

SECTOR UPDATE

Coal – Indonesia

Potential 40% Drop In 2023 NPAT; Share Prices Might Have Reflected Fundamentals

We believe coal share prices could have reflected the potential 41% decline in 2023 net income. Share prices of ADRO and ITMG have declined by 42.1% and 38.8% ytd respectively, and these should mirror the potential 41% decline in 2023 net income of both companies. The 41% decline equates to a 25% drop in ASP in 2023. For every 10% decline in coal price, 2023 NPAT of coal companies could decline by 15-17%. Upgrade the coal sector to MARKET WEIGHT, and upgrade ADRO and ITMG to HOLD.

WHAT'S NEW

- **Expecting coal prices to average US\$175/tonne in 2023 and US\$140/tonne in 2024.** Newcastle coal prices have declined 69% ytd to US\$124/tonne as coal prices are normalising faster in 2023. The weak demand due to slow industrial activity in China and falling natural gas prices have been major causes of the falling coal prices in 1H23 despite India's demand growing strongly on higher electricity consumption. We foresee higher demand for coal imports from China in 2H23 as: a) industrial activities could grow stronger, and b) demand will increase due to the winter season. We have adjusted down our 2023-24 coal prices assumptions from US\$280/tonne to US\$175/tonne and US\$250/tonne to US\$140/tonne respectively. In 1H23, coal prices averaged US\$212/tonne, with current spot at US\$125/tonne. If we assume the current price to persist until end of the year, 2023 average coal price will be US\$168/tonne. Our assumption of US\$175/tonne is to account for higher China imports due to the winter season in 2H23.
- **Rise in China's industrial activity will be a catalyst.** The economic recovery in China remains uncertain and industrial activity remains weak thus far in 1H23, particularly in the manufacturing and construction sectors, weighing on demand for commodities including coal. Domestic inventory of coal in China has also reached historical high levels due to low demand and significant imports as China was anticipating stronger demand after its economic reopening. As of mid-Jun 23, China's coal imports had surged by a substantial 86% ytd. At the same time, China's coal production remained high at 385m tonnes in May 23. Coal prices could increase if China's import demand starts to improve in 2H23.
- **Indonesia's coal production to remain high as demand from outside China grows strongly.** Indonesia is targeting record-high coal production in 2023 at 695m tonnes despite lower global coal prices and lower coal imports by China. Strong demand came from India, which raised its purchases in May 23 to 6.8m tonnes, up 26% compared with Apr 23's 5.4m tonnes. Indonesia's coal exports could remain high as India's coal imports are still rising in anticipation of a surge in demand for electricity during the summer season.
- **40% decline in NPAT should translate to 25% drop in coal ASP.** Adaro Energy Indonesia's (ADRO) 2023 net profit will likely fall 41.1% yoy to US\$1.47b from US\$2.49b in 2022. We estimate Indo Tambangraya Megah's (ITMG) 2023 net profit at US\$708m, down 41% yoy from 2022's net profit of US\$1.2b. Our 2023 average coal price assumption of US\$175/tonne equates to a 25% yoy decline in coal ASP. NPAT and share price declining by 40% would equate to a 25% decline in coal ASP (every 10% drop would result in NPAT dropping by 15-17%). Using the 2023 average coal price, ADRO's and ITMG's ASPs in 2023 should decline 28% and 23% yoy respectively, and thus we believe that the 40% decline in NPAT and share price might have reflected fundamentals.

PEER COMPARISON

Company	Ticker	Rec	Price 23-Jun-23 (Rp)	Target Price (Rp)	Potential Upside (%)	Market Cap (US\$m)	3M Avg Turnover (US\$m)	--- EV/EBITDA --- 2023F (x)	2024F (x)	----- PE ----- 2023F (x)	2024F (x)	----- P/B ----- 2023F (x)	2024F (x)	----- ROE ----- 2023F (%)	2024F (%)	Net Gearing (%)
Adaro Energy Indonesia	ADRO	HOLD	2,230	2,400	7.6%	4,602	13.1	1.7	2.2	3.2	4.6	0.8	0.8	24.2	16.9	-39.7
Indo Tambangraya Megah	ITMG	HOLD	23,900	25,000	4.6%	1,742	7.1	1.7	2.3	2.5	4.0	1.1	1.0	35.8	22.1	-70.8
Bumi Resources	BUMI	NR	112	na	na	2,683	3.9	na	na	na	na	na	na	na	na	2
Bukit Asam	PTBA	NR	3,700	na	na	2,750	8.6	2.8	3.0	6.6	7.2	1.4	1.4	23.3	20.9	-53.2
Indika Energy	INDY	NR	1,920	na	na	645	2.0	1.2	1.6	2.3	3.1	0.5	0.5	21.1	13.4	-4.4
Banpu Public Co	BANPU	NR	4,099	na	na	2,222	23.7	4.2	5.2	5.0	7.5	0.6	0.6	13.1	7.6	89
Coal India	COAL	NR	42,658	na	na	16,854	20.5	2.6	3.3	4.8	6.0	2.4	2.4	58.4	36.9	-68.3
Average							11.3	2.1	2.6	4.0	5.2	1.1	1.1	29.6	19.8	-20.8

Source: Bloomberg, UOB Kay Hian

MARKET WEIGHT

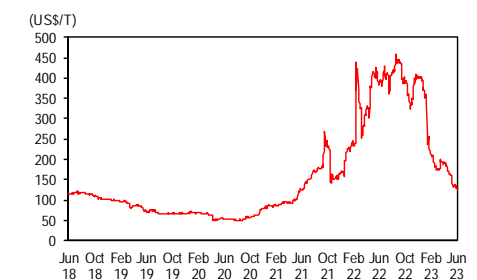
(Upgraded)

TOP PICKS

Company	Ticker	Rec	Share Price (Rp)	Target Price (Rp)
Adaro Energy Indonesia	ADRO IJ	HOLD	2,230	2,400
Indo Tambangraya Megah	ITMG IJ	HOLD	23,900	25,000

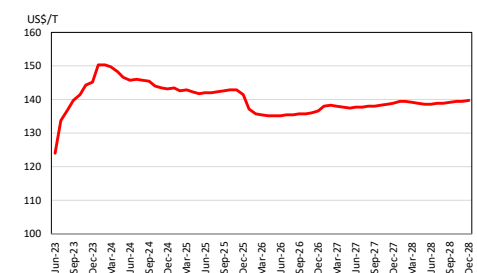
Source: UOB Kay Hian

COAL PRICES MOVEMENT AS OF 23 JUN 23



Source: Bloomberg, UOB Kay Hian

COAL FUTURES AS OF 23 JUN 23



Source: Bloomberg, UOB Kay Hian

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ACTION

- **Upgrade the coal sector to MARKET WEIGHT.** We upgrade ADRO and ITMG to HOLD with target prices of Rp2,400 (7.6% upside) and Rp25,000 (4.6% upside) respectively as we think the share prices could have reflected the potential 41% decline in 2023 net income and the 69% ytd decline in coal prices in 2023.

ESSENTIALS

- **Share prices could have reflected the drop in global coal prices.** Share prices of ADRO and ITMG have declined by 42.1% and 38.8% ytd respectively, and we think the share prices could have reflected the potential 41% decline in 2023 net income. We also expect coal futures prices to hover at an average of US\$130-140/tonne in 2H23, slightly up from the current price of US\$125/tonne and resulting in an average 2023 coal price of US\$175/tonne.

EARNINGS REVISION/RISK

- **No earnings revision on ADRO.** We maintain our 2023 net profit forecast for ADRO at US\$1.47b (-41.1% yoy) vs US\$2.49b in 2022, with 2023 revenue at US\$6.02b (-25.7% yoy) and 2023 EBITDA at US\$2.87b (-39.7% yoy). We maintain ADRO's 2023 earnings as the low calorific value (LCV) coal with 4,200 GAR prices is relatively stable at above US\$80/tonne.

EARNINGS REVISION – ITMG

Year to 31 Dec (US\$m)	----- New -----		----- Original -----		----- Diff (%) -----		----- Street -----		----- Var (%) -----	
	2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F	2023F	2024F
Production (m mt)	17	17	17	17	0.0	0.0				
ASP (US\$/t)	145	116	156	127	-7.0	-8.9				
Revenue	2,735	1,947	2,903	2,141	-5.8	-9.1	2,716	2,149	0.7	-9.4
Operating Profit	998	696	1,101	834	-9.4	-16.6	944	594	5.7	17.1
EBITDA	1,067	771	1,170	909	-8.8	-15.2	1,135	643	-6.0	19.8
Net profit	708	456	786	557	-9.9	-18.2	695	433	1.9	5.1
OP margin (%)	36.5	35.7	37.9	39.0			34.7	27.6		
EBITDA margin (%)	39.0	39.6	40.3	42.5			41.8	29.9		
Net margin (%)	25.9	23.4	27.1	26.0			25.6	20.2		

Source: UOB Kay Hian

- **We revise down ITMG's 2023 and 2024 earnings forecasts by 9.9% and 18.2% respectively,** due to changes in 2023 ASP recognition as global coal prices have normalised at a faster-than-expected rate. ITMG's coal ASP has more correlation to Newcastle coal price as it has a relatively similar calorific value (CV) to Newcastle coal CV. We estimate ITMG's 2023 revenue at US\$2.7b and 2024 revenue at US\$1.95b. 2023 and 2024 EBITDA are expected to be US\$1.1b and US\$771m respectively, while 2023 and 2024 NPAT will be US\$708m and US\$456m respectively.

- **Risk.** We remain cautious on a further decline in coal price as it could negatively impact share prices of coal-related stocks. ADRO and ITMG could decline further if global coal prices continue to drop lower than our expectation in 2H23.

VALUATION/RECOMMENDATION

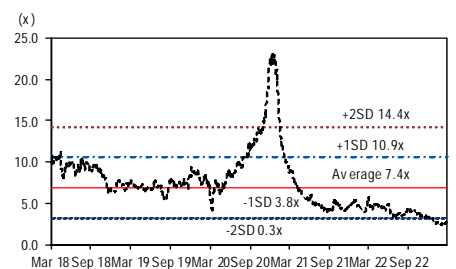
- **ADRO: Upgrade to HOLD with a target price of Rp2,400 (previous: Rp2,600),** based on -1SD to its five-year forward 2023 EV/EBITDA of 0.9x and its -1SD to five-year forward 2023 PE of 3.4x. ADRO is trading at 1x 2023F EV/EBITDA or 2.7x 2023F PE. Our target price translates to a 7.6% upside from the current price. We upgrade ADRO to HOLD as its share price has declined by 42.1% ytd and could have reflected the potential 41% yoy decline in 2023 net income and the 69% ytd decline in coal prices in 2023.
- **ITMG: Upgrade to HOLD with a target price of Rp25,000 (previous: Rp30,000),** based on -0.6SD to its five-year forward 2023 EV/EBITDA of 1.8x and its -0.6SD to five-year forward 2023 PE of 2.9x. ITMG is trading at 2.0x 2023F EV/EBITDA or 3.2x 2023F PE. Our target price translates to a 4.6% upside from the current price. We upgrade ITMG to HOLD as its share price has declined by 38.8% ytd and could have reflected the potential 41% yoy decline in 2023 net income and the 69% ytd decline in coal prices in 2023.

ADRO FORWARD EV/EBITDA



Source: Bloomberg, UOB Kay Hian

ADRO FORWARD PE



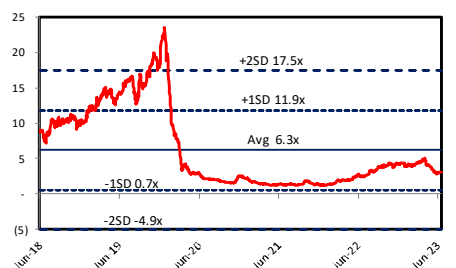
Source: Bloomberg, UOB Kay Hian

ITMG FORWARD EV/EBITDA



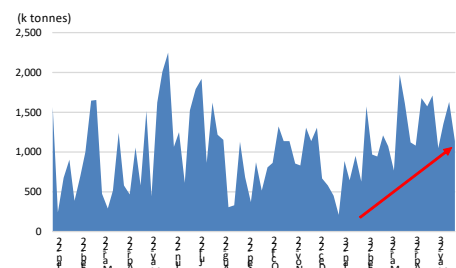
Source: Bloomberg, UOB Kay Hian

ITMG FORWARD PE



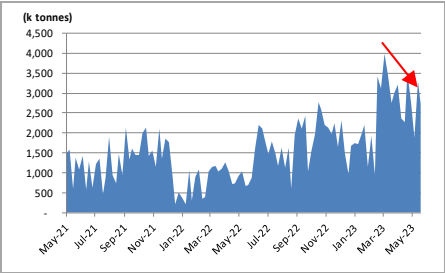
Source: Bloomberg, UOB Kay Hian

INDIA'S COAL IMPORTS AS OF MAY 23



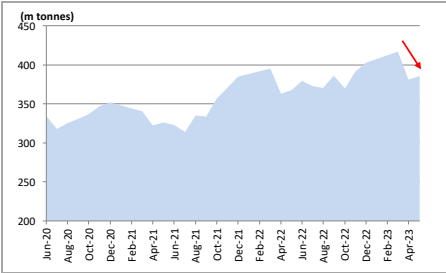
Source: Bloomberg, UOB Kay Hian

CHINA'S COAL IMPORTS AS OF JUN 23



Source: Bloomberg, UOB Kay Hian

CHINA'S COAL PRODUCTION AS OF MAY 23



Source: Bloomberg, UOB Kay Hian

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