

## COMPANY UPDATE

**HOLD**

Target Price, Rp 21,500

Upside 19.8%

ITMG IJ/ITMG.JK

Last Price, Rp 17,950

No. of shares (bn) 31,986

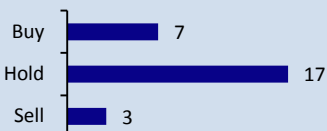
**Market Cap, Rpbn 20,282**

(US\$ mn) 1,648

3M T/O, US\$mn 3.9

**Last Recommendation**

|           |      |          |
|-----------|------|----------|
| 13-Nov-14 | HOLD | Rp21,500 |
| 11-Jul-14 | HOLD | Rp27,800 |

**Company relative to JCI Index****Market Recommendation****Consensus**

|                   | Our    | Cons   | % Diff |
|-------------------|--------|--------|--------|
| Target Price, IDR | 21,500 | 23,218 | -7     |
| EPS 2014F, IDR    | 1,925  | 2,386  | -19    |
| PE 2014F, x       | 9.3    | 7.9    | 18     |

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Danareksa research reports are also available at Reuters Multex and First Call Direct and Bloomberg.

**Indo Tambangraya Megah****Further cost efficiencies to sustain margins**

We visited the mining area of Indo Tambangraya Megah (ITMG)'s subsidiary Indominco Mandiri (IMM), as well as its new IPCC and the Bontang Coal Terminal. Despite the attractive dividend payout ratio of about 85% in the past three years which has been supported by the company's strong balance sheet, ITMG's coal production is expected to be flat in 2014 and 2015. As such, we maintain our HOLD recommendation with a Target Price of Rp21,500 (based on DCF valuation with a WACC of 12.4%). Our Target Price implies 12.9x 2015F PE.

**Indominco contributed the most to ITMG's coal production**

Located in East Kalimantan and operating under a first generation CCoW, Indominco Mandiri (IMM) is the company's largest coal producer with output reaching about 15.2mn tons in 2013 and accounting for about 51% of ITMG's total coal production. In the mining area covering 25,121ha, IMM has about 98mn tons of reserves and 750mn tons of resources with its coal transported from the mine stockyard to the port stockyard using a 35km-long road. However, coal production growth at IMM is expected to be flat with production of 15.2mn tons in 2014, and given the currently unfavorable coal prices, we don't expect production to exceed 16mn tons per annum going forward.

**Bontang Coal Terminal to support IMM's operations**

To support IMM's mining operation and to send the coal to the customers, the company operates Bontang Coal Terminal (BoCT). Located 35km from the IMM mining area, BoCT has capacity of 20.5mn tons. To send the coal from the port stockyard to the vessels, the terminal is supported by 6.5km of conveyor belt, 4.0km of which is inland conveyor and 2.5km sea conveyor.

**Expecting to sustain margins through further reduction of the stripping ratio and...**

To limit further margins deterioration as a result of weak coal prices, ITMG plans to further reduce its stripping ratio at IMM's mining area by lowering the coal production at the West Block (which has a higher stripping ratio) and increasing the production at the East Block. The average stripping ratio for IMM is about 11.8x, with the West and East Block stripping ratios standing at 16.9x and 9.7x, respectively, as of 2013. Overall, we expect ITMG's average stripping ratio to decline further to 9.5x in 2015 from 9.8x in 2014 and 11.5x in 2013.

**...the full operation of IPCC**

With the full operation of IPCC (In-Pit Crushing and Conveying) in 3Q14 with overburden removal annual capacity of 14mn bcm, the management is expecting cost savings of about US\$0.50 to 1.00/bcm (or about 10% of overburden costs) by replacing the usage of diesel consumption arising from the transportation of overburden with trucks. Currently, the IPCC project, for which the power comes from IMM's 2x7 MW coal-based power plant, is still awaiting certification by ESDM. Depending on coal price developments, the IPCC project's overburden removal capacity can be expanded to 54mn bcm.

|                    | 2012  | 2013  | 2014F | 2015F | 2016F |
|--------------------|-------|-------|-------|-------|-------|
| Revenue, USD mn    | 2,439 | 2,179 | 2,007 | 1,925 | 2,020 |
| EBITDA, USD mn     | 635   | 410   | 382   | 362   | 396   |
| EBITDA Growth, %   | -17.5 | -35.5 | -6.7  | -5.3  | 9.4   |
| Net profit, USD mn | 432   | 230   | 207   | 189   | 211   |
| EPS, USD           | 0.382 | 0.204 | 0.183 | 0.167 | 0.186 |
| EPS growth, %      | -20.9 | -46.7 | -10.1 | -8.9  | 11.5  |
| BVPS, USD          | 0.887 | 0.853 | 0.872 | 0.891 | 0.928 |
| DPS, USD           | 0.447 | 0.238 | 0.164 | 0.148 | 0.150 |
| Net Gearing, %     | -45   | -30   | -28   | -29   | -31   |
| PER, x             | 5.0   | 8.6   | 9.3   | 10.7  | 9.8   |
| PBV, x             | 2.1   | 2.1   | 2.0   | 2.0   | 2.0   |
| EV/EBITDA, x       | 2.7   | 4.1   | 4.3   | 4.8   | 4.4   |
| Yield, %           | 23.4  | 13.6  | 9.6   | 8.3   | 8.2   |

**Stable coal production in 2015**

The management is targeting coal production of 29.5mn tons in 2014. Hence, we can infer a slight increase in quarterly coal production to 7.8mn tons in 4Q14 (from 7.7mn tons in 3Q14) in order to achieve the target. The company's coal production is expected to stay flat in 2015, reaching about 30mn tons, with a lower stripping ratio than 2014's expected 9.8x. With lower demand for coal in China, ITMG plans to redirect a portion of its sales previously intended for China to India and Thailand in 2014 and 2015. Note that in 9M14, China accounted for about 25% of ITMG's total sales volume.

**Exhibit 01. Mining activities at Pit 19, the largest pit at IMM's East Block**

Source: Danareksa Sekuritas

**Exhibit 02. The New IPCC at Indominco's mining area**

Source: Danareksa Sekuritas

**Exhibit 03. Ship Loader and Coal Barging Unit (CBU) at the Bontang Coal Terminal**

Source: Danareksa Sekuritas

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