	(38)	(38)	(46)	(51)
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.	Pre-tax profit	821	659	455	492	538
	Taxation	(343)	(224)	(159)	(148)	(161)
	Reported net profit	418	404	275	321	351
	Recurring net profit	418	404	275	321	351
	Cash flow (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	133	257	6	3	(4)
	Cash flow from operations	1,131	719	657	659	695
	Capex	(457)	431	(137)	(127)	(118)
	Cash flow from investing activities	(1,038)	134	(128)	(126)	(120)
	Dividends paid	(200)	(275)	(250)	(203)	(237)
	Cash flow from financing activities	(231)	(341)	(287)	(204)	(242)
	Cash at beginning of period	1,207	928	1,576	1,874	2,242
	Net change in cash	(138)	512	242	329	333
	Ending balance cash	928	1,576	1,351	2,292	2,697
	Balance sheet (USDm)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	928	1,576	1,874	2,242	2,652
	Tangible fixed assets	1,610	1,722	1,615	1,484	1,336
	Total investments	577	793	793	793	793
	Total assets	7,061	7,211	7,082	7,222	7,387
	Short-term debt	220	549	549	549	549
	Total long-term debt	1,211	1,406	1,406	1,392	1,378
	Total liabilities	2,758	3,234	3,094	3,139	3,184
	Total equity	4,303	3,977	3,988	4,083	4,204
	Total liabilities & equity	7,061	7,211	7,082	7,222	7,387
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	11.1	(4.5)	(28.9)	11.9	8.8
	Recurrent EPS growth (%)	(13.6)	(3.2)	(32.0)	16.9	9.2
	Gross margin (%)	33.4	27.9	24.3	24.1	23.9
	Operating EBITDA margin (%)	39.5	27.5	35.2	31.0	30.4
	Net profit margin (%)	11.5	11.7	11.2	11.7	11.7
	Dividend payout ratio (%)	47.9	68.1	91.0	63.0	67.4
	Capex/sales (%)	12.6	(12.5)	5.6	4.6	4.0
	Interest cover (x)	15.6	11.0	5.4	6.0	6.6

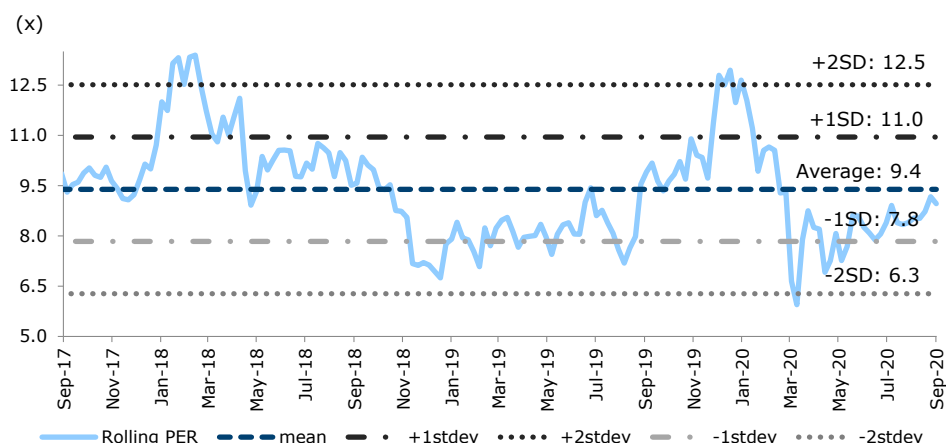
Source: Company data, RHB

Figure 1: RHB vs Street estimates

(USDm)	RHB (new)			RHB (old)			Change			Street			RHB versus Street		
	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F
Revenue	2,458	2,750	2,992	2,829	3,122	3,416	-13.1%	-11.9%	-12.4%	2,768	2,984	3,143	-11.2%	-7.8%	-4.8%
Gross profit	598	664	716	626	671	718	-4.5%	-1.1%	-0.4%	677	786	818	-11.6%	-15.6%	-12.5%
Operating profit	423	462	505	442	476	503	-4.2%	-2.9%	0.4%	490	541	543	-13.6%	-14.6%	-7.0%
Pretax profit	455	492	538	484	510	537	-6.0%	-3.4%	0.2%	486	568	561	-6.5%	-13.2%	-4.0%
Net profit	275	321	351	314	340	357	-12.5%	-5.5%	-1.6%	287	331	358	-4.3%	-3.0%	-1.9%
Margin															
Gross	24.3%	24.1%	23.9%	22.1%	21.5%	21.0%				24.5%	26.3%	26.0%			
EBIT	17.2%	16.8%	16.9%	15.6%	15.2%	14.7%				17.7%	18.1%	17.3%			
Pretax	18.5%	17.9%	18.0%	17.1%	16.3%	15.7%				17.6%	19.0%	17.8%			
NPM	11.2%	11.7%	11.7%	11.1%	10.9%	10.4%				10.4%	11.1%	11.4%			
Key assumptions															
Vol. production (m tonnes)	52.9	56.4	58.3	58.4	61.3	67.2	-9.3%	-8.1%	-13.3%						
ASP (USD/tonne)	40.2	42.8	45.4	42.8	45.4	45.6	-6.0%	-5.7%	-0.6%						
Cash cost (USD/tonne)*	20.9	23.1	24.9	24.4	26.6	27.2	-14.4%	-13.2%	-8.3%						

Source: Company data, RHB *ex-royalty cost

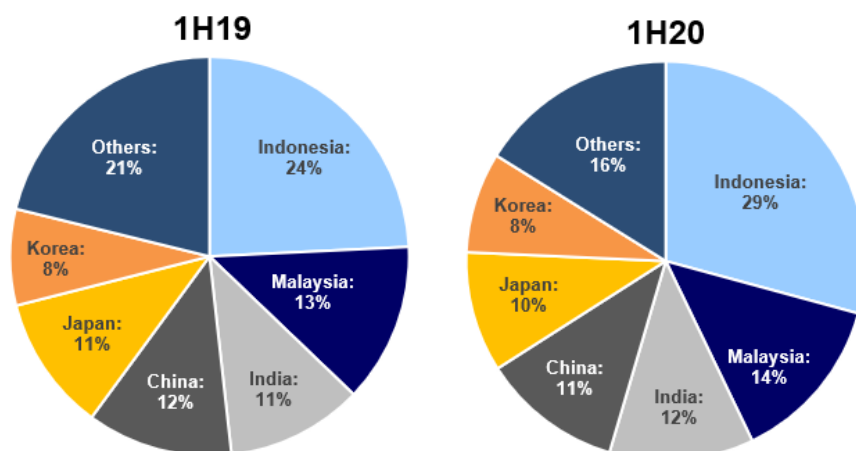
Figure 2: ADRO's 3-year average P/E band



◆ ADRO is trading near the mean of its 3-year forward-rolling P/E band, implying a c.13% upside to its P/E target (c.9x)

Source: Bloomberg, RHB

Figure 3: ADRO's coal sales destinations as at 1H20

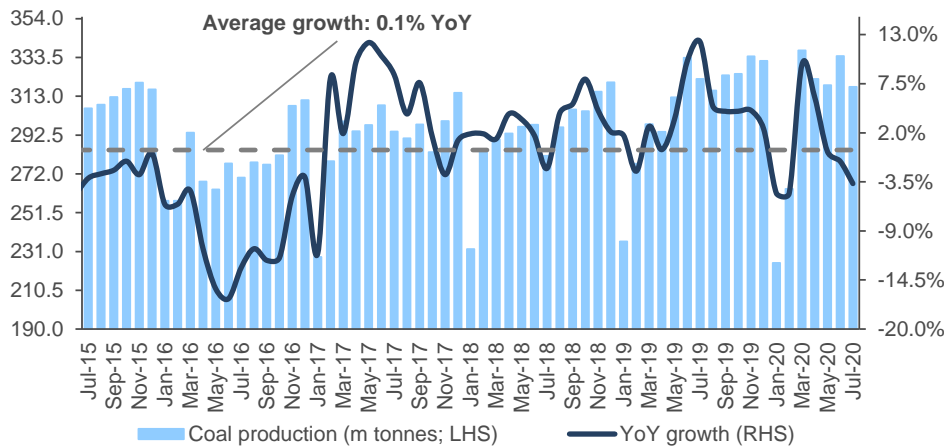


◆ Sales to the domestic market still constitute the largest portion (29%) of ADRO's total coal sales, and marking an increase from last year's figure

◆ Malaysia accounts for the biggest portion of ADRO's exported coal, followed by India, China, Japan, and Korea

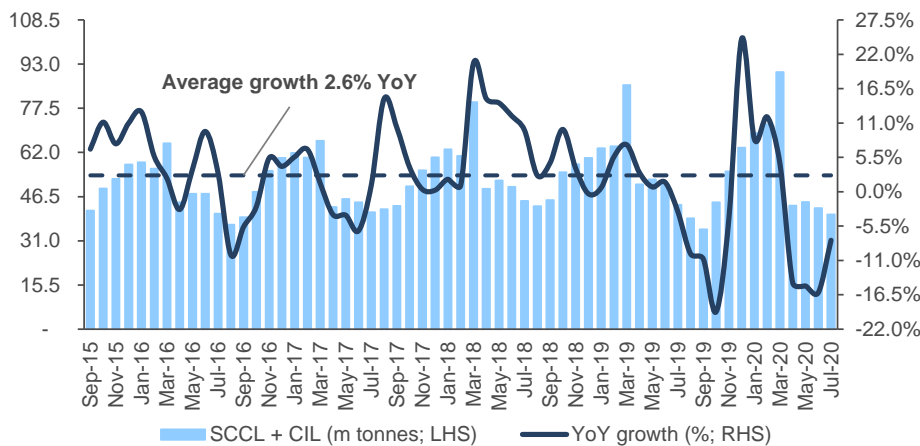
Source: Company data, RHB

Figure 4: China's coal production trend



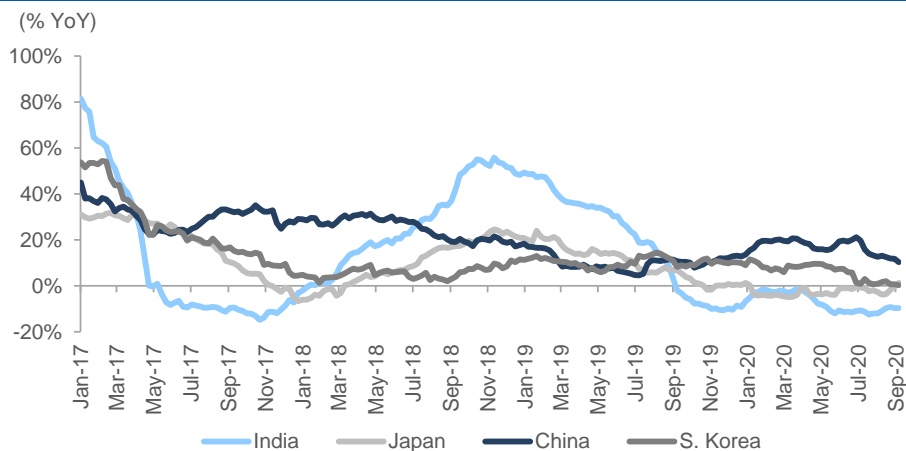
Source: National Bureau of Statistics of China, RHB

Figure 5: India's coal production trend (SCCL & CIL account for c.93% India's coal share)



Source: India's Ministry of Coal, RHB

Figure 6: Coal Import trend (12-month average)



Source: Bloomberg, RHB

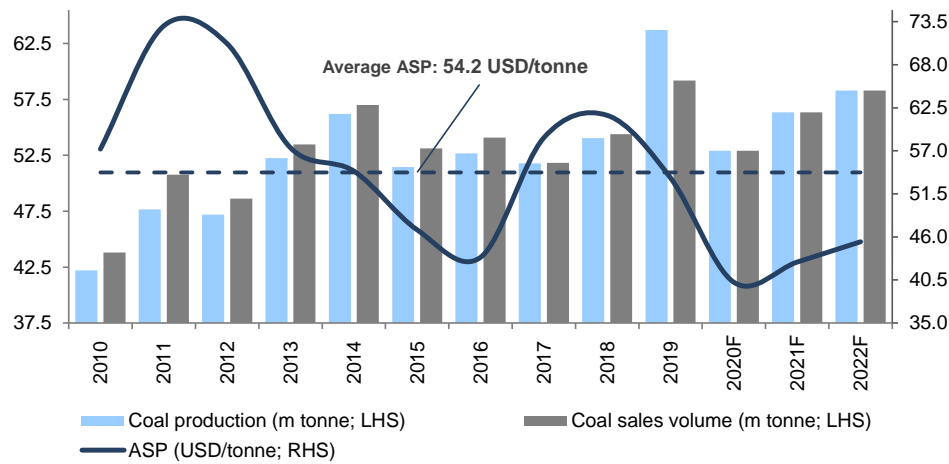
◆ Supply growth on China's domestic coal remains strong, supported by higher electrify demand stemming from the recovery in manufacturing activity. This caps the penetration of seaborne coal inbound for the country

◆ Output was halted due to mining activities being capped during the state-wide lockdown, with demand deceleration as a result of limited activity

◆ The inventory excess has prompted the Government to halt coal imports, at least until 1Q21 – so seaborne demand is limited

◆ Coal shipments to some of the biggest seaborne coal markets have declined since early 2020. A recovery may kick off in FY21, in our view

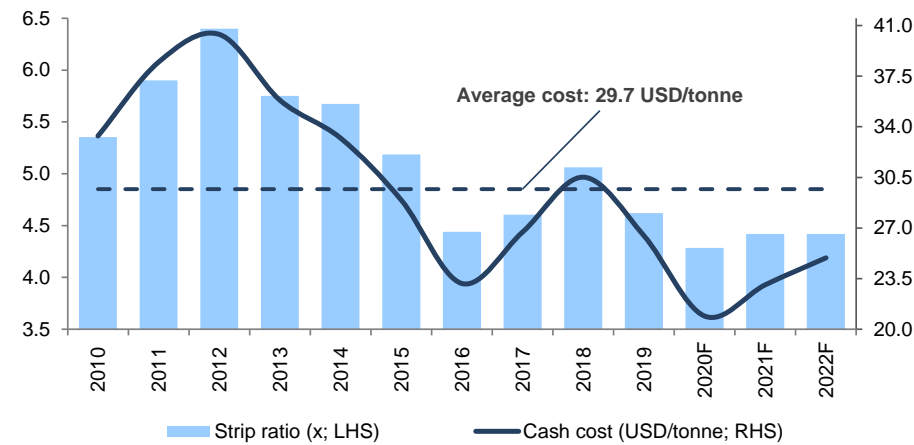
Figure 7: ADRO's coal production trend



Source: Company data, RHB

◆ Coal production hit a peak in FY19, despite the downward slide in ASP the previous year. Sales prices are expected to bottom out this year, before undergoing a mild recovery in FY21-22F

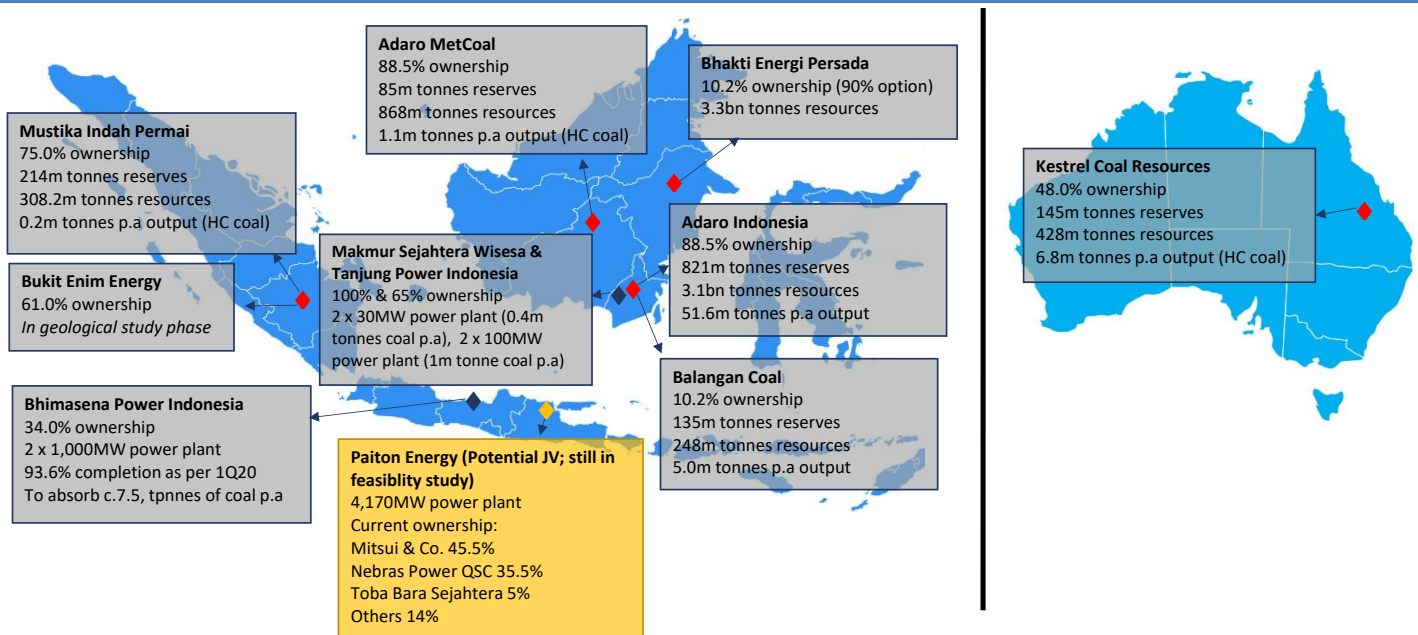
Figure 8: ADRO's cash cost trend (excluding royalty fee)



Source: Company data, RHB

◆ ADRO's cost efficiency is the key to keeping margins buoyed

Figure 9: ADRO's coal mines and power plants – HC accounts for c.12% of ADRO's coal production



Source: Company data, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-07-22	Trading Buy	1,360	1,125
2020-03-05	Neutral	1,360	1,175
2019-08-23	Buy	1,830	1,085
2018-10-31	Buy	2,600	1,650
2018-08-01	Buy	na	1,980
2018-07-06	Buy	2,600	1,785

Source: RHB, Bloomberg

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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
Take Profit:	Target price has been attained. Look to accumulate at lower levels
Sell:	Share price may fall by more than 10% over the next 12 months
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