

South East Asia Coal Sector

Assuming lower prices

Ami Tantri / Research Analyst / 62 21 2553 7976 / ami.tantri@credit-suisse.com

Paworamon (Poom) Suvarnatamee, CFA / Research Analyst / 662 614 6210 / paworamon.suvarnatamee@credit-suisse.com

Contribution by Anindito Widyanarendra

- Our global commodity team expects thermal coal prices to continue their underperformance. We expect the supply surplus to keep diminishing at least until 2015, as miners are willing to take thin or even negative margins in their stride rather than facing consequences of closing down production.
- Demand has been firm, although the recent strength was more on the availability of cheap seaborne coal. We expect China's coal import to grow but at a slower pace.
- India will remain a structural importer with domestic deficit of thermal coal, with difficulties in expanding its coal production and rail infrastructure, in addition to electricity distribution and pricing mechanism, and a weakening INR against the USD.
- We see thermal coal price remaining weak and have downgraded our coal price assumptions for 2013-16 by 8-15%. These have reduced our earnings estimates for SEA coal companies by around 6-41% for 2013-2014. We prefer Bukit Asam, one of the lowest cost producers, on its net cash position, high grade coal, large reserves, and moderate volume growth.

Supply growth slows, but the surplus remains

Our global commodity team has become more bearish on the thermal coal outlook and expects the underperformance to continue. The surplus of supply is likely to remain for a while. We estimate 22mn tonnes of oversupply this year, even after considering Colombian production disruptions by floods. The oversupply will decline slightly in 2014. Coal price is likely to stay low before surplus of supply diminishes at least until 2015.

Coal producers have shown little discipline in reducing production to support price. Miners have been willing to take thin or even negative margins due to various reasons, such as reducing mine operations can raise problems, practical and political difficulties of laying off employees; reducing costs in order to maximise output; setting up fixed contracts tonnes; forward hedging, take or pay agreements.

Indonesian coal mining companies chose to reduce strip ratio in order to reduce cost and increase their volume. Those with a high cost nature, including those operating in high strip ratio area, at a long distance from the ports, and having no proper infrastructure to bring the coal output to the mine, have preferred to reduce production. These are normally small coal companies. We estimate these high cost producers account for 18-20% of Indonesia's total coal production.

The large coal companies have indicated their intention to increase their volume.

Demand remains firm but with risk

Demand should remain firm, although we also see the recent demand strength has been supply driven from cheap seaborne coal prices. China and India, the two great hopes of seaborne coal miners, had import growth of 31% and 24%, respectively in 2012. European coal import grew 12% last year. We expect China's import to continue to grow but at a slower pace. China's position of having a domestic alternative makes it an extremely price-sensitive importer and sets the arbitrage into the country as a medium-term cap on prices. This is something we continue to see as a bearish structural influence on thermal coal prices. India remains a structural importer. Difficulties in getting environmental clearances have hindered coal production to expand and rail infrastructure to be built to transport the coal. The clarification of the tax issue removes downside risks on Indian imports this year, but there are other obstacles like the timing of reform in the electricity distribution and pricing mechanisms, and the weakening INR against the USD.

Forecast changes on lower coal price assumptions

According to our "[Global Commodity Forecast: The Setting of The Sun](#)", we have downgraded our thermal coal price assumptions to the following.

Figure 1: Newcastle fob coal price assumptions

US\$ mn	2012F	2013F	2014F	2015F	2016F	LT
New	95	90	93	100	102	100
Old		98	108	118	119	110
Change		-8%	-14%	-15%	-14%	-9%

Source: Credit Suisse estimates.

These have negative impacts on our earnings estimates for coal companies.

Our preferred stock in the sector is Bukit Asam (PTBA.JK). The company is one of the lowest cost coal producers with large high grade coal reserves, net cash position with no debt, selling mostly to the domestic market with potential exposure to developed export markets like Japan and South Korea, and moderate volume growth. In addition, the company has long-term projects in improving its railway infrastructure and mine mouth power plant projects to utilise its abundant coal reserves.

Figure 2: South East Asia Coal forecast summary

	Rating	Current		% New TP	% Chg TP	ASP (\$/t)		Sales volumes (mt)		Net income		% Chg in NI forecast	
		Price (l.c)	Upside			2013	2014	2013	2014	2013	2014	2013	2014
PTBA (Rp bn)	O	15,150	19%	18,000	-5%	72	74	18	20	3,205	3,639	-6%	-14%
ADRO (\$ mn)	N	1,270	-6%	1,200	-20%	65	66	53	55	405	456	-23%	-24%
HRUM (\$ mn)	N	4,975	-6%	4,700	-15%	78	80	14	17	115	169	-32%	-19%
INDY (\$ mn)	O	1,230	22%	1,500	-21%	55	60	37	38	44	114	-41%	-28%
ITMG (\$ mn)	N	37,500	-4%	36,000	-12%	77	80	29	30	302	350	-15%	-7%
BANPU (Bt mn)	N	361	-3%	350	-9%	82	74	44	45	6,964	8,095	-13%	-18%

Source: Company data, Credit Suisse estimates.

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Companies Mentioned (Price as of 15-Apr-2013)

Banpu Public Co Ltd (BANP.BK, Bt361.0, NEUTRAL, TP Bt350.0)
PT Adaro Energy Tbk (ADRO.JK, Rp1,270, NEUTRAL[V], TP Rp1,200)
PT Harum Energy Tbk (HRUM.JK, Rp4,975, NEUTRAL, TP Rp4,700)
PT Indika Energy Tbk (INDY.JK, Rp1,230, OUTPERFORM, TP Rp1,500)
PT Indo Tambangraya Megah (ITMG.JK, Rp37,500, NEUTRAL, TP Rp36,000)
PT Tambang Batubara Bukit Asam Tbk (PTBA.JK, Rp15,150, OUTPERFORM, TP Rp18,000)

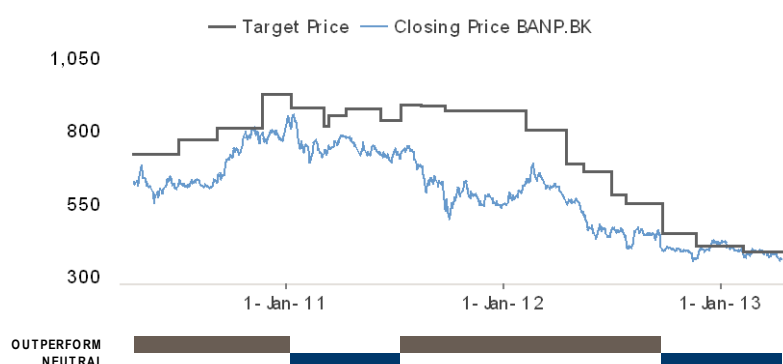
Disclosure Appendix
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Price and Rating History for Banpu Public Co Ltd (BANP.BK)

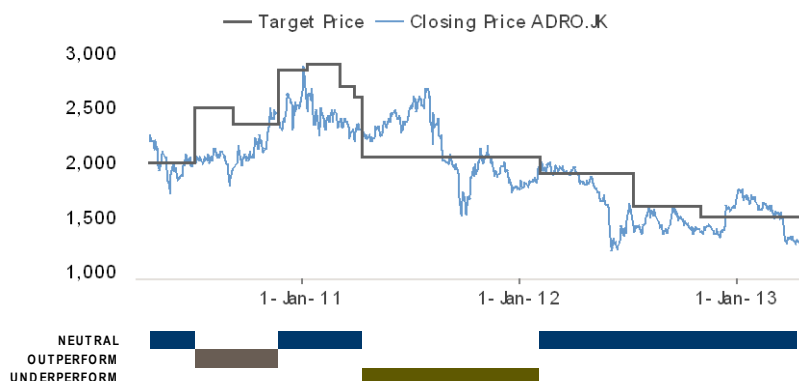
BANP.BK	Closing Price	Target Price	
Date	(Bt)	(Bt)	Rating
21-Apr-10	622.00	722.00	O
06-Jul-10	630.00	770.00	
09-Sep-10	650.00	810.00	
23-Nov-10	792.00	925.00	
10-Jan-11	810.00	879.00	N
07-Mar-11	728.00	817.00	
14-Mar-11	750.00	852.00	
13-Apr-11	778.00	875.00	
10-Jun-11	720.00	835.00	
13-Jul-11	720.00	889.00	O
16-Aug-11	678.00	885.00	
26-Sep-11	526.00	869.00	
09-Feb-12	634.00	802.00	
17-Apr-12	550.00	688.00	
16-May-12	506.00	660.00	
02-Jul-12	466.00	580.00	
25-Jul-12	430.00	553.00	
24-Sep-12	392.00	448.00	N
20-Nov-12	364.00	405.00	
07-Feb-13	380.00	385.00	

* Asterisk signifies initiation or assumption of coverage.


Price and Rating History for PT Adaro Energy Tbk (ADRO.JK)

ADRO.JK	Closing Price	Target Price	
Date	(Rp)	(Rp)	Rating
21-Apr-10	2,200	2,000	N *
06-Jul-10	2,025	2,500	O
08-Sep-10	1,940	2,350	
23-Nov-10	2,425	2,850	N
10-Jan-11	2,500	2,900	
07-Mar-11	2,375	2,700	
31-Mar-11	2,200	2,600	
13-Apr-11	2,275	2,050	U
06-Feb-12	1,940	1,900	N
07-Feb-12	1,980		*
09-Feb-12	1,980	1,900	N
11-Jul-12	1,420	1,600	
01-Nov-12	1,370	1,500	

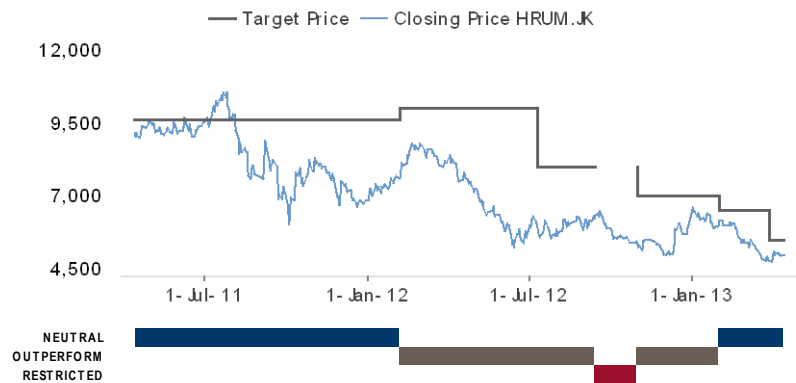
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Price and Rating History for PT Harum Energy Tbk (HRUM.JK)

HRUM.JK	Closing Price	Target Price	
Date	(Rp)	(Rp)	Rating
13-Apr-11	9,150	9,600	N *
06-Feb-12	7,600	10,000	O
07-Feb-12	7,650		*
09-Feb-12	8,100	10,000	O
11-Jul-12	5,850	8,000	
14-Sep-12	6,350		R
01-Nov-12	5,250	7,000	O
01-Feb-13	6,150	6,500	N
29-Mar-13	4,800	5,500	

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Price and Rating History for PT Indika Energy Tbk (INDY.JK)

INDY.JK	Closing Price	Target Price	
Date	(Rp)	(Rp)	Rating
13-Apr-11	4,000	5,400	O *
30-Jun-11	3,850	5,000	
15-Sep-11	2,875	3,900	
18-Apr-12	2,450		NR
27-Sep-12	1,600	2,700	O *
10-Oct-12	1,520	2,800	
01-Apr-13	1,210	1,900	

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Price and Rating History for PT Indo Tambangraya Megah (ITMG.JK)

ITMG.JK	Closing Price	Target Price	
Date	(Rp)	(Rp)	Rating
21-Apr-10	38,300	36,800	N
06-Jul-10	37,700	49,000	O
23-Nov-10	49,450	63,000	
25-Feb-11	45,200	54,000	
13-Apr-11	48,500	57,000	
25-Sep-11	40,650	53,000	
02-Nov-11	44,800	55,000	
06-Feb-12	39,350	50,000	
29-Jun-12	35,950	40,000	N
24-Jul-12	36,450	38,000	
24-Oct-12	42,550	41,000	

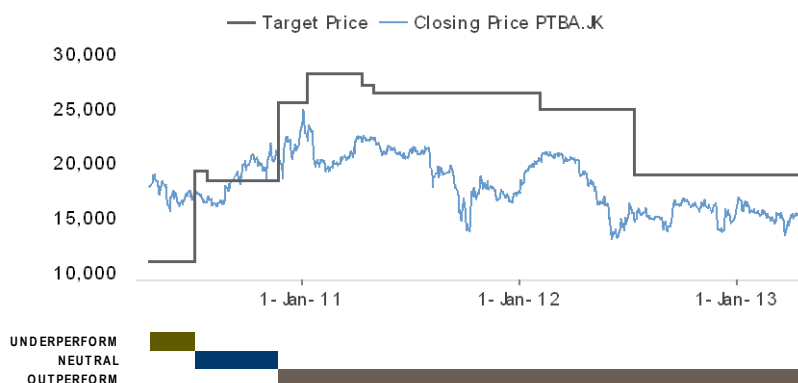
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Price and Rating History for PT Tambang Batubara Bukit Asam Tbk (PTBA.JK)

PTBA.JK	Closing Price	Target Price	
Date	(Rp)	(Rp)	Rating
21-Apr-10	17,900	11,000	U *
06-Jul-10	17,350	19,300	N
26-Jul-10	16,500	18,400	
23-Nov-10	20,400	25,600	O
10-Jan-11	22,550	28,200	
13-Apr-11	22,100	27,200	
02-May-11	22,350	26,500	
06-Feb-12	20,300	25,000	
07-Feb-12	20,200		*
09-Feb-12	20,950	25,000	O
12-Jul-12	14,900	19,000	

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Price Target: (12 months) for PT Tambang Batubara Bukit Asam Tbk (PTBA.JK)

Method: Our target price of Rp18,000 is based on 10.8x P/E target for 2014, which implies a 35% premium to the sector's average considering the company's advantages over other coal companies on stronger volume growth, high profit margin, higher ROE compared, cash position, and possible a higher dividend payment.

Risk: Risks to our target price of Rp18,000 are declining coal price, and high execution risks of railway project.

Price Target: (12 months) for PT Adaro Energy Tbk (ADRO.JK)

Method: Our target price of Rp 1,200 for PT Adaro (ADRO.JK) is based on a 2014E P/E (price/earnings) multiple of 8x, inline with sector average.

Risk: Risks to our Rp 1,200 target price for PT Adaro Energy Tbk are lower than expected volume and price, and possible higher costs considering the size of company's mining area.

Price Target: (12 months) for Banpu Public Co Ltd (BANP.BK)

Method: Our SOTP valuation of Bt350 is based on ITMG at our TP of Rp36,000, CEY at EV/EBITDA of its Australian peers of 9x, and China coal at 11x P/E.

Risk: The primary risk to our target price of Bt350/share for Banpu is the fluctuation in coal prices, which could materially impact our earnings forecast and, thus, our valuation of its coal business.

Price Target: (12 months) for PT Harum Energy Tbk (HRUM.JK)

Method: Our target price of Rp4,700/share for PT Harum Energy Tbk is based on a P/E (price-to-earnings) target of 8x our 2014 estimates, in line with sector average.

Risk: Risks to our target price of Rp4,700 for PT Harum Energy Tbk include lower-than-expected volume and declining coal price.

Price Target: (12 months) for PT Indika Energy Tbk (INDY.JK)

Method: Our Rp1,500 target price for Indika Energy Tbk is based on sum of parts valuation with EV/EBITDA target for mining contracting services of 4.8x, and P/E target of 4x for the coal mining, which is at a 30% discount to the sector to reflect the holding company discount.

Risk: Risks that could impede achievement of our Rp1,500 target price for Indika Energy Tbk include: lower than expected overburden removal, lower than expected upcoming contracts, lower coal price and production, and high oil price.

Price Target: (12 months) for PT Indo Tambangraya Megah (ITMG.JK)

Method: ITMG's target price of Rp36,000 is set based on 14x P/E in FY13 and 12x P/E in FY14 using US\$90/t coal prices in FY13 and US\$93/t in FY14.

Risk: The primary risk to our target price of Rp36,000/share for ITMG is the fluctuation in coal prices, which could materially impact our earnings forecast and, thus, our valuation of its coal business. Also, sales volume may be affected by unfavourable weather conditions or other operational disruptions. Issuance of operating licences at some coal mines is also a key risk to our forecasts.

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ASIA/PACIFIC: +852 2101-60000

EUROPE: +44 (20) 7888-8888

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