

Monday, 12 March 2018

### OVERWEIGHT

### Maintain

## Coal Mining

### Domestic coal price finally capped at USD70/tonne

PTBA relative to JCI Index



ADRO relative to JCI Index



Source : Bloomberg

The Ministry of Energy and Mineral Resources (MEMR) has capped the domestic price of coal sold to power producers at USD70/tonne for two years. The price will follow the coal benchmark price (HBA) when it is below USD70/tonne. This policy will have a negative impact on coal mining companies as their profitability will be hit. Based on sensitivity analysis using DMO scenarios, the policy will lower the earnings of the coal mining companies under our coverage by 7.3% - 18.0% for 2018 and 2019. Our top picks in the sector is ADRO.

**Lower domestic coal prices for coal-based power plants.** After the President of Indonesia signed a regulation that allows the MEMR to regulate the coal price for domestic power producers, the MEMR issued a regulation which stipulated: a) the price of coal sold to power producers under the domestic market obligation (DMO) will be capped at USD70/tonne for 6,322 kcal/kg GAR specification. When the HBA is below USD70/tonne, the price will be set based on HBA. b) the special domestic coal price for PLN will be applicable from 1 January 2018 to 31 December 2019 retroactively, and c) the maximum quota of coal that can be purchased by domestic power plants are 100mn tonnes per year.

**Capping of the coal price to maintain electricity tariffs.** The issuance of the regulation is expected to ease the financial burden on PLN, the State-Owned Electricity Company. PLN had mentioned that higher coal prices would raise production costs, with its coal-based power plants accounting for about 57.2% of the total generated power.

**Negative impact on coal mining companies.** With the domestic coal price to be capped at USD70/tonne - a 30% discount to the current coal price and 21% lower than our latest assumption of USD88/tonne for 2018 - the profitability of the coal mining companies under our coverage will be reduced. Assuming the capping of the coal price at USD70/tonne applies to DMO - which is 25% of total production - the new policy will reduce the earnings of the coal mining companies under our coverage by 7.3% - 18.0% in 2018 and 2019.

**Maintain OVERWEIGHT.** We still believe that coal prices will correct from their recent highs from 2Q18 onward given that China is continuing its policy to limit the burning of thermal coal especially in areas with high air pollution, and India will aggressively increase domestic coal prices as well as reduce its dependency on thermal coal power plants. Nonetheless, ASEAN countries are still expected to remain as centers for growing coal demand going forward. As such, we believe coal mining companies under our coverage will book brisk earnings growth in 2018. Our top picks in the sector is ADRO.



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Company	Ticker	Rec	Target Price (Rp)	Market Cap. (RpBn)	P/E (x)		P/BV (x)		ROE (%) 2018F
					2018F	2019F	2018F	2019F	
Bukit Asam	PTBA IJ	BUY	2,900	35,547.1	9.5	8.8	2.4	2.1	23.5
Adaro Energy	ADRO IJ	BUY	2,800	77,406.0	8.6	8.9	1.3	1.3	16.3
Indo Tambangraya	ITMG IJ	HOLD	33,200	35,564.4	7.7	8.2	2.1	2.0	28.8
Harum Energy	HRUM IJ	HOLD	2,200	8,651.6	11.3	10.8	1.7	1.6	14.3

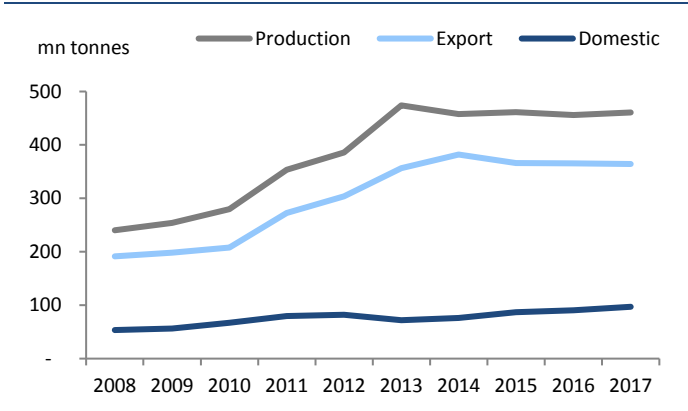
**Exhibit 1. Sensitivity on the impact of domestic coal price under DMO 25% capped at USD70/tonne**

Company	% change in earnings	
	2018F	2019F
ADRO	(9.3)	(7.3)
PTBA*	(12.7)	(10.5)
ITMG	(17.9)	(14.5)
HRUM*	(18.0)	(14.7)

\*Indicative number for PTBA and HRUM based on coal price assumption of USD88/tonne for 2018 and USD83/tonne for 2019

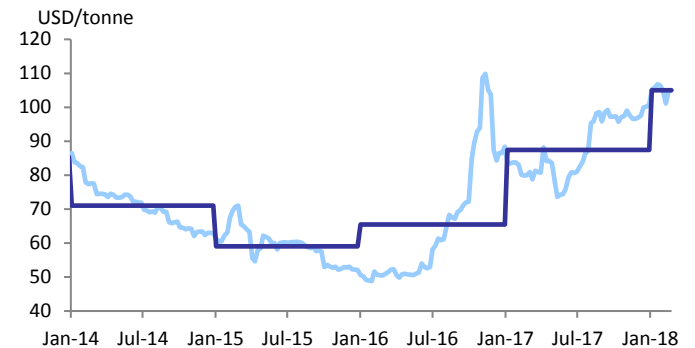
Source: Danareksa Sekuritas Estimates

**Exhibit 3. Flattish Indonesia's coal production**



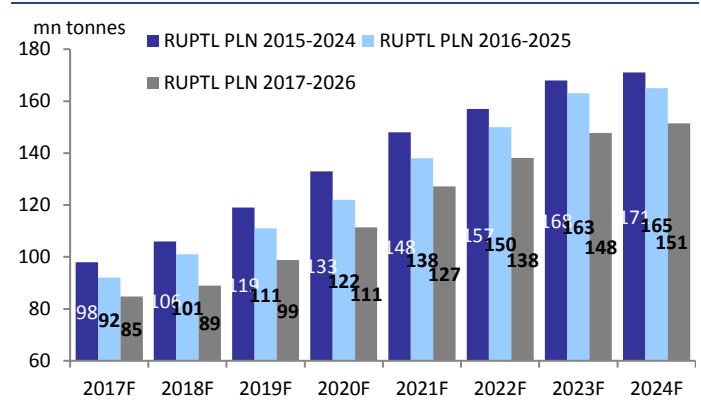
Source: Ministry of Energy Mineral Resources

**Exhibit 2. Expect rising domestic coal demand**



Source: Bloomberg

**Exhibit 4. Expect rising domestic coal demand**



Source: PLN