Coal mining | INDONESIA

BASIC MATERIALS/METALS & MINING

NOMURA

PT NOMURA INDONESIA

Isnaputra Iskandar, CFA +62 21 2991 3346 isnaputra.iskandar@nomura.com

BULLISH

ANCHOR REPORT

Perfectly placed

We initiate on Indonesia's coal mining sector with a Bullish view. The global dynamics look appealing: amid aggressive investment in coal-fired electricity capacity, we see India becoming the world's largest thermal coal importer by 2015F and China's coal imports expanding by 50% in the next two years. Indonesia looks perfectly placed to benefit — while we expect ongoing constraints in coal production in Australia and South Africa, we believe capacity expansion in Indonesia will ensure sufficient supply while proximity to the major coal-importing markets gives Indonesia a clear edge on transportation costs. At home, the power sector looks set to drive double-digit growth in coal demand through 2015F, with a market-friendly pricing mechanism adding to the appeal. Nomura recently lifted its 2011-16F coal price assumptions by 27-75%; these above-market numbers now drive our markedly higher-than-consensus FY12F earnings forecasts for the Indonesian players. Our top picks are Adaro Energy (strong volume upgrade potential, balance-sheet improvement, mid-cycle valuation) and Indo Tambangraya Megah (potential for higher dividend payouts, reserve revaluation, reasonable valuation). We also have BUYs on Tambang Batubara and Bumi Resources.

① **Bullish on coal**

② **Strong domestic demand: no fears**

③ **Profitability recovery kicks off**

④ **Selective dividend story**

Nomura Anchor Reports examine the key themes and value drivers that underpin our sector views and stock recommendations for the next 6 to 12 months.

Stocks for action

We have BUYs on all the Indonesian coal stocks that we cover. ADRO and ITMG are our top picks.

Stock	Rating	Price (Rp)	PT (Rp)
Adaro Energy (ADRO IJ)	BUY*	2,475	3,700
Indo Tambangraya Megah (ITMG IJ)	BUY*	52,200	73,000
Tambang Batubara Bukit Asam (PTBA IJ)	BUY*	22,100	30,000
Bumi Resources (BUMI IJ)	BUY*	2,950	4,300

* Initiating coverage; pricing as of 11 January, 2011

Analyst

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isnaputra.iskandar@nomura.com

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BULLISH

Action

We are Bullish on Indonesia's coal mining sector and have ADRO and ITMG as our top picks, given their strong business models, exposure to the seaborne market, robust earnings growth and healthy balance sheets. We initiate coverage of the sector with price targets of Rp3,700 for ADRO and Rp73,000 for ITMG.

Catalysts

Better-than-expected price negotiations, significant progress in projects, continued supply-demand tightness, M&A deals and market sentiment are potential catalysts.

Anchor themes

Our global mining team projects large supply deficits in the global seaborne thermal coal market over the next five years, with import growth (driven by India and China) outstripping export growth (driven by Australia and Indonesia). Strong domestic demand is likely to offer another boost to the sector.

Stocks for action

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Perfectly placed

① Bullish on coal

We are bullish on coal prices, given that we expect demand from China and India to remain structurally strong, and Australia and South Africa to continue to face capacity constraints. On 9 January, our global mining team upgraded its 2011-16F coal price assumptions by 27-75%. Nomura is one of the more bullish houses on the street.

② Strong domestic demand: no fears

Robust demand from the power sector in 2010-15F should continue to drive double-digit growth (13% CAGR) in domestic coal demand. We see minimal negative impact to the industry, in view of our expectation of sufficient coal supplies from capacity expansion plus a market-friendly domestic pricing mechanism.

③ Profitability recovery kicks off

Following a disappointing performance in 2010, Indonesian coal companies look set to post robust growth in EBITDA (60-74% CAGR) and earnings (68-159% CAGR) in 2010-12F, backed by: 1) recovering coal production (12-13% CAGR); and 2) climbing ASPs (19-26% CAGR).

④ Selective dividend story

With stronger cashflows fortifying balance sheets, we see a selective dividend payout scenario in three to four years' time, ie, after major non-M&A capex is completed in 2011-13F. ITMG and PTBA are most likely to surprise on the upside with dividends, in our view, given relatively strong financials and lower capex.

⑤ Risks to our investment view

Risk factors to our investment view include coal price volatility, disconnect between coal and oil prices, weather conditions, regulations and the reliability of coal data.

Analyst

Isnaputra Iskandar, CFA
+62 21 2991 3346
isnaputra.iskandar@nomura.com

Contents

Also see our Anchor Report: China Coal — *Always room for dessert* (18 January, 2011)

And our global mining team's report: *Chinese supply shortage and Indian electricity take-off set stage for strong coal decade* (9 January, 2011)

Drilling down

Executive summary

Key value drivers

We initiate coverage of Indonesia's coal mining sector with a Bullish sector stance. We select Adaro Energy (ADRO IJ) and Indo Tambangraya Megah (ITMG IJ) as our top picks in the sector, with price targets of Rp3,700 and Rp73,000, respectively.

Bullish on Indonesia coal mining sector, with preference for Adaro and ITMG

Our Bullish sector stance hinges upon:

- **Positive global sector outlook.** We believe that supply/demand imbalances in the sector will persist, supporting higher coal prices in the medium term.
- **Structural changes in the domestic market.** A combination of pressure from high oil prices plus abundant coal reserves in Indonesia is likely to drive robust domestic demand growth.
- **Strong earnings growth prospects.** We forecast a sector EBITDA CAGR of 60-74% over 2010-12F, underpinned by higher volumes and improving ASPs.
- **Higher dividends, although selective.** We expect coal companies to enjoy better leverage, and as such lower balance-sheet risk, on stronger coal prices. That should enable self-funding capex and the return of more money to shareholders, in our view.

Catalysts

Several factors, in our view, stand as positive catalysts to our call:

- **Better-than-expected term price negotiation.** Consensus, in our opinion, is far too conservative on coal price assumptions.
- **Significant progress in projects.** Organic and non-organic volume growth would be positive for earnings enhancements.
- **Continued supply-demand imbalance.** The imbalance between supply and demand will only drive up coal prices and sector performance, in our view.
- **M&A deals.** Indonesia is a major M&A target for supply security due to its competitive location relative to major coal-importing countries.
- **Market sentiment.** Positive market sentiment, despite having little impact on fundamentals, could be another major catalyst, in our view.

Sector performance

The coal sector, as proxied by the JAKMINE Index on the Indonesia Stock Exchange (IDX), performed in line with the overall market in 2010. We expect the coal sector to outperform the market in 2011F, with higher volumes and improving ASPs leading to stronger earnings growth.

Higher volumes and improving ASP should drive earnings growth and see the sector outperform the broader market

We believe Indonesian coal companies look reasonably valued at current levels on EV/EBITDA relative to the current coal price. We find they are also at 27% and 17% discounts, based on FY12F EV/EBITDA and P/E, to peers in China.

Risks to our investment view

We note several risk factors to our investment view, including coal price volatility, disconnect between coal and oil prices, weather conditions, regulations and coal data reliability.

Industry dynamics

Bullish on coal

Continued strength in coal markets

With demand likely to continue to outpace supply, we see continued strength in coal markets

Our global mining team issued a coal report on 9 January 2011, entitled *Chinese supply shortage and Indian electricity take-off set stage for strong coal decade.* Our forecasts show India becoming the world's largest thermal coal importer by 2015F. Nomura's India utilities analyst, Anirudh Gangahar, expects aggressive growth in India's coal-fired electricity capacity and thermal coal imports to more than triple by 2015F. While India has already recorded significant per-capita electricity consumption growth, with a 4.6% CAGR over 2005-09, its per-capita electricity consumption is still below that in developed countries and only a quarter of China's. Although India boasts large domestic coal reserves, we do not believe domestic production can keep pace with demand, considering significant environmental, social and infrastructure constraints. We also forecast China's thermal coal imports to grow by 50% over the next two years, peaking in 2012F as domestic infrastructure and mine production capacity expands.

Our global mining team has upgraded its per-tonne 2011-16F coal price assumptions by 27% to US$140, 42% to US$170, 60% to US$160, 75% to US$140, 38% to US$110 and 13% to US$90, respectively. Nomura is one of the more bullish houses on the street.

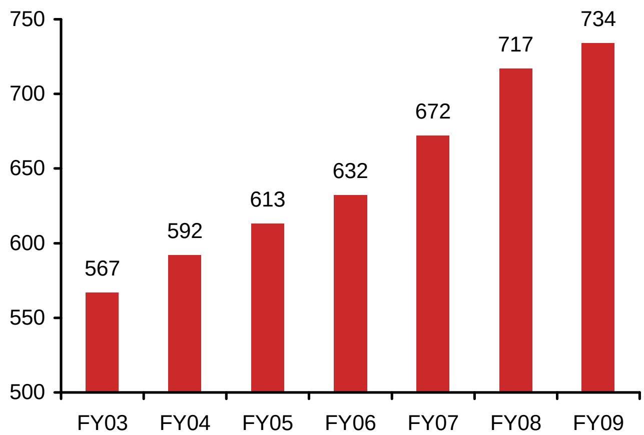
Indian coal supply unable to meet domestic demand

India set to become the world's largest thermal coal importer by 2015F

To quench domestic demand, India is likely to look increasingly to thermal coal imports to supply new electricity capacity, we believe, owing to several factors. First, although India has significant domestic coal resources (nearly 300bt, according to the French Institute of Petroleum), a significant portion of its deposits are in inaccessible locations, such as government-protected forests and in proximity to indigenous populations whose livelihoods would potentially be disrupted by mining activities. These sensitive environmental and social factors continue to hold up development of coal blocks in India.

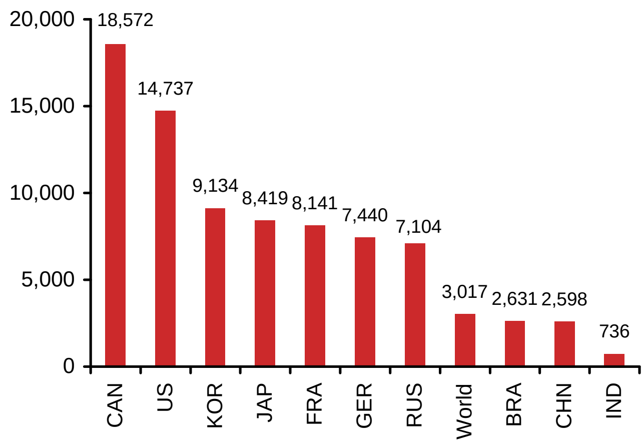
Second, most of the coal blocks in India are located in the interior region, where rail and other infrastructure are not yet sufficiently developed to move the required quantity of coal to the coasts, where most new electricity capacity is being brought online. Moreover, bulk rail contracts are not yet firmly established in the domestic rail industry, complicating the infrastructure hurdles faced by prospective producers.

Exhibit 1. India: per-capita electricity consumption (kwh)



Source: Central Electricity Authority (CEA), Nomura estimates

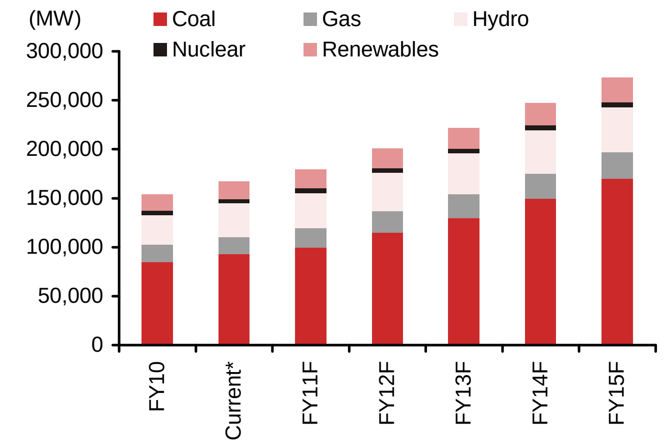
Exhibit 2. Per-capita electricity consumption comparison (kwh)



Source: IEA Energy Statistics 2010, Nomura estimates

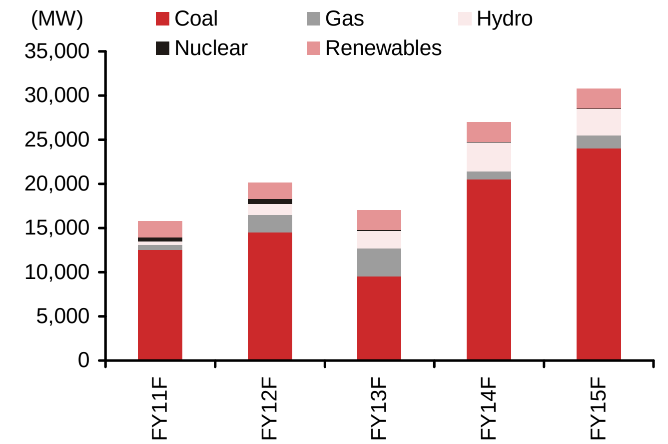
To satisfy electricity demand in India, we estimate that 112GW of capacity will be brought on line over FY11-15F, with nearly 70% of this likely to be coal-fired. Some 78GW of new coal-fired capacity would nearly double India's total coal requirements from 511 million tonnes (mt) in 2009 to 940mt in 2015F, which implies imports would have to more than triple.

Exhibit 3. India: total power capacity



Source: CEA, Nomura estimates

Exhibit 4. India: additional power capacity

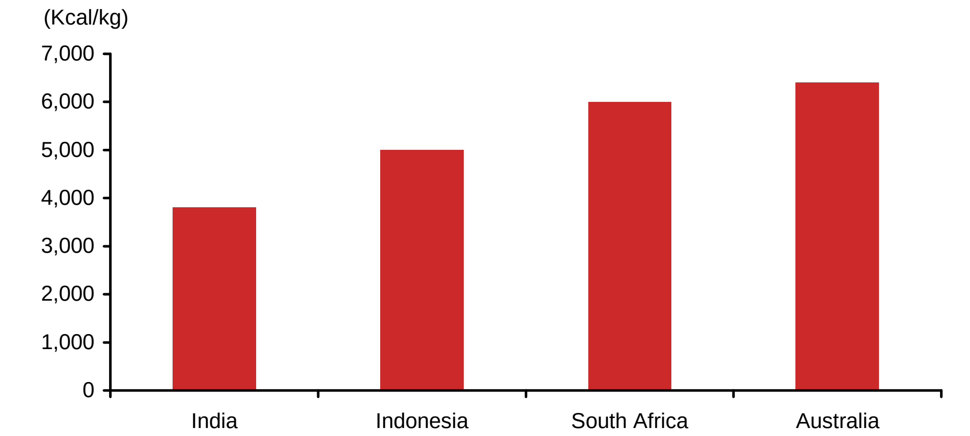


Source: IEA Energy Statistics 2010, Nomura estimates

Supply unlikely to be able to keep pace with growing demand for higher-quality coal imports in India

Even if India's vast coal resources were accessible to mining, we find these still would not be able to meet demand from newer, more efficient power stations that will require coal with higher calorific value and lower ash content. Thus, we believe these new stations will be more dependent upon higher-quality coal imports.

Exhibit 5. Thermal coal calorific value by country (2010)



Source: Platts International, Nomura estimates

Exhibit 6. India: thermal coal supply demand model

	2008	2009	2010F	2011F	2012F	2013F	2014F	2015F
Coal demand (mn tonnes)								
Power (Utilities)	332	363	372	413	473	525	590	685
Power (Captive)	29	33	39	44	47	52	57	62
Others	104	116	131	141	153	165	178	192
Total – [A]	**465**	**511**	**542**	**599**	**673**	**742**	**824**	**940**
(% y-y)	**8.5**	**9.9**	**5.9**	**10.5**	**12.4**	**10.3**	**11.1**	**14.0**
Growth (% y-y)								
Power (Utilities)	8.0	9.2	2.4	11.2	14.4	11.1	12.2	16.2
Power (Captive)	4.2	11.7	19.4	12.6	6.8	9.7	9.7	9.7
Others	11.8	11.7	13.1	8.0	8.0	8.0	8.0	8.0
Coal supply (mn tonnes)								
Domestic supply build-up								
Coal India Ltd. (CIL)	375	401	416	451	485	522	561	603
Singareni Collieries Co. (SCCL)	42	45	49	52	56	60	64	69
Others	37	44	49	54	62	72	82	95
Total supply (Thermal & Coking)	**454**	**490**	**515**	**557**	**603**	**653**	**708**	**767**
Domestic supply breakdown (%)								
Thermal (%)	96.3	96.6	96.7	96.5	97.0	97.0	97.0	97.0
Coking (%)	3.7	3.4	3.3					
Domestic thermal coal supply [B]	438	473	497	538	585	634	686	744
(% y-y)			**5.1**	**8.2**	**8.8**	**8.3**	**8.3**	**8.4**
Thermal coal imports required [A-B]	**28**	**38**	**44**	**61**	**88**	**108**	**138**	**196**
Imports @20% higher GCV				**51**	**73**	**90**	**115**	**163**

Source: Government of India data, Nomura estimates

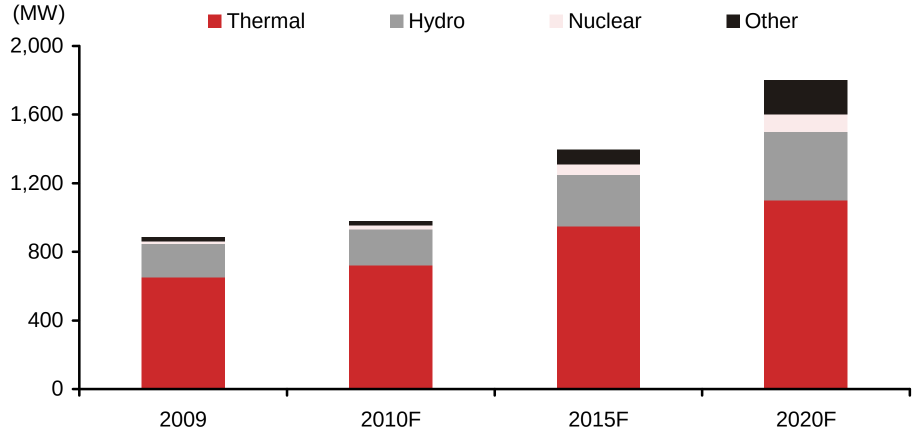
China electricity expansion to remain coal-focused

Continued electricity capacity investment driving power demand in China, with the focus still on coal-fired capacity

We believe China power demand will remain strong, driven by continued investment in additional electricity capacity. Our forecasts show installed capacity increasing to 1,377GW in 2015F, from 874GW in 2009, representing an increase of 58% or a CAGR of 8% over the period.

We estimate that nearly 500GW of the new capacity will be derived from thermal coal. This represents a 46% increase and a 7% CAGR in new coal-fired capacity over the period. China's National Development and Reform Commission (NDRC) has called for a decrease in China's energy dependency on coal from around 70% of installed electricity capacity to around 63% by 2015F. However, we believe this target is ambitious, given coal's cost competitiveness over other sources such as natural gas. The lead times and capital costs for new nuclear capacity also make new coal-fired stations preferable where new installed capacity needs to be brought online quickly.

Exhibit 7. China: electricity capacity by type



Source: Government data, Nomura estimates

Mine closures, rail bottlenecks constrain domestic supply

Government efforts to improve industry efficiency are helping to constrain supply

The Chinese government is stepping up its policy of closing smaller, more dangerous and less efficient coal mines in the major coal regions of Shaanxi, Shanxi and Inner Mongolia. The objective is to consolidate the country's coal industry to enhance efficiency across the industry and ultimately provide cheaper electricity.

Further obstacles to meeting the country's growing coal consumption are the significant railway infrastructure bottlenecks in delivering domestic coal from mines in the northwest to customers in the south and east. Along with delivery disruptions, delivery costs have increased significantly.

In line with the government's efforts to limit coal consumption, we believe the government might entertain the possibility of capping domestic coal production at 3,600-3,800mt by 2015F. Although we remain sceptical that such a target is achievable, if we weigh this against the government's target to bring down China's share of coal-fired electricity from 70% to 63%, we believe it will be more successful in limiting domestic coal production than domestic coal-fired power consumption.

We expect these three hurdles to constrain growth in China's domestic coal production over the next two to three years. We estimate that China's total domestic coal production expanded by 6.9% y-y in 2010F while power generation capacity grew by 13.5% y-y. We believe China's mine consolidation strategy will further constrain coal supply, with forecast production growth of just 4.2% and 4.2% for 2011-12F, respectively. We forecast China's thermal import requirements will peak in 2012F at 169mt.

We forecast supply deficits for seaborne thermal coal

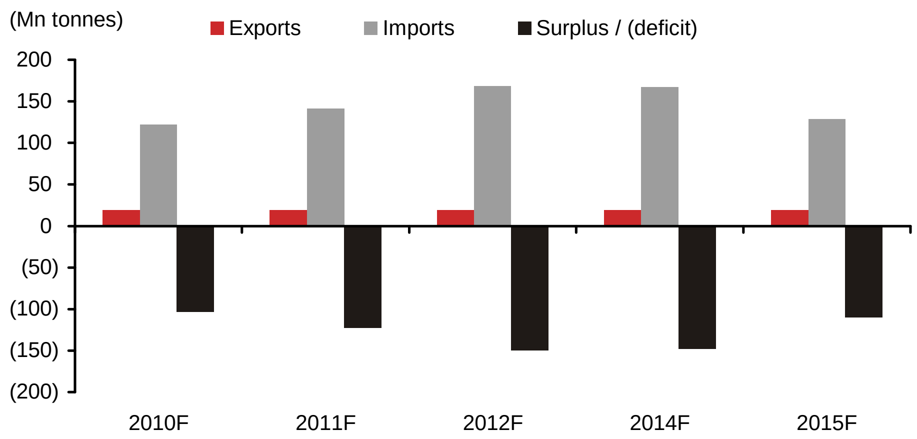
We forecast supply deficits for the global seaborne thermal coal market, mainly owing to strong import demand from India and China.

Exhibit 8. Global thermal coal supply demand

(mn tonnes)	2005	2006	2007	2008	2009	2010F	2011F	2012F	2013F	2014F	2015F	CAGR 05-10 (%)	CAGR 10-15 (%)
Thermal coal imports by region													
North America	**47.4**	**52.1**	**50.0**	**43.3**	**36.8**	**37.6**	**37.2**	**36.4**	**37.1**	**38.1**	**39.2**	(4.5)	0.8
Canada	16.6	16.4	15.1	14.8	11.2	10.5	9.5	8.0	8.0	8.2	8.5	(8.7)	(4.1)
Mexico	5.0	5.5	3.5	3.2	3.0	3.3	3.8	4.1	4.3	4.5	4.5	(8.0)	6.4
US	25.8	30.2	31.4	25.3	22.6	23.8	23.9	24.3	24.8	25.4	26.2	(1.6)	1.9
Central & South America	**5.9**	**6.2**	**8.0**	**8.9**	**8.4**	**9.0**	**9.3**	**9.6**	**10.0**	**10.4**	**11.0**	8.8	4.0
EU-15	**147.1**	**155.4**	**147.8**	**148.1**	**138.9**	**142.2**	**149.2**	**157.4**	**161.7**	**166.6**	**171.7**	(0.7)	3.8
Germany	27.7	30.1	32.4	31.5	28.2	28.8	29.6	32.2	33.0	33.8	34.7	0.8	3.8
EU-12	**12.0**	**13.4**	**13.3**	**13.2**	**13.4**	**13.3**	**14.0**	**14.5**	**15.1**	**15.6**	**16.0**	2.1	3.7
Europe Other	**13.8**	**13.7**	**18.1**	**15.3**	**15.2**	**15.6**	**15.9**	**16.2**	**16.5**	**17.0**	**17.6**	2.5	2.5
CIS	**24.2**	**29.8**	**33.4**	**31.3**	**25.9**	**28.6**	**30.1**	**32.7**	**35.9**	**39.6**	**40.5**	3.4	7.2
Russia	19.3	24.5	29.0	27.2	22.0	24.6	26.0	28.5	31.5	35.0	35.7	5.0	7.7
Middle East	**11.5**	**11.7**	**11.8**	**11.8**	**10.8**	**11.3**	**11.1**	**11.3**	**11.5**	**11.8**	**12.0**	(0.4)	1.2
Africa	**7.3**	**6.4**	**6.5**	**6.4**	**6.2**	**6.0**	**5.8**	**5.9**	**6.0**	**6.2**	**7.6**	(3.8)	4.7
Asia	**313.6**	**348.2**	**383.7**	**409.6**	**428.0**	**486.1**	**519.4**	**578.7**	**601.1**	**596.0**	**612.5**	9.2	4.7
People's Republic of China	20.3	36.7	44.2	57.7	75.4	122.1	141.7	168.6	166.9	129.0	93.0	43.2	(5.3)
India	23.7	28.5	35.8	38.8	43.0	45.6	49.7	73.0	89.8	115.0	163.3	14.0	29.1
Japan	118.0	122.4	128.0	130.8	124.0	128.3	132.2	134.8	137.5	139.6	141.0	1.7	1.9
South Korea	58.8	60.7	69.8	72.9	78.4	80.9	82.5	85.3	87.3	89.2	90.3	6.6	2.2
Republic of China (Taiwan)	52.9	56.0	57.5	58.8	58.6	59.0	59.2	59.8	60.2	60.8	61.3	2.2	0.8
Other Asia	39.9	43.9	48.4	50.6	48.6	50.1	54.1	57.1	59.3	62.4	63.7	4.7	4.9
Oceania	**1.1**	**1.4**	**0.8**	**1.3**	**1.2**	**1.2**	**1.2**	**1.3**	**1.3**	**1.4**	**1.4**	1.8	3.5
World total	**583.9**	**638.3**	**673.4**	**689.2**	**684.8**	**750.9**	**793.2**	**864.0**	**896.1**	**902.6**	**929.5**	5.2	4.4
Change (% y-y)	*5.6*	*9.3*	*5.5*	*2.3*	*(0.6)*	*9.7*	*5.6*	*8.9*	*3.7*	*0.7*	*3.0*		
Thermal coal exports by region													
North America	**20.5**	**22.7**	**28.0**	**40.0**	**35.9**	**42.0**	**43.7**	**45.5**	**46.8**	**47.0**	**46.8**	15.4	2.2
Canada	1.4	2.8	3.8	4.9	5.0	6.1	6.5	7.0	7.5	8.1	8.7	34.2	7.3
US	19.1	19.9	24.2	35.1	30.9	35.9	37.2	38.5	39.3	38.9	38.1	13.5	1.2
Central & South America	**58.9**	**67.2**	**70.8**	**78.2**	**80.1**	**84.5**	**87.4**	**90.4**	**98.2**	**101.6**	**109.3**	7.5	5.3
EU-15	**0.6**	**0.3**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	(100.0)	N/A
EU-12	**18.3**	**17.9**	**14.1**	**11.1**	**9.6**	**9.4**	**6.9**	**6.3**	**6.0**	**5.6**	**7.4**	(12.5)	(4.7)
Europe Other	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	N/A	N/A
CIS	**104.4**	**111.4**	**120.7**	**117.1**	**110.0**	**115.0**	**121.1**	**126.6**	**132.1**	**138.5**	**145.4**	2.0	4.8
Kazakhstan	25.2	27.1	29.2	27.1	25.5	29.0	29.5	30.0	32.0	33.0	34.5	2.8	3.5
Russia	76.0	81.4	88.0	85.8	80.6	82.2	88.1	93.6	97.7	103.0	108.5	1.6	5.7
Other CIS	3.2	2.9	3.5	4.2	3.9	3.8	3.5	3.0	2.5	2.5	2.4	3.5	(8.8)
Middle East	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	N/A	N/A
Africa	**70.9**	**68.1**	**65.1**	**61.3**	**62.3**	**64.0**	**68.6**	**73.3**	**77.5**	**83.7**	**90.5**	(2.0)	7.2
South Africa	70.9	68.1	65.1	61.3	62.3	64.0	68.0	72.1	75.7	80.2	85.9	(2.0)	6.1
Other Africa	0.0	0.0	0.0	0.0	0.0	0.0	0.6	1.2	1.8	3.5	4.7	N/A	N/A
Asia	**202.9**	**238.6**	**259.7**	**257.4**	**244.2**	**221.3**	**243.7**	**265.9**	**292.2**	**318.7**	**340.8**	1.8	9.0
People's Republic of China	66.4	58.9	50.6	35.8	18.5	19.1	19.1	19.1	19.1	19.1	19.1	(22.1)	0.0
Indonesia	122.5	165.7	190.9	196.6	202.2	177.8	201.0	220.2	245.8	271.6	290.9	7.7	10.3
Vietnam	10.0	10.9	15.1	19.1	16.3	14.5	12.5	10.0	9.5	7.0	5.5	7.7	(17.6)
Mongolia	0.2	0.2	0.1	0.3	2.7	5.7	7.2	9.5	13.9	17.2	21.7	95.5	30.6
Other Asia	3.8	2.9	3.0	5.6	4.5	4.2	3.8	7.1	3.9	3.8	3.8	2.2	(2.3)
Oceania	**107.5**	**112.2**	**114.9**	**124.3**	**142.6**	**146.4**	**153.8**	**161.9**	**170.1**	**178.5**	**187.5**	6.4	5.1
Australia	107.1	111.9	114.6	124.0	142.3	146.0	153.4	161.1	169.2	177.6	186.5	6.4	5.0
New Zealand	0.4	0.3	0.3	0.3	0.3	0.4	0.4	0.8	0.9	0.9	1.0	0.0	20.1
World Total	**584.0**	**638.4**	**673.3**	**689.4**	**684.7**	**682.6**	**725.2**	**770.0**	**822.8**	**873.6**	**927.8**	3.2	6.3
Change (% y-y)	*5.6*	*9.3*	*5.5*	*2.4*	*(0.7)*	*(0.3)*	*6.2*	*6.2*	*6.9*	*6.2*	*6.2*		
Surplus/(deficit)	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**	**(68.3)**	**(67.9)**	**(94.0)**	**(73.2)**	**(29.0)**	**(1.7)**		
Surplus/(deficit) (% of demand)	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**	**(9.1)**	**(8.6)**	**(10.9)**	**(8.2)**	**(3.2)**	**(0.2)**		

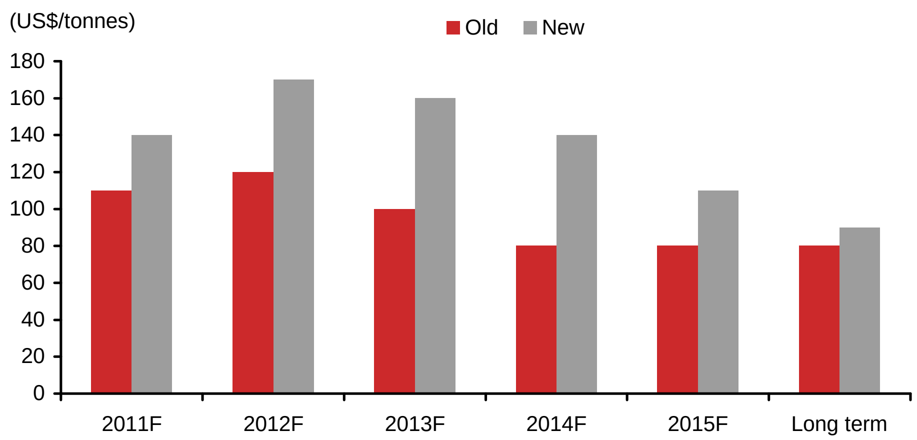
Source: Australian Mineral Economics (AME), Nomura estimates

Exhibit 9. China remains a net importer of coal



Source: Nomura estimates

Exhibit 10. Higher global coal price assumptions



Source: Nomura estimates

Indonesia's competitiveness

Indonesia's key competitive advantage is its proximity to major coal importers

In a global context, we believe Indonesia is in a more competitive position than Australia and South Africa given its closer proximity to major coal-importing countries. The following exhibit suggests that, based on AME estimates, Indonesia's transportation costs can be about US$2-12/tonne lower than those of South Africa and Australia when exporting coal to India and Southern China. On our reading, the only region that can challenge Indonesia's transportation costs is Northern China when selling coal to Southern China.

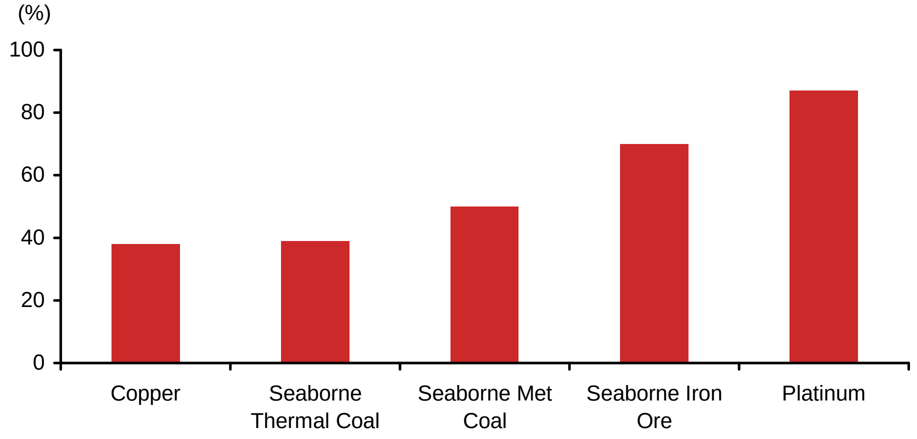
Exhibit 11. Indonesia is within close proximity to major coal importers

Source: AME, Delta Dunia Makmur (DOID)

Coal to be the epicentre of mining M&A

Thermal coal remains one of the most fragmented commodity markets, with the top-five producers accounting for only 38% of total seaborne supply in 2010. This compares with much more consolidated industries, such as seaborne iron ore and platinum, where the top-five producers account for 70% and 87% of their respective markets. Compared with other industries, such as iron ore and copper, we believe the list of coal assets that may be available for sale is much greater. We also think asset valuations are more realistic across the thermal coal industry compared with other commodities, notably copper (see our 6 January 2011, report *Copper euphoria – is it now priced in?* by Paul Cliff).

Exhibit 12. Market segmentation: top-five producers' combined market share (2010)



Source: AME, World Steel Dynamics, Ferrexpom Brook Hunt, Nomura estimates

Thermal coal remains one of the most fragmented commodity markets

Supply and demand outlook

Strong domestic demand: no fears

Double-digit growth backed by robust power demand

Power sector demand to remain the main driver

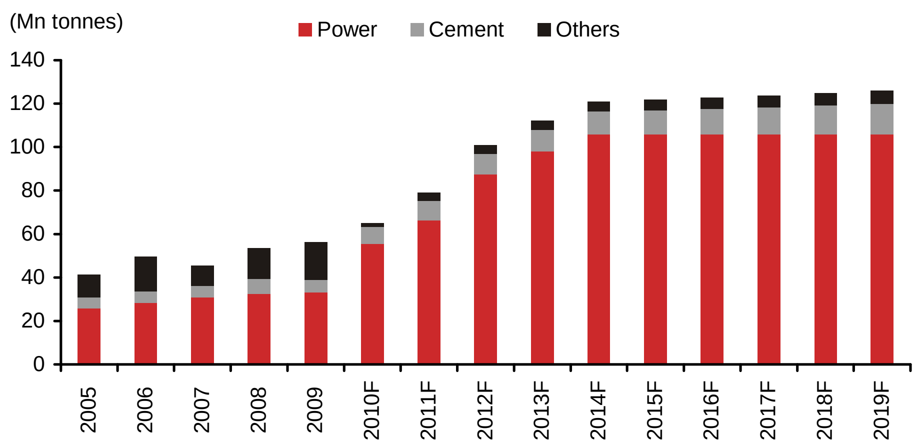
The power sector is likely to continue to drive domestic coal demand

In the past five years (2005-10F), domestic coal demand has grown from 41.2mn tonnes pa to 65.0mn tonnes pa (10% CAGR). The strong growth in domestic demand was largely driven by demand from the power sector (17% CAGR) and cement sector (8% CAGR).

Over the next five years (2010-15F), we forecast continued double-digit growth in domestic demand (13% CAGR), mainly on the back of strong demand from the power sector (14% CAGR) after Perusahaan Listrik Negara (PLN) completes its power project.

In terms of demand structure, we estimate that in 2010 the power sector contributed 85% of demand, followed by the cement sector (12%) and others (3%). We forecast in 2015F the structure will remain relatively stable, with power, cement and other sectors each accounting for 87%, 9% and 4% of the demand.

Exhibit 13. Indonesia: power sector is the demand driver

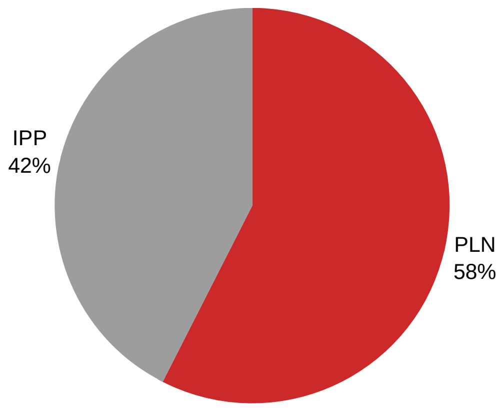


Source: Association of Indonesian Coal Mining Companies, PLN, Petromindo, Nomura estimates

Power sector additional capacity

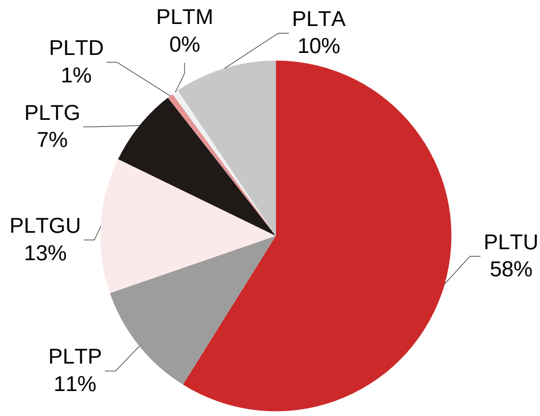
PLN's electricity supply plan suggests there will be combined additional power generation capacity of 55,485MW at PLN (58%) and independent power producers or IPPs (42%) in 2010-19F. Most of the new power plants will be coal-fired (59%), followed by gas and coal-fired (13%), geothermal (11%) and other (17%). The new capacity already takes into account completion of stage 1 and 2 power projects. Post completion of the new power capacity, contribution of the coal-fired power plants should increase from 46% in 2010F to 58% in 2019F.

Exhibit 14. Indonesia: PLN to dominate additional power capacity (2010-19F)



Source: PLN, Nomura estimates

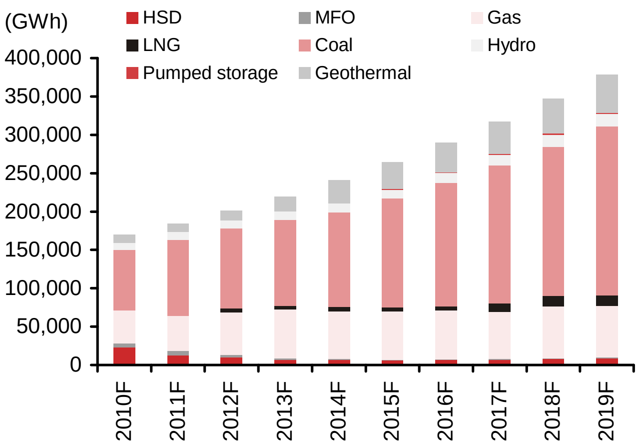
Exhibit 15. Indonesia: most new power plants will be coal-fired



Note: PLTU = coal-fired power plant, PLTA = hydropower power plant, PLTM = sunpower power plant, PLTD = diesel-fired power plant, PLTG = gas-fired power plant, PLTGU = gas-and-coal-fired power plant, PLTP = geothermal power plant

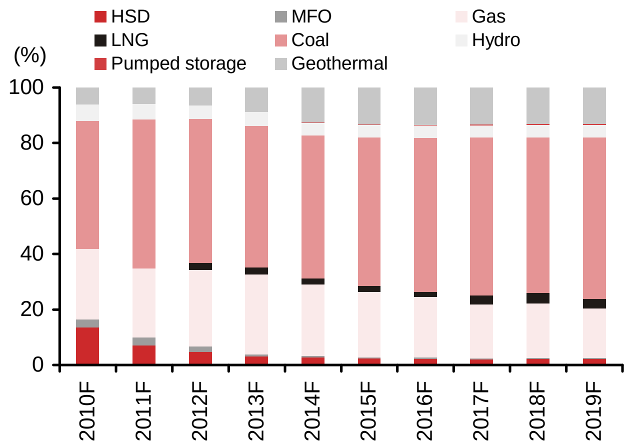
Source: PLN, Nomura estimates

Exhibit 16. Indonesia: electricity production



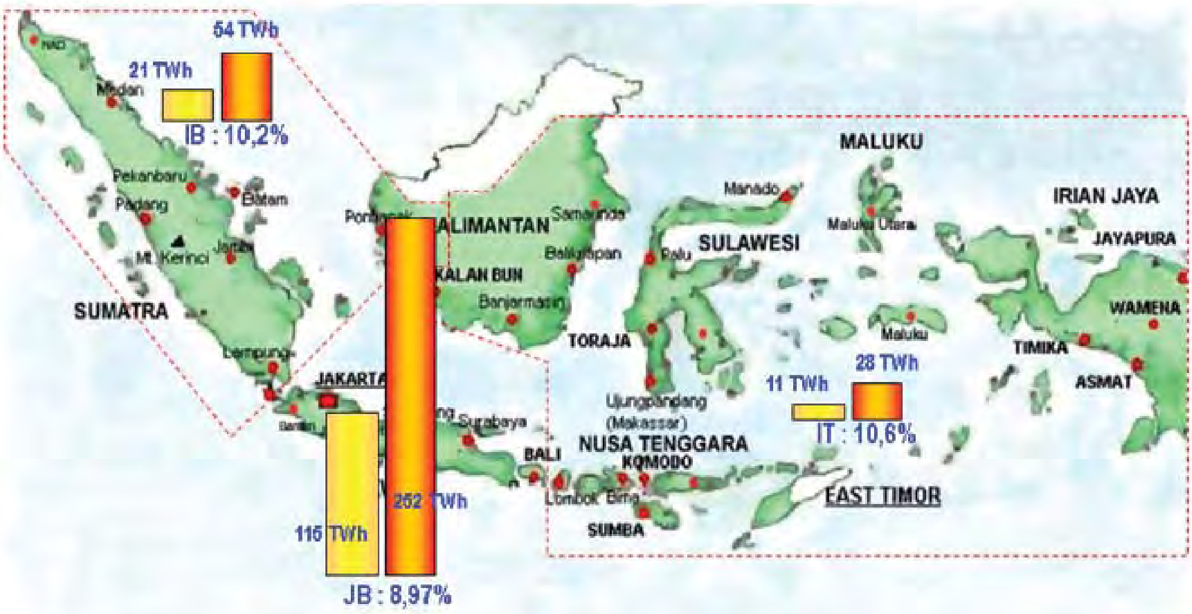
Source: PLN

Exhibit 17. Indonesia: coal dominating production



Source: PLN, Nomura estimates

Exhibit 18. PLN electricity sales



Source: PLN

New market for low-rank coal

Growing demand should create a new market for low-rank coal

PLN will need some 31mn tonnes of low-rank (low energy content) coal for its 10,000MW project, meaning that PLN's requirements for low-rank coal will create a new market for such type of coal. Currently, it is still very difficult to sell low-rank coal due to its high moisture content. The high moisture content can increase transportation cost significantly, and make low-rank coal non-marketable.

Significant low-rank coal reserves

Indonesia has around 19.0bn tonnes and 104.9bn tonnes of coal reserves and resources, respectively (see below). The reserves are highly concentrated in terms of location, mostly on the two major islands of Sumatera and Java.

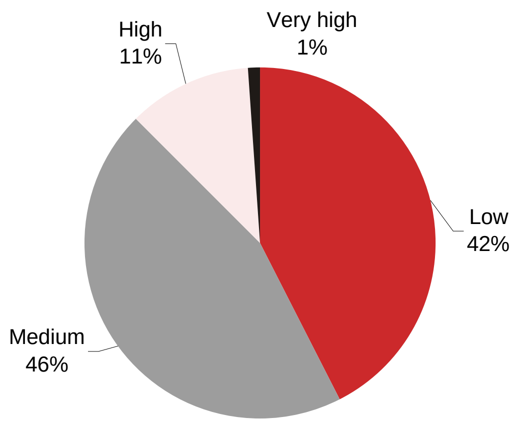
Most of Indonesia's coal is low/lignite (42% of reserves and 20% of resources) and medium/sub-bituminous (45% of reserves and 66% of resources), which are very suitable for power plant consumption. Assuming that annual domestic consumption of lignite and sub-bituminous coal is 125mn tonnes, the implied mine life is over 130 years.

Exhibit 19. Indonesia: concentrated reserves with long mine life

	(mn tonnes)			
	Resources		Reserves	
Location		(%)		(%)
Sumatera	52,437	50	11,549	61
Java	14	0	0	0
Kalimantan	52,101	50	7,458	39
Sulawesi	233	0	0	0
Maluku	2	0	0	0
Papua	153	0	0	0
Total	**104,940**	**100**	**19,007**	**100**
Implied mine life (based on 2010 production), years	400		72	

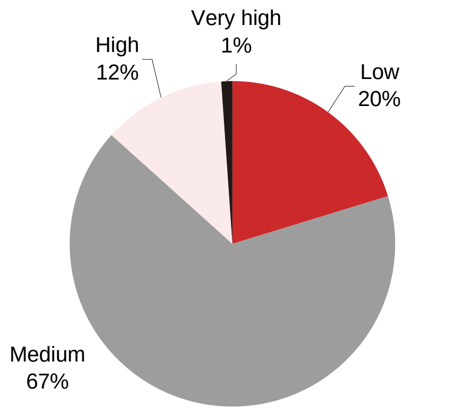
Source: Petromindo, Geological Agency of ESDM, Nomura estimates

Exhibit 20. Indonesia: reserves by type (2009)



Source: Ministry of Energy and Mineral Resources, Nomura estimates

Exhibit 21. Indonesia: resources by type (2009)



Source: Ministry of Energy and Mineral Resources, Nomura estimates

Supply will grow as well

Outlook on 2011F production

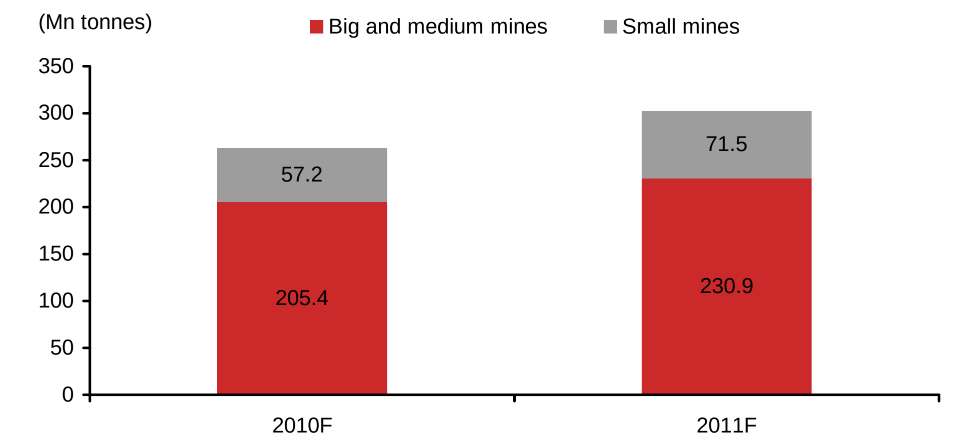
We expect stronger coal production in 2011F

Having posted a relatively weak 2010, with flat growth (+6% y-y) in production to 262.5mn tonnes, largely due to very bad weather conditions, Indonesian coal producers will record 15% y-y growth in production to 302.3mn tonnes in 2011F, on our forecasts. We expect this year's production growth to come mainly from big and medium (+12% y-y) and small (+25% y-y) mines. We expect the big and medium mines to continue to dominate production, with a 75% contribution, largely unchanged from 78% in 2010.

Weather is a major variable in our forecast. Our double-digit production growth forecast for 2011F is based on expectations of improved weather in 2011F. Based on data from Indonesia's meteorology body (Badan Meteorologi dan Geofisika/BMG) and our conversations with coal companies, we understand that weather conditions have improved compared with 3Q10. Rainfall remains high but is still within normal levels. BMG data suggest, in our view, that until March 2011 current conditions will persist. This is not unusual, considering that rainfall is usually heavier in 1Q.

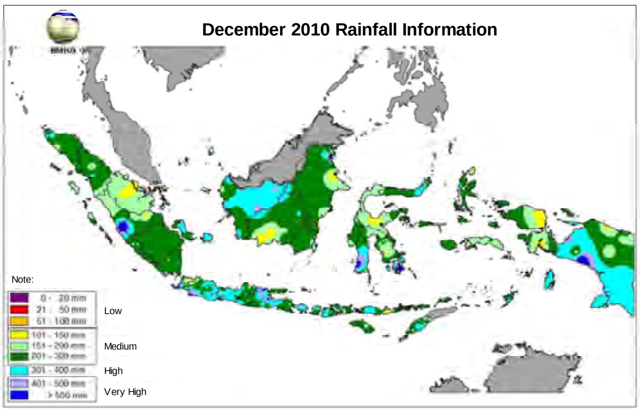
We forecast 15% y-y growth in coal production for 2011F

Exhibit 22. Indonesia: coal production forecasts



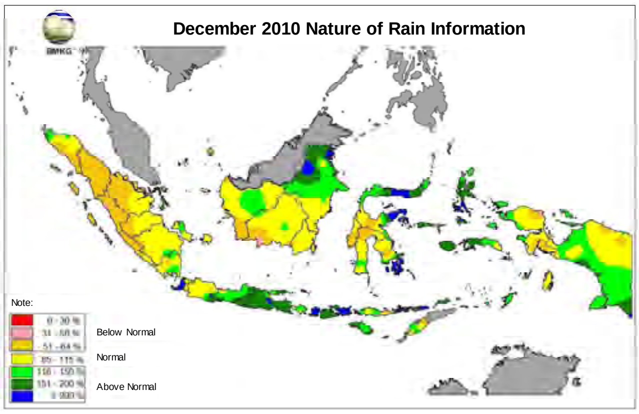
Source: Nomura estimates

Exhibit 23. Rainfall in December 2010



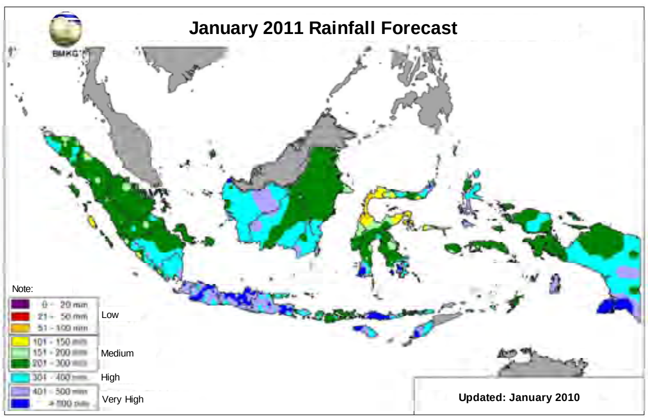
Source: BMG

Exhibit 24. Nature of rain in December 2010



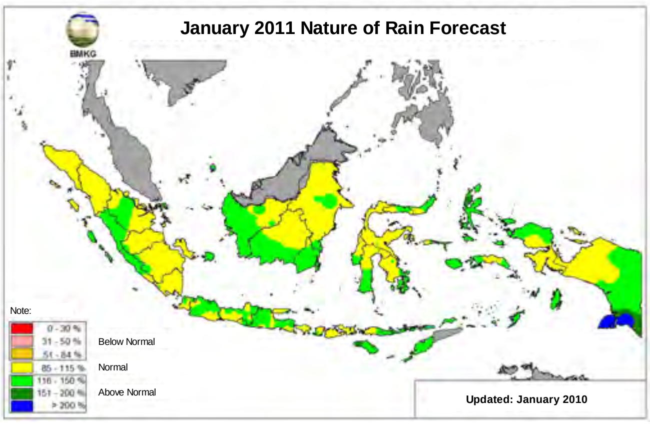
Source: BMG

Exhibit 25. Rainfall in January 2011



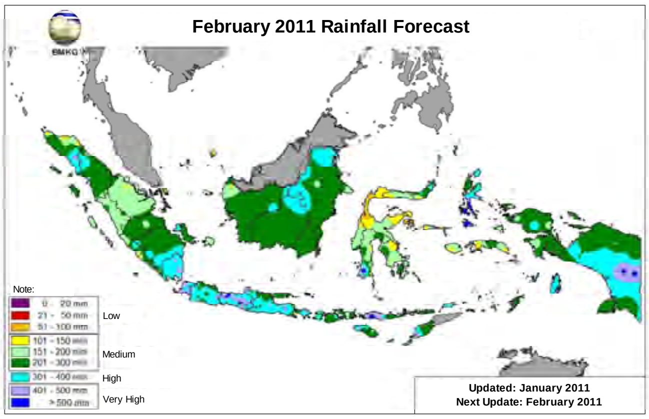
Source: BMG

Exhibit 26. Nature of rain in January 2011



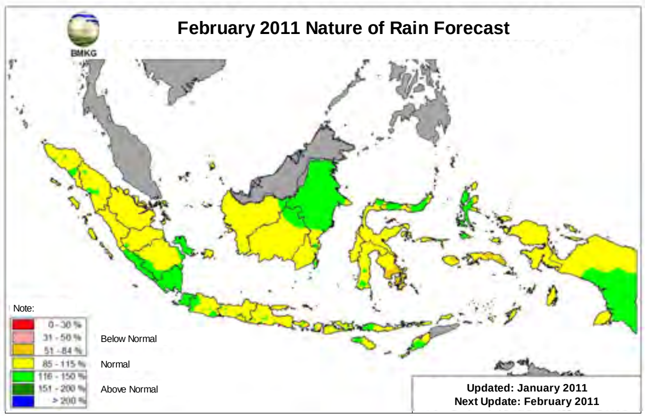
Source: BMG

Exhibit 27. Rainfall in February 2011



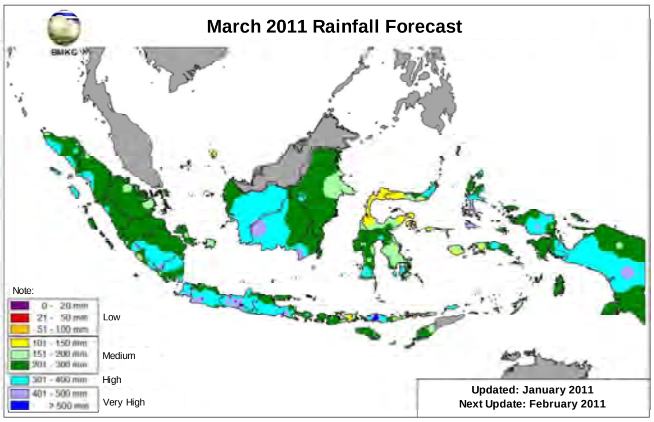
Source: BMG

Exhibit 28. Nature of rain in February 2011



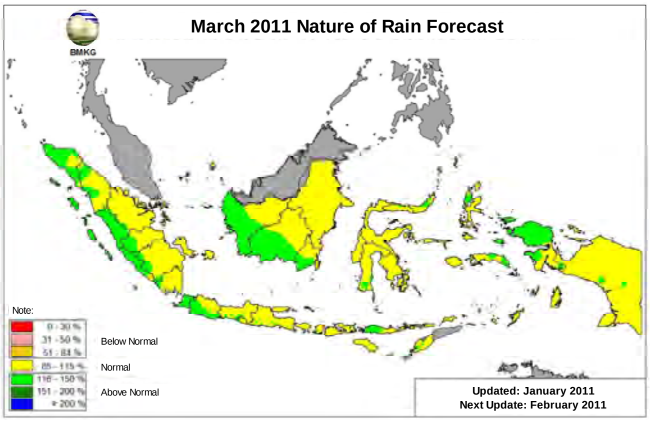
Source: BMG

Exhibit 29. Rainfall in March 2011



Source: BMG

Exhibit 30. Nature of rain in March 2011



Source: BGM

Capacity expansion to drive production

Capacity expansion and entry to new players to drive production growth

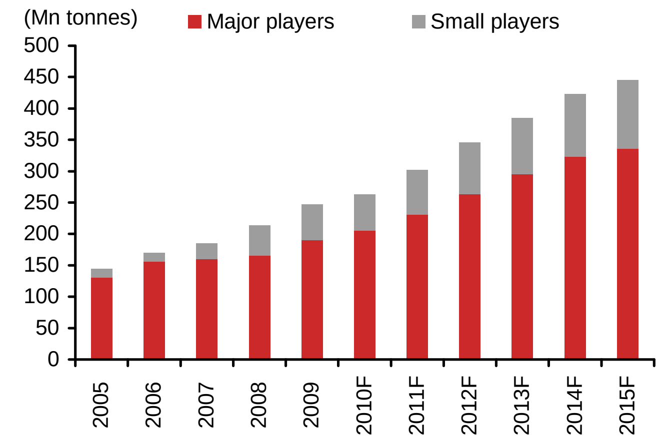
Over the next five years (2010-15F), we expect Indonesian production to continue to show double-digit growth, with an estimated CAGR of 11% from 262.5mn tonnes to 444.9mn tonnes. The growth is likely to be driven by capacity expansion at existing mines and the entry of new players into the industry.

We have factored in execution risks from production upgrades for 2015F. As such, there is upside potential to our 2015F production estimates, which we find could reach 476.2mn tonnes (13% CAGR) should the coal companies complete expansion on time.

We also note potential upside to our production forecasts from new players chasing a strong coal price. Corporate action in 2010 to enter the business includes among others:

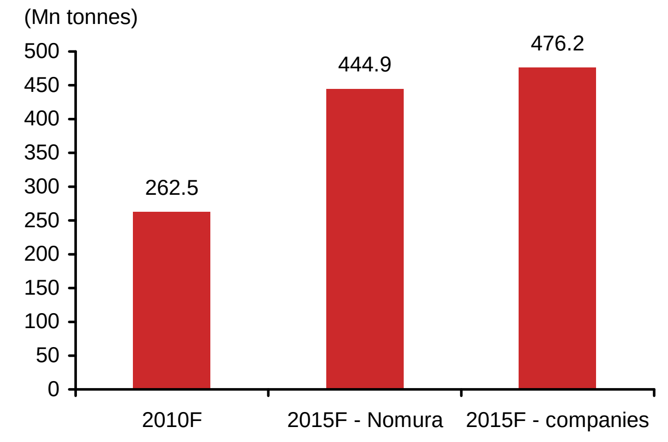
- In January 2010, Pamapersada signed agreements with PT Mandira Sanni Pratama and PT Andalan Teguh Berjaya to acquire 30% stakes in PT Asmin Bara Bronang and PT Asman Bara Jaan for US$40.1mn and Rp75mn, respectively.
- In May 2010, Bhakti Coal Resources, a subsidiary of Bhakti Investama (BHIT IJ), signed a sales and purchase agreement with PT Titan Mining Resources Investment to acquire eight coal concessions in South Sumatera.
- In May 2010, Dian Swastatika Sentosa (DSSA IJ) acquired a 99% stake in PT Karya Cemerlang Persada.

Exhibit 31. Production to grow to 444.9mn tonnes in 2015F



Source: Association of Indonesian Coal Mining Companies, Petromindo, company data, Nomura estimates

Exhibit 32. Upside to our 2015F production estimate to 476.2mn tonnes



Source: Nomura estimates

Supply – demand looks in balance

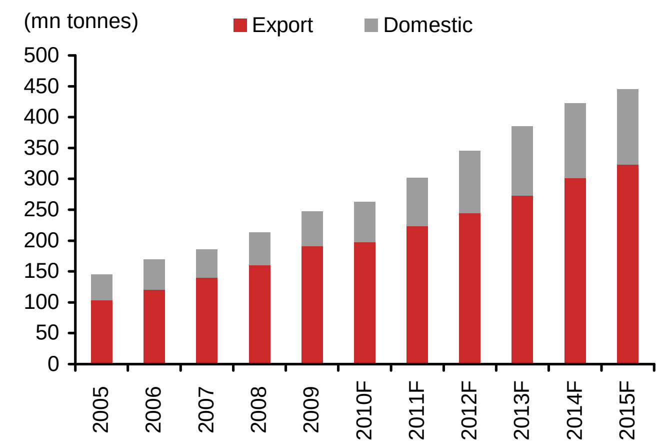
Enough supply – no need for export repatriation

Stronger domestic demand unlikely to limit exports

In the past, Indonesia sold 70-75% of its production to export markets. Despite the anticipated strong domestic demand, our analysis suggests this will not limit exports, given the following:

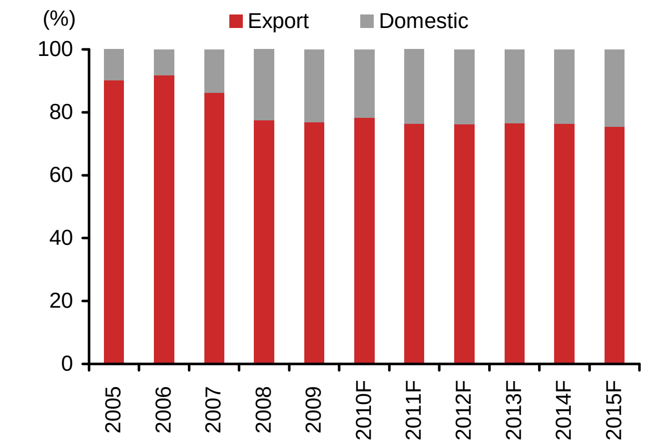
- Domestic demand, especially for the 10,000MW project, requires a different type of coal from the export market. The export market usually needs at least sub-bituminous coal quality; meanwhile, the power project requires lignite coal, which has lower energy and higher moisture content.
- The industry will expand capacity at the same time, and production capacity expansion will be for export-quality coal as well as for low-rank coal (ie, for PLN).
- PLN's coal requirement for the 10,000MW power project has been secured by a number of suppliers, which should lessen the possibility of an export repatriation scenario.

Exhibit 33. Exports likely to grow as well



Source: Association of Indonesian Coal Mining Companies, Petromindo, company data, Nomura estimates

Exhibit 34. Export proportion will likely remain stable



Source: Association of Indonesian Coal Mining Companies, Petromindo, company data, Nomura estimates

Exhibit 35. Coal suppliers for PLN's 10,000MW power project

No	Supplier	Volume, mn tonnes pa	Period
1	Consortium Arutmin Indonesia & Dharma Henwa	8.493	2009 - 2029
2	Baramutiara Prima	2.328	2009 - 2029
3	Consortium Kasih Industri & Senamas Energindo Mulia	3.810	2009 - 2029
4	Titan Mining Energy	3.205	2009 - 2029
5	Dwi Guna Laksana	2.945	2010 - 2030
6	Hanson Energy	4.372	2010 - 2030
7	Consortium Modal Investasi Mineral Mega Alam Sejahtera, & Sarana Mandiri	0.279	2010 - 2030
8	Consortium Oktasana Baruna Megah & Baramega Citra Mulia Persada	3.056	2010 - 2030
9	Consortium Bina Insan Sukses Mandiri & Tiramana; Consortium Energi Batubara Lestari & Batara Batari Sinergy Nusantara; Anzawara Satria; Consortium Selatan Selabara & Fajar Visikalam; Consortium Karya Banua & Daya Bambu Sejahtera	2.700	2010 - 2030
	Total	**31.188**	

Source: PLN, Petromindo

DMO overview: good concept but needs further details

Regulations aim to secure supply for domestic demand but need clarification to work

To secure supply for domestic demand, the government has issued two regulations on domestic market obligation (PP No. 34/1999) and domestic price setting (PP No. 17/2010). In our view, the regulations are positive and not harmful to the overall industry, given the following:

- The government will determine the amount of coal for domestic consumption based on input from users/potential users, thus reducing potential significant deviation between estimated and actual demand;
- The pricing for domestic demand will be based on a reference price issued by the government, which will refer to international prices;
- PP No. 34/1999 contains provision of a kind of domestic market obligation (DMO) credit trade for companies that are over-committed or under-committed.

While conceptually good, we believe the regulations need clarification in several areas for implementation:

- How will the government allocate proposed domestic demand among coal producers? For example, will it set the same percentage of production across the whole industry without taking into account differences in miners' coal quality?
- How will the DMO credit trade work? It is unclear whether an under-committed company buys from an over-committed company, or if the former can just pay the latter without physical trade between the two parties and the latter can ship directly to the buyer. Can the under-committed company pay a certain sum of money for the "quota price" to the over-committed company? If so, how will the quota price be determined?
- Can unfulfilled commitments in a certain year be carried forward to the next year?
- PP No. 17/2010 suggests the price will be based on reference price issued by the government, which is based on mother vessel-FOB price. What if the price is based instead on, say, barge-FOB price? How is the adjustment to be made between the two prices?

If prices are similar, will coal miners prioritise domestic demand?

We are of a view that even though domestic and export prices (for the same energy content) are similar, coal miners are unlikely to prioritise domestic demand automatically. We believe that price, despite its high importance, is not the main factor. Counterparty risk is another important factor to consider, in our view. Supplying to the domestic market means dealing with PLN, and we believe that PLN's reputation in terms of payment, track record and bureaucracy among others, will be a major consideration for coal companies.

Earnings prospects

Profitability recovery kicks off

Weak performance in 2010

2010 was tough for coal producers…

Our forecasts show four of the coal companies under our coverage posting a weak performance for 2010F. On aggregate, we expect EBITDA to be flat y-y and earnings to be down 26% y-y. PTBA will post the biggest EBITDA decline of 37% y-y, on our estimates. We expect ADRO and PTBA to post the biggest drop in earnings of 34% y-y and 32% y-y, respectively.

The main drivers behind the weak performance:

- **Flat/negative volume growth.** Poor weather conditions in 2010 saw coal companies scale back their production targets. On average, production growth was largely flat at 5% y-y.
- **Lower ASP.** Despite a higher coal price in 2010 than in 2009, we expect coal companies to post lower ASPs as some contracts were completed based on the 2009 coal price.
- **Higher oil price.** A higher oil price (up 28% from ~US$62/bbl in 2009 to US$79/bbl in 2010) pushed up production costs at coal companies in 2010.

Recovery from 2011F

… but 2011F looks brighter

We forecast Indonesian coal companies will on aggregate post strong EBITDA and earnings CAGRs of 60-74% and 68-159% for 2010-12F, on higher production volumes (12-13% CAGR) and ASPs (19-26% CAGR). In terms of margin performance, we forecast EBITDA and earnings margins will widen significantly from 25-39% and 4-24% in 2010 to 42-52% and 13-35% in 2012F, respectively. We expect BUMI to post the lowest earnings margin for 2012F of 13%, weighed down by its high debt burden.

We note that our forecasts, especially for 2012F, are probably among the highest on the street, mainly reflecting our more positive outlook on coal prices.

Exhibit 36. Coal miners: earnings recovery from 2011F

	2009	2010F	Change (%)	2011F	2012F	CAGR (10-12) (%)
ADRO						
Sales (Rpbn)	26,938	23,630	(12)	31,989	45,948	39
EBITDA (Rpbn)	9,928	9,333	(6)	14,441	24,036	60
Earnings (Rpbn)	4,367	2,880	(34)	6,033	11,255	98
Production (mn tonnes)	40.6	42.6	5	47.2	53.9	12
Sales (mn tonnes)	41.1	42.2	3	46.8	53.5	12
ASP (US$/tonne)	58.7	57.0	(3)	70.6	90.2	26
EBITDA margin (%)	37	39		45	52	
Net margin (%)	16	12		19	24	
BUMI						
Sales (US$mn)	3,219	3,994	24	5,000	7,341	36
EBITDA (US$mn)	753	988	31	1,534	3,077	77
Earnings (US$mn)	190	147	(23)	246	984	159
Production (mn tonnes)	57.5	60.0	4	66.0	77.2	13
Sales (mn tonnes)	58.2	60.0	3	66.0	77.2	13
ASP (US$/tonne)	62.9	70.1	11	84.2	105.6	23
EBITDA margin (%)	23	25		31	42	
Net margin (%)	6	4		5	13	
ITMG						
Sales (US$mn)	1,508	1,632	8	2,108	2,880	33
EBITDA (US$mn)	486	477	(2)	753	1,313	66
Earnings (US$mn)	336	305	(9)	517	934	75
Production (mn tonnes)	21.4	22.1	3	25.5	27.7	12
Sales (mn tonnes)	21.0	22.1	5	25.5	27.7	12
ASP (US$/tonne)	71.7	73.8	3	82.7	104.0	19
EBITDA margin (%)	32	29		36	46	
Net margin (%)	22	19		25	32	
PTBA						
Sales (Rpbn)	8,921	7,845	(12)	10,406	14,928	38
EBITDA (Rpbn)	3,602	2,285	(37)	3,910	6,903	74
Earnings (Rpbn)	2,728	1,852	(32)	3,001	5,248	68
Production (mn tonnes)	11.6	12.4	7	13.7	15.8	13
Sales (mn tonnes)	12.1	13.0	7	14.3	16.4	13
ASP (US$/tonne)	70.7	67.3	(5)	80.8	101.1	23
EBITDA margin (%)	40	29		38	46	
Net margin (%)	31	24		29	35	

Source: Company data, Nomura estimates

Returns to shareholders

Selective dividend story

The money has to go back to shareholders

We believe that the coal companies, starting in 2013F, will have capacity to return some money to shareholders in the form of higher dividends, given: 1) self-funding capex on stronger coal prices; 2) net cash positions by 2012F; 3) major capex spending centred in 2011-13F; and 4) no major M&A capex planned.

Operating cashflow to finance non-M&A capex centred in 2011-13F

Given the coal companies' intentions to upgrade their production capacity significantly by 2014F, we forecast capex will be centred in 2011-13F. Thereafter, we expect capex to fall, covering mainly maintenance.

In terms of capex financing, our analysis suggest that all coal companies under our coverage will have very strong operating cashflows in 2011-13F, enabling them to finance their annual (non-M&A) capex.

There is likely to be money left over after capex in 2011-13F

Exhibit 37. Potential returns to investors

	2011F	2012F	2013F	2014F
Operating CF (OCF), (US$mn)				
ADRO	861	1,420	1,704	1,672
BUMI	269	934	1,413	1,449
ITMG	555	955	1,054	902
PTBA	284	494	625	614
Total	**1,969**	**3,802**	**4,796**	**4,637**
Capex (US$mn)				
ADRO	513	513	310	310
BUMI	300	300	300	150
ITMG	73	73	73	73
PTBA	80	80	80	30
Total	**966**	**966**	**763**	**563**
OCF - capex, (US$mn)				
ADRO	348	907	1,394	1,362
BUMI	(31)	634	1,113	1,299
ITMG	482	882	981	829
PTBA	204	414	545	584
Total	**1,003**	**2,836**	**4,033**	**4,074**

Source: Nomura estimates

No major M&A capex

Major spending on M&A unlikely

We understand that in addition to organic growth, coal companies are eyeing M&A opportunities to drive non-organic growth. We do not expect acquisition of any listed coal companies considering: 1) high valuations (the smallest listed coal company has a market cap of more than US$2.0bn) and 2) the unwillingness of major shareholders to sell. That said, any M&A targets that coal companies are eyeing should, we believe, be green- or brown-field assets which have an estimated value of some US$1.0bn.

Exhibit 38. Coal miners: market capitalisation

Company	Ticker	Market cap (US$mn)
Adaro Energy	ADRO IJ	8,885
Bumi Resources	BUMI IJ	6,982
Bayan Resources	BYAN IJ	6,611
Indo Tambangraya Megah	ITMG IJ	6,528
Tambang Batubara Bukit Asam	PTBA IJ	5,773
Harum Energy	HRUM IJ	2,745
Indika Energy	INDY IJ	2,719
Berau Coal	BRAU IJ	2,094

Note: as of 10 January 2011 close

Source: Bloomberg

Moving towards lower balance-sheet risk and higher debt capacity

Stronger balance sheets point to dividends and expansion

Stronger coal prices and higher volume will likely lead to stronger operating cashflows and earnings, as well as lower balance-sheet risk and higher debt capacity, which can be used to fund expansion.

Exhibit 39. Coal miners: lower balance-sheet risk and higher debt capacity

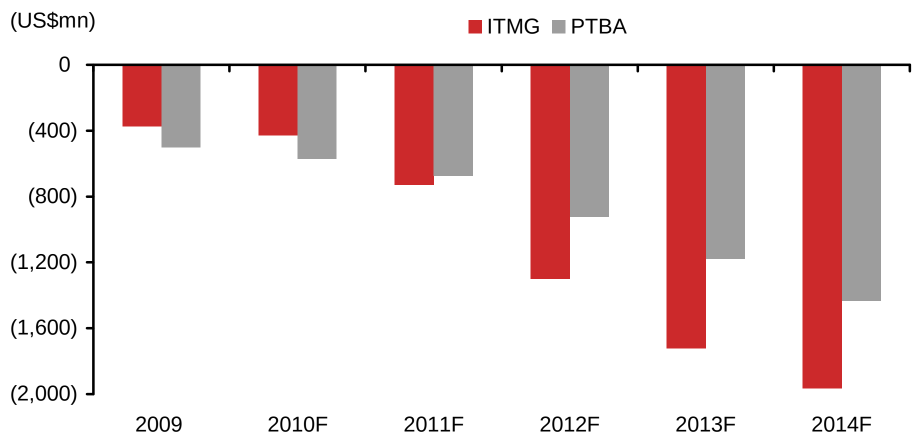
	2009	2010F	2011F	2012F
Debt / equity				
ADRO	0.86	0.68	0.45	0.22
BUMI	2.37	2.05	1.81	1.17
ITMG	0.07	0.00	0.00	0.00
PTBA	0.00	0.00	0.00	0.00
Total	1.08	0.94	0.72	0.44
Net debt / equity				
ADRO	0.22	0.21	0.06	(0.15)
BUMI	2.33	1.95	1.66	0.80
ITMG	(0.47)	(0.46)	(0.58)	(0.69)
PTBA	(0.83)	(0.83)	(0.73)	(0.69)
Total	0.61	0.56	0.33	(0.03)

Source: Company data, Nomura estimates

ITMG and PTBA are the strongest candidates

We believe ITMG and PTBA are most likely to surprise on the upside with dividends, given their relatively strong financials (both are already in net cash positions) and lower capex. On top of that, we think that, from the perspective of ITMG and PTBA's major shareholders, there should be higher dividend payment demands to enable the paying off of debts and/or the funding for expansion.

Exhibit 40. ITMG and PTBA are building strong net cash positions



Source: Company data, Nomura estimates

We think ADRO may be another candidate for higher-than-expected dividend payout, considering our forecasts for net cash by 2012F. However, ADRO's senior note will mature by 2019F, possibly preventing the company from paying out higher dividends. For BUMI, despite a declining gearing ratio, we do not expect much higher dividends given: 1) its outstanding US$1.9bn loan to China Investment Corporation (CIC), and 2) BUMI's aggressive balance-sheet management which might put restriction on higher dividends.

Stock picks

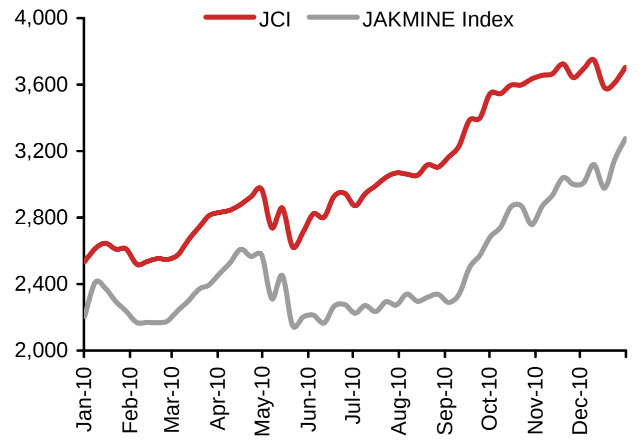
ADRO and ITMG are our top picks

Bullish on the coal sector

Coal sector offers attractive supply-demand dynamics

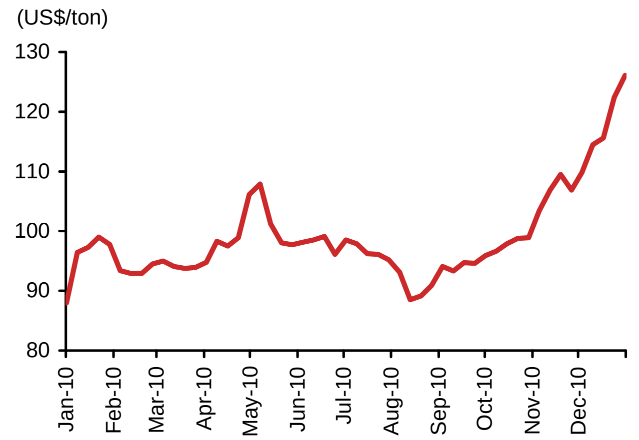
We like the coal sector for its attractive supply-demand dynamics in both global and domestic markets. The sector, as proxied by the JAKMINE Index on the Indonesia Stock Exchange (IDX), performed relatively in line with the overall market in 2010. We expect the sector to perform more strongly in 2011F, on higher volumes and better ASPs leading to stronger earnings growth.

Exhibit 41. Sector performed in line



Source: Bloomberg

Exhibit 42. Coal price recovery ahead



Source: Bloomberg

We prefer Adara and ITMG

We believe the companies that will benefit most from the positive coal market conditions are those with: 1) a strong business model, with installed and expanding capacity; 2) exposure to the seaborne market to feed strong demand; 3) competitive costs; and 4) a strong financial position so that upsides in the coal market will benefit shareholders.

Among the coal miners under our coverage, we have Adaro Energy (ADRO IJ) and Indo Tambangraya Megah (ITMG IJ) as our top sector picks, with price targets of Rp3,700 and Rp73,000, respectively.

Exhibit 43. Sector picks: ADRO and ITMG are top picks

Stock	Nomura rating	Price (Rp)	Price target (Rp)	EV/EBITDA (x) 2011F	EV/EBITDA (x) 2012F	P/E (x) 2011F	P/E (x) 2012F
ADRO IJ	BUY	2,475	3,700	5.6	3.1	13.1	7.0
ITMG IJ	BUY	52,200	73,000	7.7	4.0	12.7	7.0
PTBA IJ	BUY	22,100	30,000	11.5	6.2	17.0	9.7
BUMI IJ	BUY	2,950	4,300	6.8	3.0	27.7	6.9
Average				**7.9**	**4.1**	**17.6**	**7.7**

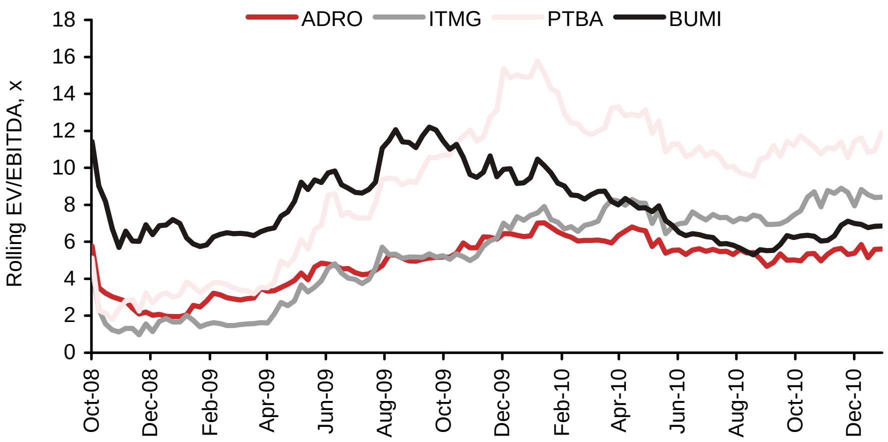
Note: pricing as of 11 January, 2011

Source: Nomura estimates

Valuations

Indonesian coal companies look reasonably valued on EV/EBITDA relative to the current coal price. PTBA and ADRO, despite trading higher than peers on EV/EBITDA, are still trading below their end-2009 multiples. BUMI is trading below its historical average EV/EBITDA despite expectations of lower balance-sheet risk. While ITMG is trading above its historical average EV/EBITDA, we think this is justified given the current higher coal price and expected stronger coal prices going forward.

Exhibit 44. Rolling EV/EBITDA



Source: Company data, Nomura estimates

Trading at discounts to China peers on EV/EBITDA and P/E

We find the Indonesian coal companies are trading at 27% and 17% discounts to China coal companies based on 2012F EV/EBITDA and P/E, respectively. The discounts, in our view, may reflect price restrictions on ASPs for China coal companies which prevent them from fully leveraging increases in coal prices.

Exhibit 45. Valuation comparison: Indonesia vs China coal miners

Stock		Nomura rating	11 Jan price (LC)	EV/EBITDA (x) 2011F	EV/EBITDA (x) 2012F	P/E (x) 2011F	P/E (x) 2012F
ADRO IJ	ADRO IJ	BUY	2,475	5.6	3.1	13.1	7.0
ITMG IJ	ITMG IJ	BUY	52,200	7.7	4.0	12.7	7.0
PTBA IJ	PTBA IJ	BUY	22,100	11.5	6.2	17.0	9.7
BUMI IJ	BUMI IJ	BUY	2,950	6.8	3.0	27.7	6.9
Average domestic				**7.9**	**4.1**	**17.6**	**7.7**
Shenhua Energy-H	1088 HK	BUY	34.2	6.5	5.3	11.9	9.7
China Coal-H	1898 HK	NEUTRAL	12.6	7.1	5.6	11.6	8.7
Yanzhou Coal-H	1171 HK	BUY	25.0	7.0	5.8	10.7	9.2
Average				**6.9**	**5.6**	**11.4**	**9.2**

Source: Nomura estimates

Key catalysts

We highlight several factors/variables which could be positive catalysts for the sector:

- **Better-than-expected term price negotiation.** We believe the street assumption of only US$100-110/tonne for the 2011F term price is still conservative, considering that Xstrata has agreed to supply coal to Tepco at US$115/tonne.
- **Significant progress in projects.** The industry is building up higher capacity, both organically and non-organically, to meet strong coal demand. Significant progress in the capacity upgrade programme should be positive for the sector.
- **Supply-demand imbalance.** We expect the coal market situation to remain tight as strong demand is likely to be followed by major capacity expansion in Australia and South Africa. Any supply disruption would likely lift coal prices.
- **M&A deals.** The tight coal market has pushed buyers from China, India, and other countries looking for assets globally to secure future coal supplies. Indonesia, due to its competitive location, is a strong candidate for M&A deals, we believe.
- **Market sentiment.** The floods in Queensland of Australia are a good example of how market sentiment can have an influence, we believe. Even though the floods will affect supplies of coking coal (and not thermal coal), thermal coal players' shares have reacted positively to the developments.

Risks

Risks to our investment view

Coal price volatility

We assume that coal price movements will be affected by fundamental factors, supply and demand. But we note that non-fundamental factors, such as asset class and trading volatility, can also affect coal price volatility.

Disconnect between coal and oil prices

Coal price and oil price have had a strong positive correlation in the past (coefficient correlation = 0.90). We expect the strong positive correlation between the two commodity prices to continue. Any disconnect — eg, a higher oil price is not followed by a higher coal price — could have a major impact on coal company financials.

Weather

After the very bad weather conditions of 2010, we assume the weather will be better in 2011F, and as such forecast 15% y-y production growth in Indonesia. But weather is unpredictable and can have a significant impact on the industry.

Regulatory risk

In Indonesia, we believe that regulatory risk is highest in the mining sector compared with other sectors. The risk lies not only in implementation of mining regulations but in synchronising the mining sector regulations with those in other related sectors.

Industry data reliability

It is difficult to find reliable data on Indonesia’s coal industry. Data from one source can vary significantly from that of another. Given Indonesia’s position as the world’s largest coal exporter, miscalculation in industry statistics can have a significant impact on the global coal market, in our view.

Adaro Energy ADRO IJ

BASIC MATERIALS/METALS & MINING | INDONESIA

Initiation

BUY

NOMURA

PT NOMURA INDONESIA

Isnaputra Iskandar, CFA +62 21 2991 3346 isnaputra.iskandar@nomura.com

Action

We initiate coverage on Adaro Energy with price target of Rp3,700. Our BUY rating is premised on: 1) the firm's solid operations with strong volume upgrade potential, 2) likely balance sheet improvement on stronger operations increasing the possibility of higher dividends, and 3) mid-cycle valuations.

Catalysts

Better-than-expected price negotiation, operational recovery and significant progress in projects.

Anchor themes

Our global mining team forecasts large supply deficits in the global seaborne thermal coal market over the next five years, with import growth driven by India and China outstripping export growth driven by Australia and Indonesia. Strong domestic demand is another boost to the sector.

Closing price on 11 Jan	Rp2,475
Price target	**Rp3,700**
Upside/downside	49.5%
Difference from consensus	**27.6%**
FY11F net profit (Rpbn)	6,033
Difference from consensus	**14.6%**

Source: Nomura

Nomura vs consensus

Our earnings forecasts are higher on our more bullish view on coal prices.

The premier coal

① Strong operations to support expansion

We believe ADRO's integrated business, good track record and expanding infrastructure will support an almost doubling of the company's production over the next 4-5 years to feed strong demand for its environmentally friendly coal. Cost reduction initiatives are also in the pipeline, and we think these should lower production costs that are already the lowest among Indonesian coal companies under our coverage.

② Improved balance sheet

Strong cash flows, leading to self-financing capex, have led to lower balance-sheet risk, we believe. With no expected major M&A transactions and no major debt repayments, higher dividends — subject to lenders' and shareholders' approval — are possible, especially post FY12F when ADRO, on our estimates, will be in a net cash position.

③ Lower-than-peer valuations look unjustified to us

Prevailing valuations are still in the mid-cycle of the stock's historical valuation range. Relatively speaking, lower-than-peer valuations for ADRO are unjustified, in our view, given the company's track record and positive outlook.

④ Risk factors

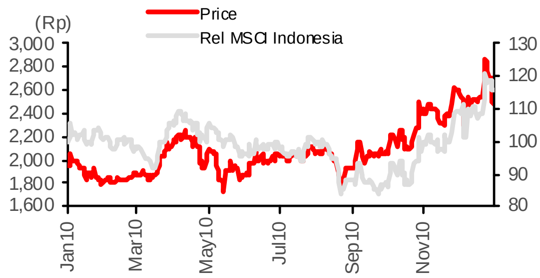
Key risk factors to our target price include coal price volatility, a decoupling between coal prices and oil prices, weather conditions, regulation and project execution.

Key financials & valuations

31 Dec (Rpbn)	FY09	FY10F	FY11F	FY12F
Revenue	26,938	23,630	31,989	45,948
Reported net profit	4,367	2,880	6,033	11,255
Normalised net profit	4,367	3,052	6,033	11,255
Normalised EPS (Rp)	136.5	95.4	188.6	351.9
Norm. EPS growth (%)	246.6	(30.1)	97.7	86.5
Norm. P/E (x)	18.1	25.9	13.1	7.0
EV/EBITDA (x)	7.1	8.9	5.6	3.1
Price/book (x)	4.5	4.0	3.1	2.2
Dividend yield (%)	0.0	1.0	0.7	0.7
ROE (%)	27.8	15.5	26.8	37.2
Net debt/equity (%)	21.6	20.8	6.1	net cash
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (Rp)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI Indonesia



	1m	3m	6m
Absolute (Rp)	(4.8)	19.3	20.7
Absolute (US$)	(5.4)	17.3	20.3
Relative to Index	5.3	28.4	16.3
Market cap (US$mn)			8,721
Estimated free float (%)			40.2
52-week range (Rp)			2,875/1,720
3-mth avg daily turnover (US$mn)			15.61
Stock borrowability			Hard
Major shareholders (%)			
Adaro Strategic investments			43.9

Source: Company, Nomura estimates

Background

Company background

Adaro Energy (ADRO) is an integrated coal company with operations in South Kalimantan. ADRO is the owner of Adaro Indonesia, the largest coal miner in terms of production in Indonesia and in the southern hemisphere. In 2010, we expect Adaro to have produced 42.6mn tons, and forecast it will increase production to 47.2mn tons in 2011F.

Adaro Indonesia is the largest coal miner in terms of production in Indonesia and in the southern hemisphere

Adaro produces sub-bituminous coal with medium energy and very low sulphur content, and, according to company data, has JORC-compliant reserves and resources of 889mn tons (Tutupan: 585mn tons and Wara: 304mn tons) and 3.4bn tons, respectively. Based on 2010 production, Adaro's mine life is some 21 years.

In addition to coal mining, ADRO, through its various subsidiaries, is engaged in the businesses of contract mining, transportation and infrastructure. Each line of business is intended to provide integrated services to the coal mine business, with some businesses also providing services to third parties.

In terms of shareholding structure, as of 30 Sep 2010, ADRO's shareholders are as follows: Adaro Strategic Investments (43.91%), management (15.94%) and the public (40.15%).

Exhibit 46. ADRO's integrated coal operations

Source: Company data

Exhibit 47. Largest coal miner in Indonesia and the southern hemisphere

Source: Company data

Financial analysis

Financial forecasts

Assumptions

Our financial forecasts for FY10-12F are premised on several assumptions highlighted in the exhibit below:

Exhibit 48. Forecast assumptions

	2010F	2011F	2012F
Economy			
Average exchange rate, Rp/US$	9,000	9,000	9,000
Year-end exchange rate, Rp/US$	9,000	9,000	9,000
Rupiah inflation, %	5.1	5.9	5.3
Financial statements			
Production volume, mn tons	42.6	47.2	53.9
Sales volume, mn tons	42.6	47.2	53.9
JFY coal price, US$/ton	98.0	140.0	170.0
Average selling price (ASP), US$/ton	57.0	70.6	90.2
Oil price, US$/barrel	79.0	95.0	110.0
Stripping ratio, ton/bcm	5.5	6.0	6.0
Capex, US$mn	200	513	513
Cash cycle, days	(2)	(2)	(2)
Interest on cash balance, %	2	2	2
Income tax rate, %	53	45	45
Dividend payout, %	20	20	20

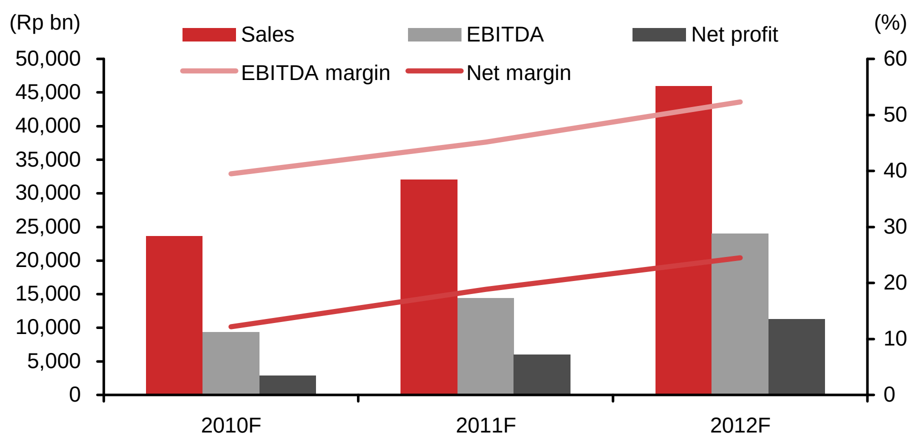
Source: Nomura estimates

Earnings to recover strongly in FY11-12F

Having posted negative core earnings growth (-37% y-y) in FY10 on bad weather, which led to flat volume growth, lower ASP and higher production cash cost, ADRO's profitability will, on our forecasts, bounce back and post a CAGR of 98% over FY10-12F.

We see this being driven by a combination of higher volume from 42.6mn tons to 53.9mn tons (12% CAGR 2010-12F), higher ASP from US$57.0/tonne to US$90.2/tonne (26% CAGR) and lower financing charges, despite higher production cash costs (6% CAGR). We forecast the higher volume will contributed by both Tututpan and Wara mines from 40.6mn tons and 2.0mn tins in 2010 to 43.9mn tons and 10mn tons, respectively in 2012F. Having said that, we forecast EBITDA and net margins will widen from 39% and 12%, respectively, in FY10F to 52% and 25% in FY12F.

Exhibit 49. Stronger profitability



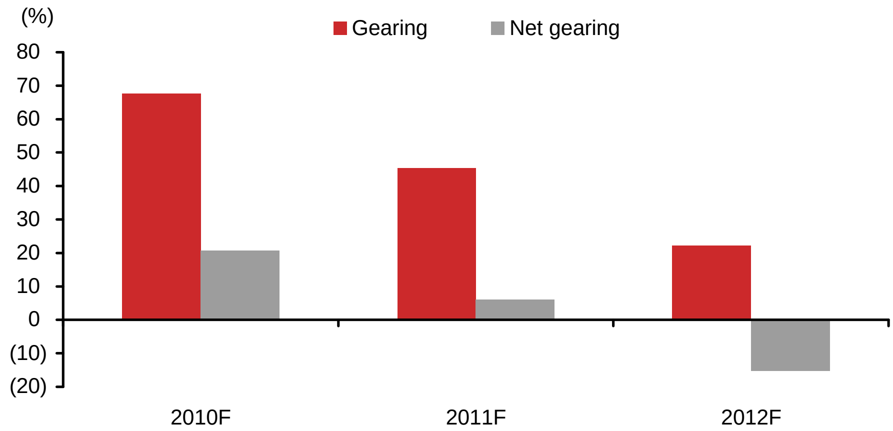
Source: Nomura estimates

Balance sheet getting stronger

A combination of relatively strong profitability – compared with historical levels – and repayments of debt principals in FY10F brought down ADRO's gearing (debt/equity) to 68%, on our estimates, from 86% in FY09. We expect ADRO's balance sheet to get stronger in the future due to stronger operations, enabling it to finance its capex internally and lower debt levels. We forecast gearing will come down to 47% and 26% in FY11-12F, respectively, and estimate ADRO will be in a net cash position by end-FY12F.

In terms of cash cycle period (we define the cash cycle as receivable days plus inventory days minus payable days), we assume it was -2 days at end-FY10F and will remain the same for FY11-12F.

Exhibit 50. Stronger balance sheet



Source: Nomura estimates

Sensitivity analysis

We have run several FY11-12F earnings sensitivities on changes in coal price, production volume, oil price and exchange rate assumptions.

- **Coal price**

Coal price volatility has a big impact on our earnings forecasts. Our sensitivity analysis suggests that for every 10% change to our 2011-12F coal price assumptions, our earnings projections change by 23% and 18%, respectively.

- **Production volume**

Though not as sensitive as changes in ASP assumptions, our earnings estimates are also quite sensitive to changes in production volume assumptions. Our sensitivity analysis suggests that for every 10% change to our 2011-12F production assumptions, our earnings estimates will change by 12% and 11%, respectively.

- **Oil price**

Our sensitivity analysis suggests that for every 10% change to our 2011-12F oil price assumptions, our earnings estimates will change by 2% for each year. The earnings sensitivity is not high because, on our estimates, fuel costs account for 13% of ADRO's 2010 production cost.

- **Exchange rate**

Our earnings estimates are sensitive to changes in our exchange rate assumptions. Our sensitivity analysis suggests that for every 10% depreciation of the rupiah (vs the US dollar), our FY11-12F core earnings estimates would rise by 13% and 12%, respectively, and vice-versa.

Risk factors

Risk factors

Coal price volatility

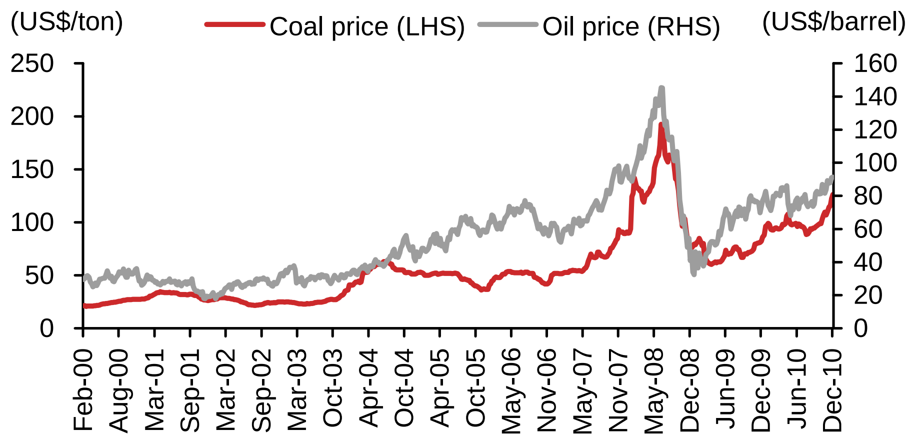
Non-fundamental factors could swing coal price movement

Coal is a new growing asset class, and as such its price movements can be affected by non-fundamental factors. Our sensitivity analysis suggests that for every 10% change to our 2011-12F coal price assumptions, our earnings projections will change by 23% and 18%, respectively.

Decoupling of coal price and oil price could dent ADRO's results

We have assumed that the strong positive correlation between coal and oil prices (coefficient correlation = 0.90) will continue in the future. A decoupling between these two commodity prices, ie, higher oil price not followed by higher coal price, can have a significant impact on ADRO's financials. Our sensitivity analysis suggests that for every 10% decrease in coal price and 10% increase in oil price, our 2011-12F earnings estimates will decline by 26% and 20%, respectively.

Exhibit 51. Strong correlation between coal price and oil price



Source: Bloomberg

Exhibit 52. High R2 regression between coal price and oil price

SUMMARY OUTPUT

Regression statistics	
Multiple R	0.89542
R Square	0.80178
Adjusted R Square	0.80143
Standard Error	14.95695
Observations	567

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	511,251.77744	511,251.77744	2,285.32915	1.0456E-200
Residual	565	126,396.34585	223.71035		
Total	566	637,648.12330			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	(5.49720)	1.44896	(3.79390)	0.000164296	(8.34320)	(2.65120)	(8.34320)	(2.65120)
X Variable 1	1.15458	0.02415	47.80512	1.0456E-200	1.10714	1.20202	1.10714	1.20202

Source: Nomura estimates

Weather

Bad weather in 2010 prompted ADRO to revise down its coal production target. Starting this year, we have assumed that weather conditions will improve and production will grow by 11% and 14% in 2011-12F, respectively. But weather is a non-controllable and unpredictable factor that can have a significant impact on ADRO's operations. Our sensitivity analysis suggests that for every 10% change to our 2011-12F production assumptions, our earnings estimates will change by 12% and 11%, respectively.

Regulatory risk

Regulatory risk in the mining sector in Indonesia, in our view, is probably greater than in other sectors. The risk lies not only in the implementation of mining regulations but on synchronisation of the mining sectors with regulations in other sectors that impact the mining sector as well.

Execution risk

ADRO intends to double its production from 40mn tons to 80mn tons over the next 4-5 years. The success of its production upgrade will depend on several factors, such as availability of required equipment, performance of contractors and other factors, which to an extent are beyond the company's control.

Wara performance

The production expansion to 80mn tons pa will be highly reliant on Wara's ability to significantly ramp up its annual production from 2mn tons in 2010 to 30mn tons in the future (by 2016F). This is because production upside from the existing Tutupan mine has become limited.

Mining contractor risk

ADRO has a high dependence on external mining contractors, as close to 70% of its coal production is mined by external contractors; the rest (30%) is mined by its subsidiary, Saptaindra Sejati (SIS).

Exchange rate volatility

ADRO's financial performance is tethered to exchange rate volatility, as most of its revenue is in US dollars or linked to the dollar, while some of its expenses are paid in rupiah. Our sensitivity analysis suggests that for every 10% depreciation in the rupiah relative to the US dollar, our FY11-12F core earnings estimates will be up by 13% and 12%, respectively, and vice-versa.

Valuation methodology

We set our 2011-end target price for ADRO at Rp3,700, which implies FY11-12F EV/EBITDA of 8.3-4.7x and P/E of 19.6-10.5x. We derive our target price using a DCF methodology, with discount rates of 10.0% and 11.3% for the coal and non-coal businesses, respectively. We set 8% and 0% terminal value growth rates for coal and non-coal businesses, respectively. For ADRO's stake at the IndoMet Coal project, our valuation is based on acquisition cost.

Financial statements

Income statement (Rpbn)					
Year-end 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Revenue	18,093	26,938	23,630	31,989	45,948
Cost of goods sold	(13,149)	(15,900)	(15,435)	(18,697)	(23,015)
Gross profit	**4,943**	**11,038**	**8,196**	**13,292**	**22,933**
SG&A	(731)	(1,109)	(842)	(1,049)	(1,360)
Employee share expense					
Operating profit	**4,212**	**9,928**	**7,354**	**12,242**	**21,572**
EBITDA	**5,192**	**11,711**	**9,333**	**14,441**	**24,036**
Depreciation	(396)	(763)	(975)	(1,191)	(1,454)
Amortisation	(584)	(1,019)	(1,004)	(1,007)	(1,011)
EBIT	**4,212**	**9,928**	**7,354**	**12,242**	**21,572**
Net interest expense	(568)	(848)	(901)	(767)	(595)
Associates & JCEs	(21)	-	(0)	-	-
Other income	(698)	(502)	56	(490)	(490)
Earnings before tax	**2,925**	**8,578**	**6,508**	**10,986**	**20,487**
Income tax	(1,602)	(4,119)	(3,449)	(4,944)	(9,219)
Net profit after tax	**1,323**	**4,459**	**3,059**	**6,042**	**11,268**
Minority interests	64	(49)	(6)	(9)	(12)
Other items	(126)	(43)	-	-	-
Preferred dividends					
Normalised NPAT	**1,260**	**4,367**	**3,052**	**6,033**	**11,255**
Extraordinary items	(373)	-	(172)	-	-
Reported NPAT	**887**	**4,367**	**2,880**	**6,033**	**11,255**
Dividends	-	-	(761)	(544)	(576)
Transfer to reserves	**887**	**4,367**	**2,119**	**5,490**	**10,679**
Valuation and ratio analysis					
FD normalised P/E (x)	62.8	18.1	25.9	13.1	7.0
FD normalised P/E at price target (x)	93.9	27.1	38.8	19.6	10.5
Reported P/E (x)	89.2	18.1	27.5	13.1	7.0
Dividend yield (%)	-	-	1.0	0.7	0.7
Price/cashflow (x)	73.0	11.2	17.5	10.2	6.2
Price/book (x)	5.7	4.5	4.0	3.1	2.2
EV/EBITDA (x)	16.8	7.1	8.9	5.6	3.1
EV/EBIT (x)	20.7	8.4	11.3	6.6	3.4
Gross margin (%)	27.3	41.0	34.7	41.6	49.9
EBITDA margin (%)	28.7	43.5	39.5	45.1	52.3
EBIT margin (%)	23.3	36.9	31.1	38.3	46.9
Net margin (%)	4.9	16.2	12.2	18.9	24.5
Effective tax rate (%)	54.8	48.0	53.0	45.0	45.0
Dividend payout (%)	-	-	26.4	9.0	5.1
Capex to sales (%)	8.1	4.1	7.6	14.4	10.0
Capex to depreciation (x)	3.7	1.5	1.8	3.9	3.2
ROE (%)	11.0	27.8	15.5	26.8	37.2
ROA (pretax %)	18.6	31.8	22.6	34.5	55.4
Growth (%)					
Revenue	56.1	48.9	(12.3)	35.4	43.6
EBITDA	100.2	125.5	(20.3)	54.7	66.5
EBIT	87.0	135.7	(25.9)	66.5	76.2
Normalised EPS	1,323.1	246.6	(30.1)	97.7	86.5
Normalised FDEPS	1,323.1	246.6	(30.1)	97.7	86.5
Per share					
Reported EPS (Rp)	28	137	90	189	352
Norm EPS (Rp)	39	137	95	189	352
Fully diluted norm EPS (Rp)	39	137	95	189	352
Book value per share (Rp)	438	545	618	789	1,103
DPS (Rp)	-	-	24	17	18

Source: Nomura estimates

Stronger profitability going forward on higher prices and higher volume

Cashflow (Rpbn)					
Year-end 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
EBITDA	5,192	11,711	9,333	14,441	24,036
Change in working capital	(171)	1,803	295	(479)	(944)
Other operating cashflow	(3,936)	(6,417)	(5,099)	(6,209)	(10,317)
Cashflow from operations	**1,085**	**7,097**	**4,529**	**7,753**	**12,776**
Capital expenditure	(1,464)	(1,114)	(1,800)	(4,617)	(4,617)
Free cashflow	**(379)**	**5,983**	**2,729**	**3,136**	**8,159**
Reduction in investments	(1)	1	(3,157)	-	-
Net acquisitions	(9,578)	(100)	(3,157)	-	-
Reduction in other LT assets	4,449	10	(0)	0	0
Addition in other LT liabilities	3,319	(688)	(0)	-	-
Adjustments	(7,714)	683	3,157	(0)	(0)
Cashflow after investing acts	**(9,905)**	**5,889**	**(428)**	**3,136**	**8,159**
Cash dividends	-	(761)	(544)	(576)	(1,207)
Equity issue	11,847	-	-	-	-
Debt issue	(445)	4,497	(1,058)	(1,918)	(3,572)
Convertible debt issue					
Others	87	(766)	6	9	12
Cashflow from financial acts	**11,489**	**2,969**	**(1,595)**	**(2,485)**	**(4,766)**
Net cashflow	**1,584**	**8,859**	**(2,023)**	**650**	**3,393**
Beginning cash	832	2,416	11,275	9,251	9,902
Ending cash	2,416	11,275	9,251	9,902	13,295
Ending net debt	7,605	3,770	4,111	1,543	(5,422)

Source: Nomura estimates

Stronger cashflows bring down balance sheet risk

Balance sheet (Rpbn)					
As at 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Cash & equivalents	2,416	11,275	9,251	9,902	13,295
Marketable securities					
Accounts receivable	2,332	2,882	2,528	3,423	4,917
Inventories	305	250	250	250	250
Other current assets	2,804	1,429	1,429	1,429	1,429
Total current assets	**7,857**	**15,837**	**13,460**	**15,004**	**19,891**
LT investments	6	5	3,162	3,162	3,162
Fixed assets	5,924	7,416	8,226	11,635	14,778
Goodwill	9,128	9,092	8,602	8,111	7,621
Other intangible assets	10,470	9,792	9,292	8,793	8,293
Other LT assets	335	325	325	325	325
Total assets	**33,720**	**42,465**	**43,066**	**47,030**	**54,069**
Short-term debt	1,695	2,045	1,918	3,572	754
Accounts payable	2,602	2,168	2,109	2,524	3,074
Other current liabilities	2,426	3,783	3,783	3,783	3,783
Total current liabilities	**6,722**	**7,996**	**7,810**	**9,879**	**7,611**
Long-term debt	8,326	13,000	11,444	7,873	7,119
Convertible debt					
Other LT liabilities	4,645	3,957	3,957	3,957	3,957
Total liabilities	**19,693**	**24,953**	**23,211**	**21,709**	**18,687**
Minority interest	18	67	73	82	94
Preferred stock					
Common stock	13,931	13,931	13,931	13,931	13,931
Retained earnings	422	4,028	6,364	11,822	21,870
Proposed dividends					
Other equity and reserves	(344)	(514)	(514)	(514)	(514)
Total shareholders' equity	**14,009**	**17,445**	**19,781**	**25,239**	**35,287**
Total equity & liabilities	**33,720**	**42,465**	**43,066**	**47,030**	**54,069**
Liquidity (x)					
Current ratio	1.17	1.98	1.72	1.52	2.61
Interest cover	7.4	11.7	8.2	16.0	36.2
Leverage					
Net debt/EBITDA (x)	1.46	0.32	0.44	0.11	net cash
Net debt/equity (%)	54.3	21.6	20.8	6.1	net cash
Activity (days)					
Days receivable	39.3	35.3	41.8	34.0	33.2
Days inventory	7.6	6.4	5.9	4.9	4.0
Days payable	59.7	54.7	50.6	45.2	44.5
Cash cycle	(12.9)	(13.0)	(2.9)	(6.4)	(7.3)

Source: Nomura estimates

Indo Tambangraya Megah ITMG IJ

BASIC MATERIALS/METALS & MINING | INDONESIA

Initiation

Isnaputra Iskandar, CFA +62 21 2991 3346 isnaputra.iskandar@nomura.com

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BUY

Action

We initiate coverage of ITMG with a BUY rating, price target of Rp73,000, which implies 2011F EV/EBITDA of 11.2x and PER of 17.7x. Our positive stance on the stock hinges upon: 1) ITMG's good operations, 2) potential higher dividend payout, 3) reserve revaluation which can lower mine life risk, 4) reasonable valuation.

Catalysts

Better-than-expected term price negotiations, production recovery, reserves revaluation, and higher dividend.

Anchor themes

Our global mining team forecast large supply deficits in the global seaborne thermal coal market over the next five years with import growth (driven by India and China) outstripping export growth (driven by Australia and Indonesia). Strong domestic demand would be another boost to the sector.

Closing price on 11 Jan	Rp52,200
Price target	**Rp73,000**
Upside/downside	39.8%
Difference from consensus	**28.9%**
FY11F net profit (US$mn)	517
Difference from consensus	**-0.8%**

Source: Nomura

Nomura vs consensus

We are more bullish on 2012F earnings forecast due to our higher coal price assumptions.

A diversified and defensive miner

① A diversified miner with seaborne exposure

As the fourth-largest coal miner in Indonesia, ITMG has diversified mine operations lowering operational risk and providing potential upside from coal blending. It has a wide range of customers with very strong exposure to promising and growing seaborne markets.

② Possibility of higher dividends

In our view, post the acquisition of Centennial Coal, Banpu could ask for higher dividends from ITMG. We believe that ITMG has the capacity to meet such demands due to its solid balance sheet and strong operating cash flow to fund both organic and non-organic expansion. We now assume a 60% payout, but think ITMG could easily increase it to 100% – almost a 5% yield, which would be the highest in the sector.

③ Reserve valuation to mitigate mine life risk

The reserve revaluation to be done in 1Q11 is positive as it can enlarge the reserve base. The larger reserve figure should mitigate investor concerns over the company's relatively short mine life (13.7 years vs peers' 22-172 years).

④ Attractive valuation

The current valuation at 7.7x 2011F EV/EBITDA is attractive as it is: 1) in the mid-cycle valuation of 4-9x (excluding 2008 crisis valuation), 2) 1x standard deviation, and 3) in line with domestic peers.

⑤ Risks to our investment view

Risks include: 1) coal price volatility, 2) disconnection between coal and oil prices, 3) weather, 4) regulatory regime, 5) capacity upgrade execution, 6) mining contractors' performance, and 7) disappointing dividend policy.

Key financials & valuations

31 Dec (US$mn)	FY09	FY10F	FY11F	FY12F
Revenue	1,508	1,632	2,108	2,880
Reported net profit	336	305	517	934
Normalised net profit	336	305	517	934
Normalised EPS (US$)	0.30	0.27	0.46	0.83
Norm. EPS growth (%)	42.8	(9.2)	69.6	80.7
Norm. P/E (x)	16.9	21.5	12.7	7.0
EV/EBITDA (x)	11.0	12.8	7.7	4.0
Price/book (x)	8.0	7.0	5.2	3.5
Dividend yield (%)	2.7	2.5	2.8	4.7
ROE (%)	48.0	35.5	47.1	59.2
Net debt/equity (%)	net cash	net cash	net cash	net cash
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (US$)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI Indonesia

	1m	3m	6m
Absolute (Rp)	(0.3)	22.2	34.4
Absolute (US$)	(0.9)	20.2	33.8
Relative to Index	9.8	31.3	29.9
Market cap (US$mn)			6,497
Estimated free float (%)			35.0
52-week range (Rp)			56,800/28,950
3-mth avg daily turnover (US$mn)			8.77
Stock borrowability			Hard
Major shareholders (%)			
Banpu Minerals (Singapore)			65.0

Source: Company, Nomura estimates

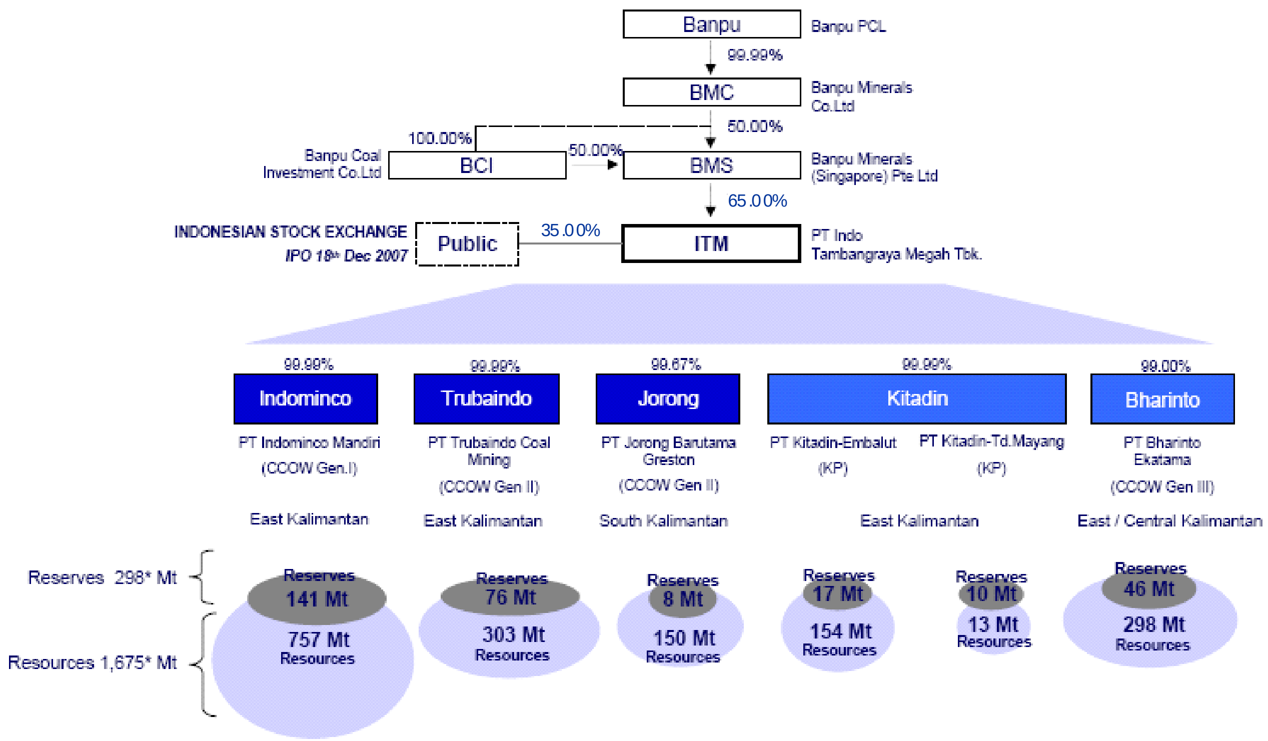
Company background

Company background

ITMG was established in 1987 and is the fourth largest coal mining company in Indonesia. The company has five mines which are located in East Kalimantan (Indominco, Trubaindo, Kitadin and Bharinto) and South Kalimantan (Jorong). The mines that ITMG has operate under different mine schemes. The mines that operate under the Coal Contract of Work (CCoW) scheme are Indomindo (first generation), Trubandio (second generation) and Jorong (second generation) and Bharinto (third generation). Kitadin is operating under the Mining Authorization/(Kuasa Pertambangan/ (KP) scheme.

ITMG has approximate coal resources of 1,675mn tons and reserves of almost 300mn tons. The resources and reserves are concentrated in three mines, Indominco, Trubaindo, and Bharinto. Based on 2009 coal production of 21mn tons, ITMG's mine life is some 14 years. In terms of its ownership structure, ITMG is 65% owned by Banpu of Thailand and 35% by public.

Exhibit 53. ITMG business model



Source: Company data

Valuation methodology

We set our target price at Rp73,000/share which implies 11.2x 2011F EV/EBITDA and 17.8x 2011F earnings. We set our target price based on average of 11.8x 2011F EV/EBITDA and 16.9x 2011F earnings. We use regression analysis which measures casual relationship between EV/EBITDA and PER as the dependent variables and coal price as the independent variable to set our target EV/EBITDA and PER multiples. We use data weekly data starting beginning of April 2009 when global equity and commodity markets started to recover. Based on our US$140/ton coal price assumption for 2011, the implied EV/EBITDA and PER multiples are 11.8x and 16.9x, respectively. Our target price is higher than our DCF valuation of ITMG's reserves and resources of Rp27,900/share. The main reason that our DCF valuation is much lower than our target price lies mainly on ITMG's short mining life.

Financial analysis

Financial forecasts

Assumptions

Our assumptions for 2010-12F financial forecasts are highlighted below.

Exhibit 54. Forecast assumptions

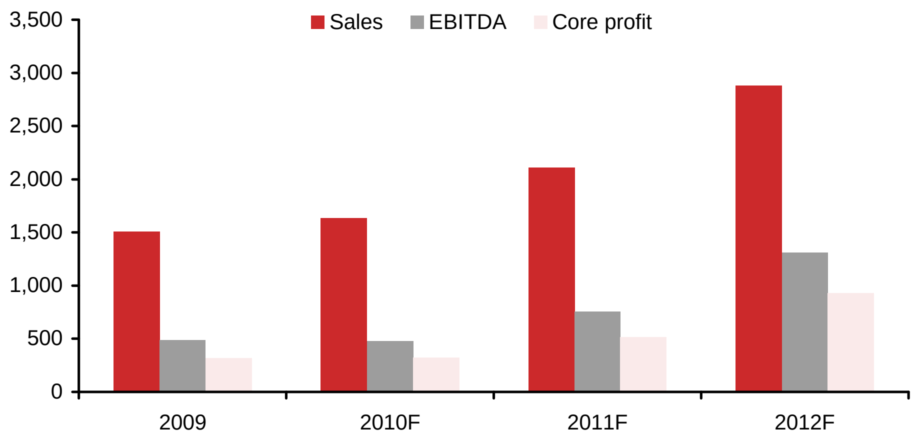
	2010F	2011F	2012F
Economy			
Average exchange rate, Rp/US$	9,000	9,000	9,000
Year-end exchange rate, Rp/US$	9,000	9,000	9,000
Rupiah inflation, %	5.1	5.9	5.3
Financial statements			
Production volume, mn tons	22.1	25.5	27.7
Sales volume, mn tons	22.1	25.5	27.7
JFY coal price, US$/ton	98.0	140.0	170.0
Average selling price (ASP), US$/ton	73.8	82.7	104.0
Oil price, US$/barrel	79.0	95.0	110.0
Stripping ratio, ton/bcm	11.7	11.0	10.3
Capex, US$mn	138.0	73.0	73.0
Cash cycle, days	20	20	20
Interest on cash balance, %	1	1	1
Income tax rate, %	25	25	25
Dividend payout, %	60	60	60

Source: Nomura estimates

Profit and loss forecasts

For 2011F-12F, we forecast strong core earnings growth of 60% and 81%, to US$513mn and US$934mn, respectively, mainly on the back of a combination of volume recovery (15% YoY in 2011F and 9% YoY) and higher ASPs (12% YoY in 2011F and 26% in 2012F). In terms production cash costs, despite higher oil price assumptions, we forecast costs to stay at US$36/tonne in both years as we expect the stripping ratio to decline to 11.3bcm/ tonne in 2011 and 10.0bcm/ tonne in 2012. A higher contribution from non-Indominco mines (35% in 2010, 39% in 2011, and 46% in 2012) which have lower stripping ratios, will lower ITMG's overall stripping ratio in the future, we believe.

Exhibit 55. Stronger operations

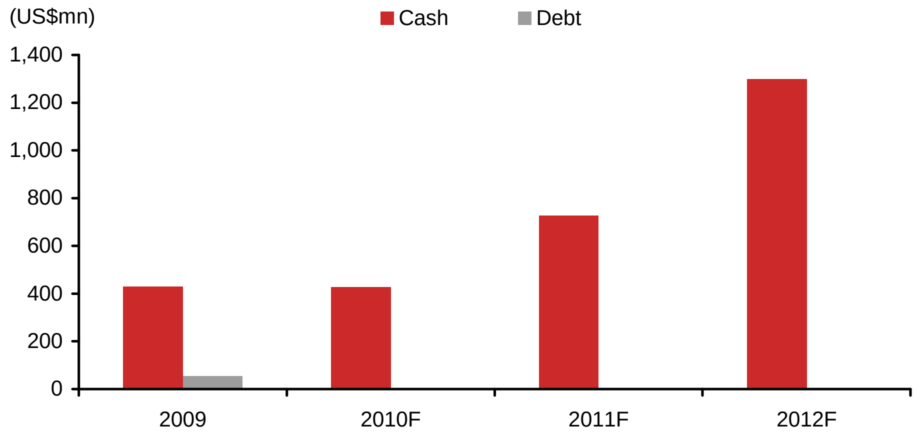


Source: Company data, Nomura estimates

Balance sheet forecasts

We forecast the company's balance sheet to remain very strong in 2011-12 and be in a net cash position after full payment of debts in 3Q10. In terms of the cash cycle period, we forecast it to remain 20 days (trade receivable 30 days, inventory 25 days, and trade payable 35 days), which are in line with 2009 levels.

Exhibit 56. ITMG balance sheet is very strong



Source: Company data, Nomura estimates

Sensitivity analysis

We have conducted earnings sensitivity analysis on several input variables: ASP, production/sales volume and oil price.

- **Average selling price**

Changes in ASP can have a significant financial impact on ITMG. Our sensitivity analysis suggests that for every 10% change in our 2011-12F coal price assumptions, our 2011-12F core earnings forecasts would change by 26% and 20%, respectively.

- **Production/sales volume**

Our sensitivity analysis suggests that for every 10% change in our 2011-12F production/sales volume assumptions, our 2011-12F earnings forecasts would change by 13% and 12%, respectively.

- **Oil price**

Volatility in oil price should not have a significant impact to our earnings forecasts as fuel costs represent some 13% of ITMG's total costs in 2011-12. Our sensitivity analysis suggests that for every 10% change in our 2011-12F oil price assumptions, our 2011-12F earnings estimates would change by 2% and 2%, respectively.

Where could we go wrong?

Risks to our investment view

Coal price volatility

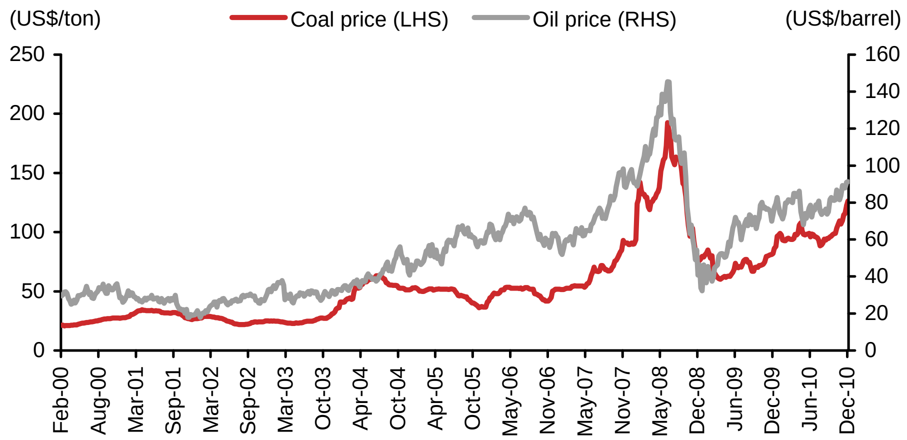
Coal price movements are very crucial to ITMG's earnings performance

We assume that coal price movements will be affected by fundamental factors, i.e. supply and demand. However, we have noticed that non-fundamental factors such as asset class, trading volatility, etc. also affect coal price volatility. As we highlighted previously, our sensitivity analysis suggests that for every 10% change in our 2011-12F coal price assumptions, our 2011-12F core earnings forecasts would change by 26% and 20%, respectively.

Disconnection between coal price and oil price

Coal prices and oil prices have had a strong positive correlation in the past 10-11 years (coefficient correlation = 0.90). We expect the strong positive correlation between the two commodity prices to continue in the future. Any disconnection between the two, i.e. higher oil prices are not followed by higher coal prices, could have a significant impact on ITMG's financials. Our sensitivity analysis suggests that for every 10% decrease in coal prices and 10% increase in oil price, our 2011-12F earnings estimates would decline by 29% and 21%, respectively.

Exhibit 57. Coal and oil prices have a strong positive correlation



Source: Bloomberg

Exhibit 58. High R2 regression between coal price and oil price

SUMMARY OUTPUT

Regression statistics	
Multiple R	0.89542
R Square	0.80178
Adjusted R Square	0.80143
Standard Error	14.95695
Observations	567

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	511,251.77744	511,251.77744	2,285.32915	1.0456E-200
Residual	565	126,396.34585	223.71035		
Total	566	637,648.12330			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	(5.49720)	1.44896	(3.79390)	0.000164296	(8.34320)	(2.65120)	(8.34320)	(2.65120)
X Variable 1	1.15458	0.02415	47.80512	1.0456E-200	1.10714	1.20202	1.10714	1.20202

Source: Nomura estimates

Weather

Having had very bad weather conditions in 2010, we assume that weather will be better starting in 2011F, and forecast that production volume will grow by some 15% and 9% in 2011-12, respectively. However, unpredictable weather factors can have a significant impact on the company's operations. Our sensitivity analysis suggests that for every 10% change in our 2011-12F production/sales volume assumptions, our 2011-12F earnings forecasts would change by 13% and 12%, respectively.

Regulatory risk

Regulatory risk in the mining sector in Indonesia is probably the highest compared to other sectors, in our view. The risk lies not only in the implementation of mining regulations but on synchronization of the mining sectors with regulations in other sectors which have an impact on the mining sector as well.

Industry data reliability

It is very difficult to find reliable data on the Indonesian coal industry. Data from one source could be significantly different from other sources. Given Indonesia's position as the world's largest coal exporter, miscalculation in industry statistics could have a significant impact on the global coal market, in our view.

Execution risk

ITMG's future growth is dependent upon its success in both increasing production from the existing mines and monetizing the mines. There is no assurance that ITMG will successfully increase production as there are a couple of factors that are beyond ITMG's control, such as the availability of required equipment.

Mining contractor risk

ITMG's mining operations are almost 100% done by mining contactors. Even though we agree that the engagement of mining contractors can increase ITMG's efficiency in terms of cash flow management and production cost, troubles at the contractors could have a negative impact on ITMG.

A disappointing dividend policy

Even though we are not aggressive in terms of dividend payout assumptions in our financial analysis (our assumption is only 60%), we believe and have mentioned that higher-than-expected dividend payments could be a positive catalyst to drive up the share price. Likewise, lower-than-expected dividends could be a negative catalyst to the share price.

Financial statements

Income statement (US$mn)					
Year-end 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Revenue	1,317	1,508	1,632	2,108	2,880
Cost of goods sold	(839)	(938)	(1,039)	(1,238)	(1,425)
Gross profit	**478**	**570**	**593**	**870**	**1,455**
SG&A	(138)	(135)	(172)	(190)	(221)
Employee share expense					
Operating profit	**340**	**436**	**421**	**681**	**1,234**
EBITDA	**378**	**486**	**477**	**753**	**1,313**
Depreciation	(37)	(49)	(55)	(71)	(78)
Amortisation	(1)	(1)	(1)	(1)	(1)
EBIT	**340**	**436**	**421**	**681**	**1,234**
Net interest expense	4	2	2	4	7
Associates & JCEs					
Other income	1	19	(17)	4	4
Earnings before tax	**346**	**456**	**406**	**689**	**1,245**
Income tax	(111)	(121)	(102)	(172)	(311)
Net profit after tax	**235**	**336**	**305**	**517**	**934**
Minority interests	-	-	-	-	-
Other items	-	-	-	-	-
Preferred dividends					
Normalised NPAT	**235**	**336**	**305**	**517**	**934**
Extraordinary items					
Reported NPAT	**235**	**336**	**305**	**517**	**934**
Dividends	(88)	(151)	(161)	(183)	(310)
Transfer to reserves	**147**	**184**	**143**	**334**	**624**
Valuation and ratio analysis					
FD normalised P/E (x)	26.0	16.9	21.5	12.7	7.0
FD normalised P/E at price target (x)	36.3	23.6	30.1	17.7	9.8
Reported P/E (x)	26.0	16.9	21.5	12.7	7.0
Dividend yield (%)	1.4	2.7	2.5	2.8	4.7
Price/cashflow (x)	25.9	14.2	18.5	11.8	6.9
Price/book (x)	8.9	8.0	7.0	5.2	3.5
EV/EBITDA (x)	15.5	11.0	12.8	7.7	4.0
EV/EBIT (x)	17.2	12.2	14.6	8.6	4.3
Gross margin (%)	36.3	37.8	36.3	41.3	50.5
EBITDA margin (%)	28.7	32.2	29.2	35.7	45.6
EBIT margin (%)	25.8	28.9	25.8	32.3	42.8
Net margin (%)	17.8	22.2	18.7	24.5	32.4
Effective tax rate (%)	32.0	26.5	25.0	25.0	25.0
Dividend payout (%)	37.4	45.1	52.9	35.4	33.2
Capex to sales (%)	7.2	5.8	8.5	3.5	2.5
Capex to depreciation (x)	2.5	1.8	2.5	1.0	0.9
ROE (%)	44.0	48.0	35.5	47.1	59.2
ROA (pretax %)	53.3	57.1	51.4	76.0	128.9
Growth (%)					
Revenue	70.6	14.5	8.2	29.2	36.6
EBITDA	144.9	28.5	(1.9)	57.8	74.4
EBIT	181.5	28.2	(3.4)	61.7	81.3
Normalised EPS	321.1	42.8	(9.2)	69.6	80.7
Normalised FDEPS	321.1	42.8	(9.2)	69.6	80.7
Per share					
Reported EPS (US$)	0.21	0.30	0.27	0.46	0.83
Norm EPS (US$)	0.21	0.30	0.27	0.46	0.83
Fully diluted norm EPS (US$)	0.21	0.30	0.27	0.46	0.83
Book value per share (US$)	0.54	0.70	0.82	1.12	1.67
DPS (US$)	0.08	0.13	0.14	0.16	0.27

Source: Nomura estimates

Strong EBITDA CAGR in 2010-12F

Cashflow (US$mn)					
Year-end 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
EBITDA	378	486	477	753	1,313
Change in working capital	(29)	37	(7)	(34)	(58)
Other operating cashflow	(113)	(123)	(116)	(164)	(300)
Cashflow from operations	**236**	**401**	**354**	**555**	**955**
Capital expenditure	(95)	(88)	(138)	(73)	(73)
Free cashflow	**141**	**313**	**216**	**482**	**882**
Reduction in investments	-	-	-	-	-
Net acquisitions	-	(0)	-	-	-
Reduction in other LT assets	(29)	(17)	0	(0)	0
Addition in other LT liabilities	6	(7)	-	-	-
Adjustments	15	26	(0)	0	(0)
Cashflow after investing acts	**133**	**314**	**216**	**482**	**882**
Cash dividends	(88)	(151)	(161)	(183)	(310)
Equity issue	-	-	-	-	-
Debt issue	(81)	44	(55)	-	-
Convertible debt issue					
Others	(0)	(0)	(0)	-	-
Cashflow from financial acts	**(169)**	**(108)**	**(216)**	**(183)**	**(310)**
Net cashflow	**(36)**	**207**	**(1)**	**299**	**572**
Beginning cash	258	222	429	428	727
Ending cash	222	429	428	727	1,299
Ending net debt	(211)	(374)	(428)	(727)	(1,299)

Source: Nomura estimates

Balance sheet (US$mn)					
As at 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Cash & equivalents	222	429	428	727	1,299
Marketable securities					
Accounts receivable	147	144	154	192	255
Inventories	36	65	72	86	99
Other current assets	93	36	36	36	36
Total current assets	**498**	**673**	**689**	**1,041**	**1,689**
LT investments					
Fixed assets	315	344	426	428	424
Goodwill					
Other intangible assets	25	25	23	22	21
Other LT assets	140	157	157	157	157
Total assets	**979**	**1,199**	**1,297**	**1,649**	**2,291**
Short-term debt	6	55	-	-	-
Accounts payable	62	89	99	118	136
Other current liabilities	258	236	236	236	236
Total current liabilities	**326**	**380**	**335**	**354**	**372**
Long-term debt	5	-	-	-	-
Convertible debt					
Other LT liabilities	38	31	31	31	31
Total liabilities	**369**	**411**	**366**	**385**	**402**
Minority interest	-	-	-	-	-
Preferred stock					
Common stock	408	408	408	408	408
Retained earnings	208	395	538	872	1,496
Proposed dividends					
Other equity and reserves	(6)	(15)	(15)	(15)	(15)
Total shareholders' equity	**610**	**787**	**931**	**1,265**	**1,889**
Total equity & liabilities	**979**	**1,199**	**1,297**	**1,649**	**2,291**
Liquidity (x)					
Current ratio	1.53	1.77	2.06	2.94	4.55
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	31.4	35.2	33.2	30.0	28.5
Days inventory	14.0	19.7	24.0	23.2	23.7
Days payable	29.3	29.4	33.0	31.9	32.5
Cash cycle	16.1	25.5	24.2	21.3	19.6

Source: Nomura estimates

Debt-free balance sheet

Tambang Batubara Bukit Asam

PTBA IJ

BASIC MATERIALS/METALS & MINING | INDONESIA

Initiation

Isnaputra Iskandar, CFA +62 21 2991 3346 isnaputra.iskandar@nomura.com

BUY

NOMURA

PT NOMURA INDONESIA

Action

We initiate coverage of PTBA with a BUY rating, due to: 1) PTBA's downward earnings protection, 2) positive outlook on railway performance, 3) further production enhancements from projects and 4) reasonable valuation due to its high cash balance. Price target of Rp30,000 implies 16.1-8.8x 2011-12F EV/EBITDA.

Catalysts

Better-than-expected term price negotiations, improvements in railway performance, successful M&A deals, and significant progress in projects.

Anchor themes

Our global mining team forecasts large supply deficits in the global seaborne thermal coal market over the next five years, with import growth, driven by India and China, outstripping export growth, driven by Australia and Indonesia. Strong domestic demand is another boost to the sector.

Closing price on 11 Jan	Rp22,100
Price target	**Rp30,000**
Upside/downside	35.7%
Difference from consensus	**22.3%**
FY11F net profit (Rpbn)	3,001
Difference from consensus	**-14.8%**

Source: Nomura

Nomura vs consensus

Our 2012F earnings estimates are higher than consensus' on higher coal price assumptions.

Sitting on potential upside

① Downward protection

PTBA's long-term contract with PLN, now 8.0mn tonnes p.a, should give the former not only a captive market but also downside protection on PLN's sustainable demand and high dependence on PTBA's coal. Pricing should not be an issue due to: 1) its link to the international price and 2) no government intervention in the pricing negotiations.

② Remain positive on railway

We remain positive on the outlook of the railway performance, and believe it will meet our conservative target of 22.7mn tonnes by 2017F. Key factors are: 1) cultural change in management of PTKA (the railway company), 2) feasibility of the railway project, and 3) PTKA's reliance on the project to boost its profitability.

③ Many ways to monetize reserves

PTBA's US$2.3bn projects, if executed in time, can more than quadruple production to 50mn tonnes in 2016, we believe. Execution is key, but PTBA's strong partners should lower the risk. Funding should not burden the balance sheet given the projects' leverage and PTBA's small stake in the projects and strong cash positions (US$571mn by end of 2010F).

④ Reasonable PER valuation

PTBA's higher 2011F PER multiple is due to its high cash balance. Stripping out the cash position, PTBA's 2011F PER stands at 14.9x, which is lower than its peers' 17.8x.

⑤ Risks to our investment view

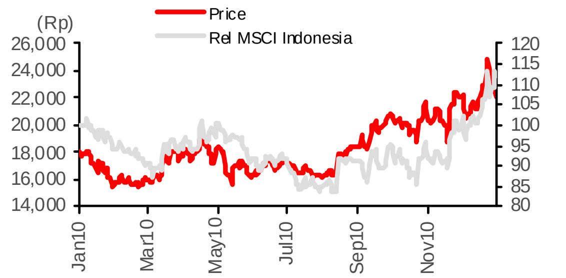
Key risk factors include coal price volatility, disconnection between coal and oil prices, weather, regulation, high reliance on a single customer and on railway performance.

Key financials & valuations

31 Dec (Rpbn)	FY09	FY10F	FY11F	FY12F
Revenue	8,948	7,845	10,406	14,928
Reported net profit	2,731	1,852	3,001	5,248
Normalised net profit	2,731	1,852	3,001	5,248
Normalised EPS (Rp)	1,185	804	1,302	2,278
Norm. EPS growth (%)	60.0	(32.2)	62.0	74.9
Norm. P/E (x)	18.6	27.5	17.0	9.7
EV/EBITDA (x)	12.8	20.0	11.5	6.2
Price/book (x)	8.9	8.2	6.2	4.2
Dividend yield (%)	2.0	2.7	1.8	2.9
ROE (%)	56.3	31.1	41.5	51.8
Net debt/equity (%)	net cash	net cash	net cash	net cash
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (Rp)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI Indonesia



	1m	3m	6m
Absolute (Rp)	0.5	6.0	27.4
Absolute (US$)	(0.2)	4.2	26.9
Relative to Index	10.5	15.4	22.9
Market cap (US$mn)			5,609
Estimated free float (%)			35.0
52-week range (Rp)			24,900/15,400
3-mth avg daily turnover (US$mn)			6.89
Stock borrowability			Hard
Major shareholders (%)			
Government of Indonesia			65.0

Source: Company, Nomura estimates

Company breakdown

Company background

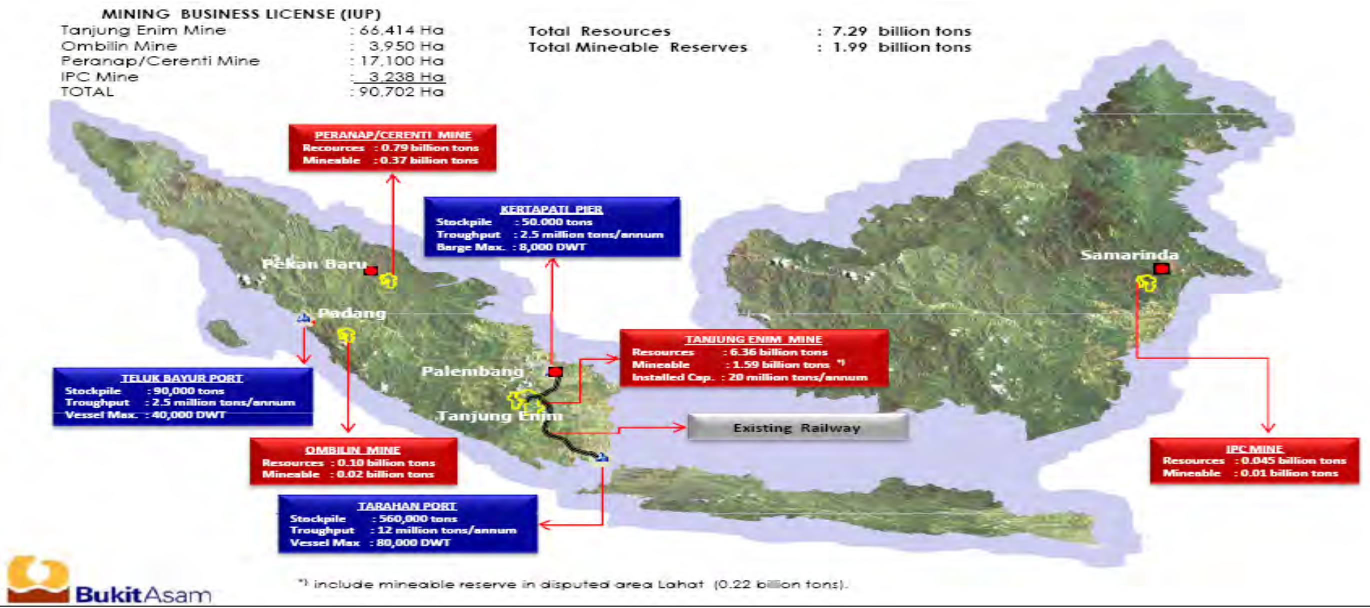
PTBA is a state-owned coal mining company with operations in both Sumatera and Kalimantan islands. The mine operations in Sumatera include Tanjum Enim (South Sumatera), Ombilin (West Sumatera) and Peranap/Cerenti (Riau) mines. In Kalimantan, PTBA has a 51% stake in International Prima Coal (IPC) located in East Kalimantan, which it acquired in 2H08.

To support the mine operations, PTBA owns three ports: 1) Tarahan (416.6km from Tanjung Enim mine with capacity of 12mn tonnes p.a.), 2) Kertapati (167.6km from Tanjung Enim mine with capacity of 2.5mn tonnes p.a.) and 3) Teluk Bayur which has annual capacity of 2.5mn tonnes. To transport coal from Tanjung Enim mine to the Tarahan and Kertapati ports, PTBA uses railway lines owned by PT Kereta Api (PTKA), the state railway company.

PTBA now has resources of 7.29bn tonnes and mineable reserves of 1.99bn tonnes which are concentrated (87% of resources and 80% of reserves) in the Tanjung Enim mine. Based on 2009 production volume, the implied mine life of the company is over 170 years, which is the highest among the listed coal mining companies in Indonesia.

In terms of ownership structure, PTBA shares are owned by the Government of Indonesia (65%) and public and management (35%).

Exhibit 59. PTBA mine locations



Source: Company data

Valuation methodology

We set our 2011-end target price at Rp30,000/share using a DCF methodology with a 11.9% weighted average cost of capital (WACC). Our target price implies 2011-12F EV/EBITDA of 16.1-8.8 and PER of 23.0-13.2x. Our 11.9% discount rate is based on the following assumptions: 1) 9% risk free rate, 2) 6% risk premium, 3) 1.21 levered beta, 4) 10% gross Rupiah cost of debt, 5) 25% income tax rate, and 6) 50/50 debt/equity ratio. Our DCF valuation is based on our 10-year (2012-21F) financial forecasts, and afterwards we take a terminal value based upon 10% terminal value growth for the available reserves after 2021 (1,740mn tons in our estimate). We think that 10% terminal value growth is reasonable because at the end of 2021, the implied PTBA mine life (based on 2021 production of is some 24mn tons) is still over 72 years. In addition to that, due to the significant resources that PTBA has, we also add valuation of PTBA's resources in our DCF calculation which is based upon US$0.25/ton of resources, lower than the current valuation of some US$0.7-0.8/ton.

Financial analysis

Financial forecasts

Forecast assumptions

The table below highlights assumptions that we use for our 2010-12F earnings forecasts.

Exhibit 60. Forecast assumptions

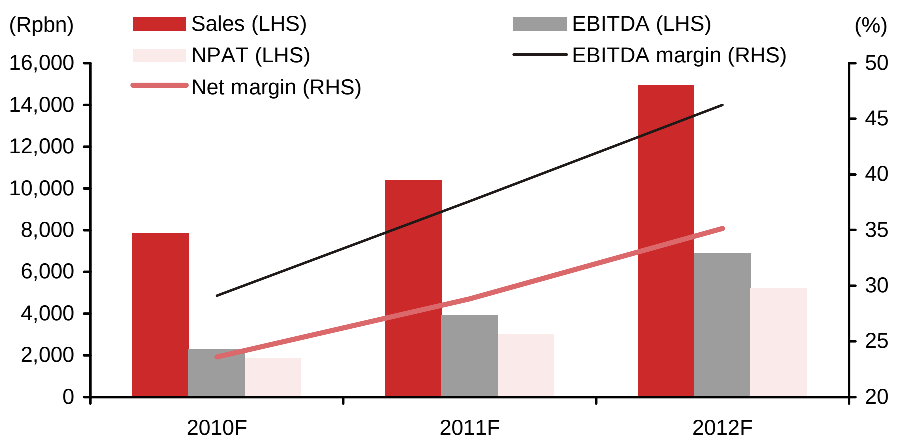
	2010F	2011F	2012F
Economy			
Average exchange rate, Rp/US$	9,000	9,000	9,000
Year-end exchange rate, Rp/US$	9,000	9,000	9,000
Rupiah inflation, %	5.1	5.9	5.3
Financial statements			
Production volume, mn tonnes	12.4	13.7	15.8
Sales volume, mn tonnes	13.0	14.3	16.4
Railway volume, mn tonnes	10.6	11.7	13.5
Domestic ASP, Rp/ton	614,003	721,639	858,127
Export ASP, Rp/ton	65.5	81.6	107.3
Average railway tariff, Rp/ton	134,327	141,044	148,527
Oil price, US$/barrel	79.0	95.0	110.0
Capex, US$mn	30.0	80.0	80.0
Cash cycle, days	92	92	92
Interest on cash balance, %	5.2	3.0	3.0
Income tax rate, %	25.0	25.0	25.0
Dividend payout, %	50.0	50.0	50.0

Source: Nomura estimates

Profit and loss forecasts

We forecast in 2010-12F PTBA will post an earnings CAGR of 68% from Rp1,852bn in 2010F to Rp5,245bn in 2012F on the back of higher sales volume (+13.1% CAGR), higher domestic and export ASP (+18.2% and 27.9% CAGR, respectively). We forecast its EBITDA margin will then increase from 29.1% in 2010F to 46.2% in 2012F.

Exhibit 61. We forecast higher earnings and margins



Source: Nomura estimates

Balance sheet forecasts

We expect PTBA’s balance sheet to remain strong and debt-free in future. We forecast the cash balance to increase from Rp5.1tn at the end of 2010 to Rp8.3tn at the end of 2012. We also forecast cash cycle days (we define cash cycle days as receivable days plus inventory days minus payable days) to remain stable at 92 days, in line with 2009 levels.

Exhibit 62. Balance sheet to remain strong in the future

Source: Nomura estimates

Sensitivity analysis

We conducted sensitivity analysis on our 2011-12F earnings forecasts on three main variables: coal price, railway volume and railway tariffs.

- **Coal price**

Our sensitivity analysis suggests that for every 10% change in our 2011-12F international coal price assumptions, our 2011-12F earnings forecasts would change by some 18-16%, respectively.

- **Railway volume**

Railway performance is very critical to PTBA’s production and earnings achievements. Our sensitivity analysis suggests that for every 10% change in our 2011-12F railway volume assumptions, our 2011-12F earnings forecasts would change by some 13-10%, respectively.

- **Railway tariff**

We have assumed that railway tariffs will increase by 5% in 2011 and 2012. Our sensitivity analysis suggests that for every 10% change in our 2011-12F railway tariff assumptions, our 2011-12F earnings estimates would change by 4-3%, respectively.

- **Exchange rate**

Our sensitivity exercises suggest that for every 10% change in our 2011-12F exchange rate assumptions, our 2011-12F earnings estimates would change by 15-14%.

Where could we go wrong?

Risks to our investment view

Coal price volatility

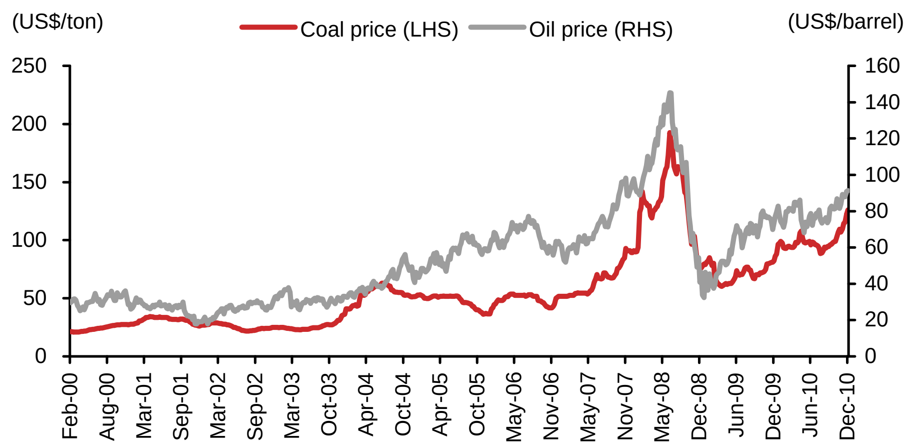
Impact of coal price volatility is significant on PTBA's financials

Most of PTBA's ASPs are driven by internal coal price which can be affected, in addition to supply and demand dynamics, by non-fundamental factors such as trading volatility/sentiment, currency movements and rebalancing of asset portfolios. Our sensitivity analysis suggests that for every 10% change in our 2011-12F coal price assumptions, our earnings estimates would change by 18-16%, respectively.

Disconnection between coal price and oil price

Coal prices and oil prices have had a strong positive correlation in the past ten to 11 years (coefficient correlation = 0.90). We expect the strong positive correlation between the two commodity prices to continue in the future. Disconnection between the two, i.e. higher oil prices are not followed by higher coal prices, could have a significant impact on PTBA's financials. Our sensitivity analysis suggests that for every 10% decrease in coal price and 10% increase in oil price, our 2011-12F earnings estimates would decline by 18% and 16%, respectively.

Exhibit 63. Coal and oil prices have a strong positive correlation



Source: Bloomberg

Exhibit 64. High R2 regression between coal price and oil price

SUMMARY OUTPUT

Regression statistics	
Multiple R	0.89542
R Square	0.80178
Adjusted R Square	0.80143
Standard Error	14.95695
Observations	567

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	511,251.77744	511,251.77744	2,285.32915	1.0456E-200
Residual	565	126,396.34585	223.71035		
Total	566	637,648.12330			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	(5.49720)	1.44896	(3.79390)	0.000164296	(8.34320)	(2.65120)	(8.34320)	(2.65120)
X Variable 1	1.15458	0.02415	47.80512	1.0456E-200	1.10714	1.20202	1.10714	1.20202

Source: Nomura estimates

Weather

Weather is an external uncontrollable factor which can affect PTBA's operational performance. We have assumed that starting in 2011, weather conditions will improve. Our sensitivity analysis suggests that for every 10% change in our 2011-12F production volume assumptions, our 2011-12F earnings estimates would change by 16-21%, respectively.

Regulatory risk

Regulatory risk in the mining sector in Indonesia is probably the highest compared to other sectors. The risk lies not only in the implementation of mining regulations but on synchronization of the mining sectors with regulations in other sectors which have impact on the mining sector as well. The fact that PTBA is operating under a Mining Authorization (Kuasa Pertambangan/KP) will expose it to further regulatory risk, in our view, as PTBA can be exposed to additional government regulations in the future which may not be favourable to the company.

Data reliability

It is very difficult to find reliable data on Indonesian coal industry. Data from one source could be significantly different from other sources. Given Indonesia's position as the world's largest coal exporter, miscalculation of industry statistics could have a significant impact on the global coal market, in our view.

High reliance on a single customer

PTBA's sells some 55-60% of its annual production to Perusahaan Listrik Negara (PLN), the state electricity company, and its subsidiary. The proportion to PLN could be bigger in future as PTBA has signed an MoU with PLN to supply low-CV coal.

High reliance on railway performance

PTBA has high dependence on the performance of PTKA to transport its coal from mine sites to ports. Over 80% of PTBA's sales are transported through railways. Our sensitivity analysis suggests that for every 10% change in our 2011-12F railway volume assumptions, our 2011-12F earnings forecasts would change by some 13-10%, respectively.

Execution risk

Our volume growth assumptions are dependent upon PTKA's success in ramping up railway volumes. We have confidence that the railway company will be able to do it, but there is no such an assurance that it can do it as per schedule, as there are external factors which we think can not be controlled by PTKA.

External mining contractor risks

In order to diversify operational risks, PTBA has engaged mining contractors to mine some 50% of its production. Even though this policy is good from efficiency and cashflow management perspectives, on the flip side this can also pose additional risk to PTBA should the mining contractors be in trouble.

Exchange rate volatility

We estimate that over 80% of PTBA's sales volume is priced in US dollar or linked to US dollar, while most of the costs are stated in Rupiah. That said, Rp/US$ volatility could have significant impact on PTBA's earnings. Our sensitivity exercises suggest that for every 10% change in our 2011-12F exchange rate assumptions, our 2011-12F earnings estimates will change by 15-14%.

Financial statements

Strong EBITDA growth in 2010-12F

Income statement (Rpbn)					
Year-end 31 Dec	FY08	FY09	FY10F	FY11F	FY12F
Revenue	7,216	8,948	7,845	10,406	14,928
Cost of goods sold	(3,686)	(4,104)	(4,283)	(5,090)	(6,436)
Gross profit	**3,530**	**4,844**	**3,561**	**5,316**	**8,492**
SG&A	(1,036)	(1,295)	(1,326)	(1,456)	(1,657)
Employee share expense					
Operating profit	**2,494**	**3,548**	**2,235**	**3,860**	**6,834**
EBITDA	**2,564**	**3,602**	**2,285**	**3,910**	**6,903**
Depreciation	(70)	(54)	(50)	(50)	(68)
Amortisation					
EBIT	**2,494**	**3,548**	**2,235**	**3,860**	**6,834**
Net interest expense	108	202	244	154	182
Associates & JCEs					
Other income	(51)	15	-	-	-
Earnings before tax	**2,551**	**3,765**	**2,479**	**4,014**	**7,016**
Income tax	(837)	(1,033)	(620)	(1,004)	(1,754)
Net profit after tax	**1,714**	**2,733**	**1,859**	**3,011**	**5,262**
Minority interests	(7)	(2)	(7)	(10)	(14)
Other items					
Preferred dividends					
Normalised NPAT	**1,707**	**2,731**	**1,852**	**3,001**	**5,248**
Extraordinary items					
Reported NPAT	**1,707**	**2,731**	**1,852**	**3,001**	**5,248**
Dividends	(380)	(1,007)	(1,364)	(926)	(1,500)
Transfer to reserves	**1,327**	**1,724**	**488**	**2,075**	**3,747**
Valuation and ratio analysis					
FD normalised P/E (x)	29.8	18.6	27.5	17.0	9.7
FD normalised P/E at price target (x)	40.5	25.3	37.3	23.0	13.2
Reported P/E (x)	29.8	18.6	27.5	17.0	9.7
Dividend yield (%)	0.7	2.0	2.7	1.8	2.9
Price/cashflow (x)	31.6	18.6	24.8	19.9	11.5
Price/book (x)	12.7	8.9	8.2	6.2	4.2
EV/EBITDA (x)	18.7	12.8	20.0	11.5	6.2
EV/EBIT (x)	19.2	13.0	20.5	11.6	6.2
Gross margin (%)	48.9	54.1	45.4	51.1	56.9
EBITDA margin (%)	35.5	40.3	29.1	37.6	46.2
EBIT margin (%)	34.6	39.7	28.5	37.1	45.8
Net margin (%)	23.7	30.5	23.6	28.8	35.2
Effective tax rate (%)	32.8	27.4	25.0	25.0	25.0
Dividend payout (%)	22.3	36.9	73.6	30.9	28.6
Capex to sales (%)	1.2	0.6	3.4	6.9	4.8
Capex to depreciation (x)	1.2	1.1	5.4	14.3	10.5
ROE (%)	51.1	56.3	31.1	41.5	51.8
ROA (pretax %)	103.5	110.3	65.8	96.2	127.2
Growth (%)					
Revenue	75.0	24.0	(12.3)	32.6	43.5
EBITDA	165.5	40.5	(36.6)	71.1	76.5
EBIT	178.0	42.3	(37.0)	72.7	77.0
Normalised EPS	134.4	60.0	(32.2)	62.0	74.9
Normalised FDEPS	134.4	60.0	(32.2)	62.0	74.9
Per share					
Reported EPS (Rp)	741	1,185	804	1,302	2,278
Norm EPS (Rp)	741	1,185	804	1,302	2,278
Fully diluted norm EPS (Rp)	741	1,185	804	1,302	2,278
Book value per share (Rp)	1,735	2,474	2,686	3,587	5,213
DPS (Rp)	165	437	592	402	651

Source: Nomura estimates

Cashflow (Rpbn)					
Year-end 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
EBITDA	2,564	3,602	2,285	3,910	6,903
Change in working capital	(442)	(152)	169	(496)	(869)
Other operating cashflow	(513)	(714)	(397)	(859)	(1,586)
Cashflow from operations	**1,610**	**2,736**	**2,057**	**2,555**	**4,447**
Capital expenditure	(86)	(58)	(270)	(720)	(720)
Free cashflow	**1,523**	**2,679**	**1,787**	**1,835**	**3,727**
Reduction in investments	(43)	3	-	-	-
Net acquisitions	(343)	(10)	-	-	-
Reduction in other LT assets	7	(154)	(0)	-	-
Addition in other LT liabilities	129	236	-	-	-
Adjustments	(93)	(85)	0	-	-
Cashflow after investing acts	**1,180**	**2,669**	**1,787**	**1,835**	**3,727**
Cash dividends	(380)	(1,007)	(1,364)	(926)	(1,500)
Equity issue	-	-	-	-	-
Debt issue	-	-	-	-	-
Convertible debt issue					
Others	19	6	7	10	14
Cashflow from financial acts	**(361)**	**(1,002)**	**(1,356)**	**(916)**	**(1,486)**
Net cashflow	**819**	**1,667**	**430**	**919**	**2,241**
Beginning cash	2,223	3,042	4,709	5,139	6,058
Ending cash	3,042	4,709	5,139	6,058	8,299
Ending net debt	(3,042)	(4,696)	(5,139)	(6,058)	(8,299)

Source: Nomura estimates

Balance sheet (Rpbn)					
As at 31 Dec	**FY08**	**FY09**	**FY10F**	**FY11F**	**FY12F**
Cash & equivalents	3,042	4,709	5,139	6,058	8,299
Marketable securities					
Accounts receivable	1,377	1,491	1,308	1,734	2,488
Inventories	420	410	428	508	643
Other current assets	111	173	173	173	173
Total current assets	**4,950**	**6,783**	**7,048**	**8,474**	**11,603**
LT investments	126	123	123	123	123
Fixed assets	384	372	592	1,262	1,913
Goodwill					
Other intangible assets	199	199	199	199	199
Other LT assets	448	602	602	602	602
Total assets	**6,106**	**8,079**	**8,563**	**10,659**	**14,440**
Short-term debt	-	14	-	-	-
Accounts payable	69	58	61	72	91
Other current liabilities	1,284	1,309	1,309	1,309	1,309
Total current liabilities	**1,353**	**1,381**	**1,370**	**1,381**	**1,400**
Long-term debt					
Convertible debt					
Other LT liabilities	676	912	912	912	912
Total liabilities	**2,029**	**2,293**	**2,282**	**2,293**	**2,312**
Minority interest	80	84	92	102	116
Preferred stock					
Common stock	1,183	1,183	1,183	1,183	1,183
Retained earnings	2,816	4,519	5,007	7,082	10,829
Proposed dividends					
Other equity and reserves					
Total shareholders' equity	**3,998**	**5,701**	**6,189**	**8,264**	**12,012**
Total equity & liabilities	**6,106**	**8,079**	**8,563**	**10,659**	**14,440**
Liquidity (x)					
Current ratio	3.66	4.91	5.14	6.13	8.29
Interest cover	na	na	na	na	na
Leverage					
Net debt/EBITDA (x)	net cash	net cash	net cash	net cash	net cash
Net debt/equity (%)	net cash	net cash	net cash	net cash	net cash
Activity (days)					
Days receivable	49.1	58.5	65.1	53.4	51.8
Days inventory	34.3	36.9	35.7	33.6	32.7
Days payable	8.4	5.7	5.1	4.8	4.6
Cash cycle	75.1	89.7	95.7	82.2	79.9

Source: Nomura estimates

A strong balance sheet with no debt

Bumi Resources BUMI IJ

BASIC MATERIALS/METALS & MINING | INDONESIA

Initiation

BUY

NOMURA

PT NOMURA INDONESIA

Isnaputra Iskandar, CFA +62 21 2991 3346 isnaputra.iskandar@nomura.com

Action

Our Buy recommendation on BUMI is based on 1) positive impact from the Vallar deal, 2) continued deleveraging, which should lower balance sheet risk, 3) strong EBITDA growth, and 4) our expectation that the valuation discount will narrow as balance sheet improvements kick in. Our target price of Rp4,300 implies 2011-12F EV/EBITDA of 8.8-4.0x.

Catalysts

Better-than-expected term coal price negotiations continued deleveraging, operational improvements and unlocking of value through its subsidiaries.

Anchor themes

Our global mining team forecasts large supply deficits in the global seaborne thermal coal market over the next five years with import growth (driven by India and China) outstripping export growth (driven by Australia and Indonesia). Strong domestic demand would be another boost to the sector.

Closing price on 11 Jan	Rp2,950
Price target	**Rp4,300**
Upside/downside	45.8%
Difference from consensus	**0.0%**
FY11 net profit (US$mn)	246.0
Difference from consensus	**na**

Source: Nomura

Nomura vs consensus

Our 2012F earnings estimates are more bullish than consensus' on our higher coal price assumption.

Kickers...on the ball

① Vallar deal is the kicker

We expect the Vallar deal to be share price positive because of: 1) lower balance sheet risk through debt refinancing and/or restructuring, 2) lower share price volatility as a result of pooling of the group's ownership in Bumi under Vallar, and 3) potential improvement in corporate governance.

② Deleveraging despite scepticism

Despite market scepticism, BUMI is continuing its deleveraging process; it lowered last year's debt by some US$500mn. Management has said it intends to lower the debt further by another US$800-1,000mn in 2011, but we have not factored this into our forecasts. Should the plan go ahead, we estimate a post-tax earnings addition of US$28-34mn, representing 11-13% of our 2011F earnings forecast.

③ Strong 2010-12F EBITDA growth

We forecast BUMI will post a 77% EBITDA CAGR in 2010-12F on a combination of higher volume (13% CAGR) and better ASP (23% CAGR) in spite of higher production cash costs (5% CAGR).

④ 26% discount to peers

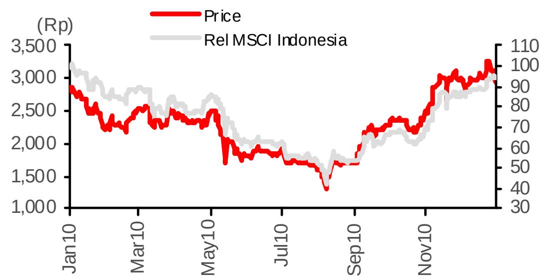
BUMI's coal assets are trading at 2011F EV/EBITDA of 6.2x, a 26% discount to the average EV/EBITDA of its domestic peers. We expect the discount to narrow given improvements on the balance sheet side. Our SOTP-based price target of Rp4,300 offers potential upside of 45.8%, hence we recommend BUY.

Key financials & valuations

31 Dec (US$mn)	FY09	FY10	FY11	FY12F
Revenue	3,219	3,994	5,000	7,341
Reported net profit	190	147	246	984
Normalised net profit	190	147	246	984
Normalised EPS (US$)	0.009	0.007	0.012	0.047
Norm. EPS growth (%)	(48.8)	(22.8)	67.4	299.9
Norm. P/E (x)	30.9	46.3	27.7	6.9
EV/EBITDA (x)	10.8	8.9	6.2	2.9
Price/book (x)	4.4	3.5	3.2	2.2
Dividend yield (%)	1.6	0.9	0.4	0.7
ROE (%)	14.4	8.7	12.1	37.8
Net debt/equity (%)	233.3	194.9	166.5	80.4
Earnings revisions				
Previous norm. net profit		na	na	na
Change from previous (%)		na	na	na
Previous norm. EPS (US$)		na	na	na

Source: Company, Nomura estimates

Share price relative to MSCI Indonesia



	1m	3m	6m
Absolute (Rp)	(0.8)	28.3	58.6
Absolute (US$)	(1.4)	26.1	58.0
Relative to Index	9.2	37.3	54.0
Market cap (US$mn)			6,751
Estimated free float (%)			91.3
52-week range (Rp)			3,275/1,290
3-mth avg daily turnover (US$mn)			44.24
Stock borrowability			Hard
Major shareholders (%)			
Glencore International			5.1
			3.6

Source: Company, Nomura estimates

Company background

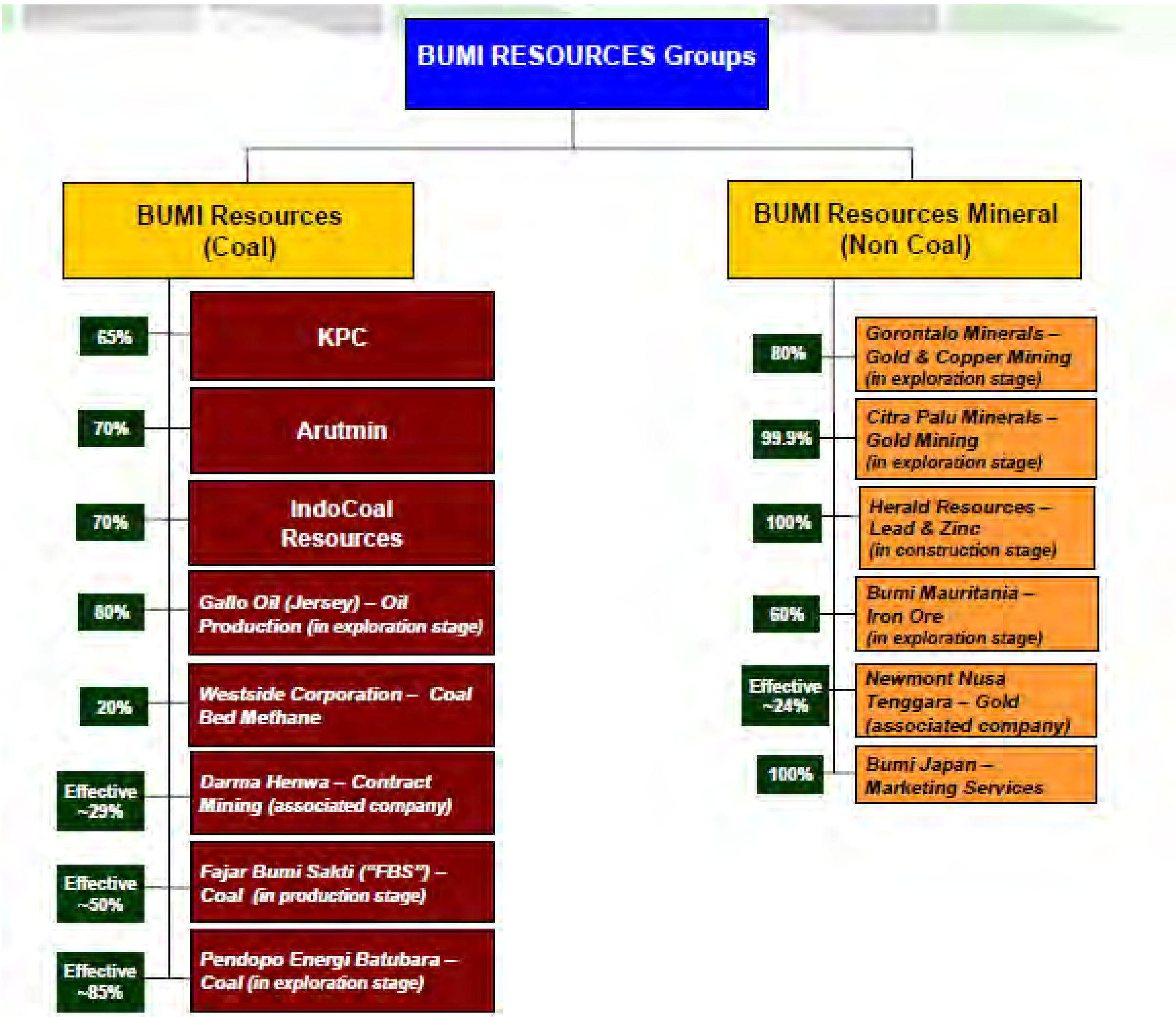
Company background

Bumi Resources (BUMI IJ) is the owner of two major mine assets in Indonesia: Kaltim Prima Coal (KPC) and Arutmin which have operations in Kalimantan. Total combined production of the two mines are some 60mn tons on our estimates, making BUMI the biggest coal producer in Indonesia. Through capacity expansions of its mines, BUMI intends to increase its production to some 100-110mn tons in 2-3 years. In addition to these coal assets, BUMI also owns two other coal mines — Fajar Bumi Sakti (FBS) and Pendopo Energi Batubara (PEB) — and a mining contractor (Darma Henwa/DEWA IJ).

The combined reserves and resources of the four mines now stand at some 2,904mn tons and 7,782mn tons, respectively. Total reserves of KPC and Arutmin themselves are some 2,121mn tons. Based on 2010 production, the implied mine life of the KPC and Arutmin reserves is some 35 years.

Another important asset that BUMI owns is mineral assets through its subsidiary, Bumi Resources Minerals (BRMS IJ) which was listed on the Indonesia Stock Exchange (IDX) in December 2010. BRMS has a couple of mineral assets – Newmont Nusa Tenggara (NNT), Herald Resources, Gorontalo Minerals, Citra Palu Minerals, and Bumi Mauritania – and one coal marketing service company, Bumi Japan. NNT is the largest mineral asset.

Exhibit 65. BUMI's corporate structure



Source: Company

Exhibit 66. One of BUMI's facilities at Arutmin

Source: Company

Financial analysis

Financial forecasts

We based our 2010-12F on financial forecasts assumptions highlighted in Exhibit 3 below:

Exhibit 67. Assumptions

	2010F	2011F	2012F
Economy			
Average exchange rate, Rp/US$	9,000	9,000	9,000
Year-end exchange rate, Rp/US$	9,000	9,000	9,000
Rupiah inflation, %	5.1	5.9	5.3
Financial statements			
Production volume, mn tons	60.0	66.0	77.2
Sales volume, mn tons	60.0	66.0	77.2
JFY coal price, US$/ton	98.0	140.0	170.0
Average selling price (ASP), US$/ton	70.1	84.2	105.6
Oil price, US$/barrel	79.0	95.0	110.0
Stripping ratio, ton/bcm	11.0	11.0	11.0
Capex, US$mn	450	300	300
Cash cycle, days	17	17	17
Interest on cash balance, %	3	3	3
Income tax rate, %	45	45	45
Dividend payout, %	20	20	20

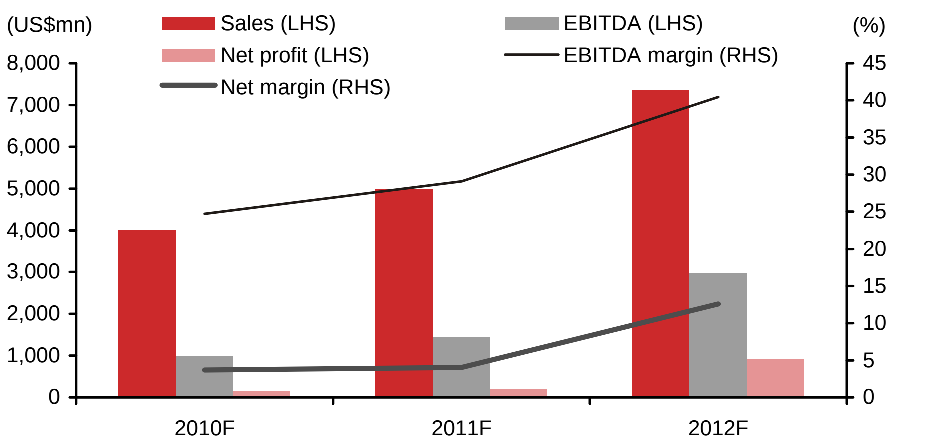
Source: Nomura estimates

Profit and loss

We forecast BUMI to grow earnings from US$147mn in 2010 to US$984mn in 2012 (159% CAGR) on a combination of: 1) higher production (13% CAGR), from 60mn tons in 2010 to 77.2mn tons in 2012, and 2) stronger ASP (23% CAGR), from US$70.1/ton in 2010 to US$105.6/ton in 2012.

We forecast EBITDA margin will then rise from 25% to 42% over the same period and net margin will increase from 4% to 13%. The company's net margin is currently still relatively low, and we expect a only a small increase as BUMI will still have to pay high interest charges of over US$500mn pa in 2010-12.

Exhibit 68. Stronger profitability



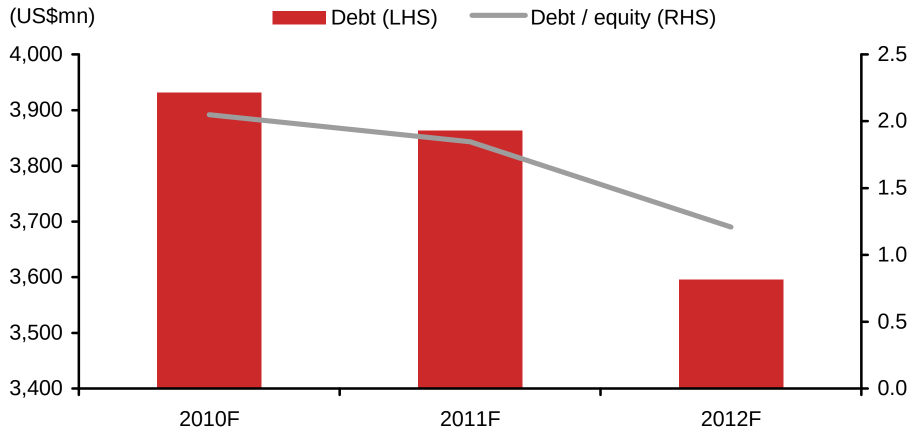
Source: Nomura estimates

Balance sheet

We have not assumed aggressive debt reduction in our financial model for 2010-12. We assume the debt will decline gradually from US$3.9bn at the end of 2010 to

US$3.6bn at the end of 2012. Bear in mind that BUMI plans to reduce debt by another US$800-1,000mn which, if executed, would save a significant amount in interest charges. We forecast gearing (debt/equity) will decline from 2.1x at the end of 2010 to 1.2x at the end of 2012, mainly due to a larger equity base driven by stronger operating cash flows.

Exhibit 69. Gearing to fall due to stronger operating cash flows



Source: Nomura estimates

Sensitivity analysis

We have performed earnings sensitivity analysis on coal price, volume, and oil price variables.

- **Coal price**

Our earnings forecasts are very sensitive to changes in our coal price assumption. Our sensitivity analysis suggests that for every 10% change in our 2012F coal price assumption, our 2012F earnings estimates change by 35%.

- **Production volume**

Our sensitivity analysis suggests that for every 10% change in our 2011-12F production volume assumptions, our 2011-12F earnings estimates change by 29% and 15%, respectively.

- **Oil price**

For every 10% change in our 2011-12F oil price assumptions, our 2011-12F earnings forecasts change by 18% and 6%, respectively.

Where could we go wrong?

Risk factors

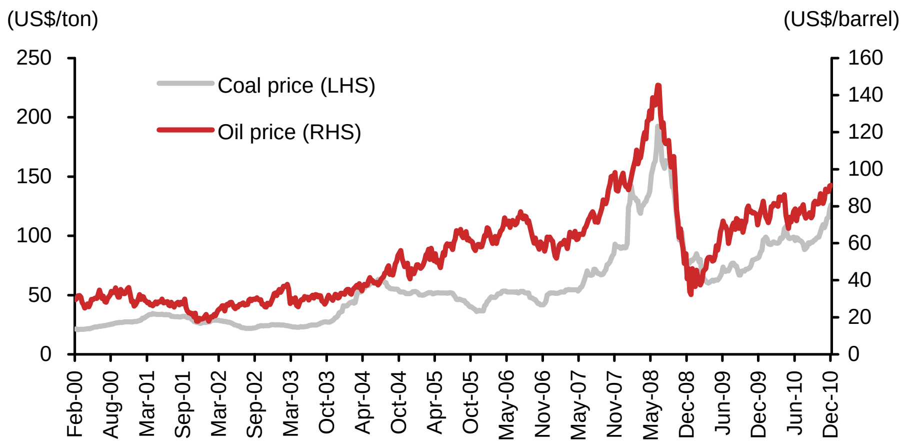
Coal price volatility

Most of BUMI's ASPs are driven by the internal coal price. Beyond supply and demand dynamics, this price can be affected by non-fundamental factors such as trading volatility/sentiment, currency movements and rebalancing of the asset portfolio. Our sensitivity analysis suggests that for every 10% change in our coal price assumption, 2012F earnings change by 35%.

Risk of coal price and oil price decoupling

Coal prices and oil prices have had a strong positive correlation over the past 10-11 years (coefficient correlation = 0.90). We expect the strong positive correlation between the two to continue. However, a decoupling of the two – ie, a higher oil price that is not followed by a higher coal price – would have a significant impact on BUMI's financials.

Exhibit 70. Coal and oil prices have a strong positive correlation



Source: Bloomberg

Exhibit 71. High R2 regression between coal price and oil price

SUMMARY OUTPUT

Regression statistics	
Multiple R	0.89542
R Square	0.80178
Adjusted R Square	0.80143
Standard Error	14.95695
Observations	567

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	511,251.77744	511,251.77744	2,285.32915	1.0456E-200
Residual	565	126,396.34585	223.71035		
Total	566	637,648.12330			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	(5.49720)	1.44896	(3.79390)	0.000164296	(8.34320)	(2.65120)	(8.34320)	(2.65120)
X Variable 1	1.15458	0.02415	47.80512	1.0456E-200	1.10714	1.20202	1.10714	1.20202

Source: Nomura estimates

Weather

Extreme weather is an external uncontrollable factor that could affect BUMI's operational performance. We assume that starting in 2011, the weather will improve from that of 2010. Our production assumptions are sensitive to weather conditions and we have conducted an earnings sensitivity analysis on this variable. Our sensitivity analysis suggests that for every 10% change in our 2011-12F production volume assumptions, our 2011-12F earnings estimates will change by 29% and 15%, respectively.

Regulatory risk

Regulatory risk in the mining sector in Indonesia is probably the highest of any other sector, in our view. The risk lies not only in the implementation of mining regulations but also the synchronization of implementation of the regulations among upstream/downstream segments of the mining industry that would in turn affect the mining sector.

Industry data reliability

It is very difficult to find reliable data on the Indonesian coal industry. Data from one source could be significantly different from that of other sources. Given Indonesia's position as the world's largest coal exporter, miscalculation or error in industry statistics would have a significant impact on the global coal market.

Execution risk

We have assumed that BUMI will able to engage contractors, secure the required equipment, and do other necessary mining activities to ramp up its production.

External mining contractor risk

To diversify operational risks, BUMI has engaged with mining contractors to mine reserves and aims to engage more in the future. Even though this policy is good from the perspectives of efficiency and cash flow management, the flip side is that it also poses additional risk to BUMI should the mining contractors be in trouble.

Balance sheet risk

To lower the balance sheet burden, management intends to continue the deleveraging which it started in 2010. Unsuccessful deleveraging could result in a higher risk premium and cost of debt, which could hurt the company's financials and share price performance.

Tax dispute risk

Although BUMI has repeatedly mentioned that it has already settled its tax obligations, the Directorate General of Taxation has continued to make mention of BUMI's unpaid tax obligations.

Share price volatility risk

We assume that following the Vallar transaction, all the group's ownership in BUMI will be consolidated under Vallar, hence reducing share price volatility in BUMI.

Valuation

Valuation methodology

Our target price of Rp4,300 implies 2011-12F EV/EBITDA of 8.8-4.0x. We use a sum of the part (SOTP) methodology (multiplied by BUMI's stake in each of the assets) to value BUMI as follows:

- for the existing mines, KPC and Arutmin, we value the assets using DCF at a 12.36% discount rate. The discount rate is based on cost of equity of 20.7%, net rupiah cost of debt of 8.8% and a debt/equity ratio of 70/30. Our cash flow projections for this DCF value is until 2021F assuming 10% terminal growth;
- for KPC and Arutmin we value the assets at US$0.8/ton;
- for the reserves and resources of BUMI's two subsidiaries, Fajar Bumi Sakti (FBS) and Pendopo Energi Batubara (PEB), we assign a valuation of US$0.1/ton;
- for BUMI's stake at Darma Henwa (DEWA IJ) and Bumi Resources Minerals (BRMS IJ), we use the closing prices as of 30 December 2010 of Rp71/share and Rp670/share, respectively.

We then adjust the valuation of our estimate of BUMI's net debt position (as of 31 December 2011) of US$3.6bn to arrive at BUMI equity value.

Exhibit 72. Equity valuation of BUMI - Rp4,300/share

Asset	Equity value* (Rpbn)
Existing KPC Arutmin	55,347
KPC + Arutmin resources	23,644
FBS reserves + resources	44
PEB reserves + resources	843
Bumi Resources Minerals	9,962
Darma Henwa	447
Total	**90,287**
NAV/share, Rp	**4,346**

* Post adjustments of BUMI's stakes in individual assets

Source: Nomura research estimates

Appendix

Vallar transaction

In November 2009, BUMI and Vallar did a US$3bn combined share swap and cash transaction. The transaction entails Vallar acquiring a 75% stake of Berau Coal (BRAU IJ) and a 25% stake in BUMI. Vallar would then issue new shares to be swapped for BRAU and BUMI shares. The BUMI shares that are to be swapped are those owned the Bakrie Group.

In our view, the transaction is positive because:

- It should be able to lower BUMI's financing costs; Vallar is owned by Nathaniel Rothschild, which has a strong reputation in financial industry;
- Some of Bakrie Group's stake in BUMI will be pooled through Vallar, which should reduce share price volatility, in our view.

IPO of Bumi Resources Minerals

BUMI's subsidiary, Bumi Resources Minerals (BRMS IJ) — the minerals business of BUMI — was listed on the Indonesia Stock Exchange (IDX) in December 2010. We believe the market has not fully appreciated the progress at BRMS. We believe that BRMS, as a listed company, will be better appreciated by the market, which should in turn benefit BUMI.

Financial statements

Robust EBITDA growth

Income statement (US$mn)					
Year-end 31 Dec	FY08	FY09	FY10	FY11	FY12F
Revenue	3,378	3,219	3,994	5,000	7,341
Cost of goods sold	(1,766)	(2,116)	(2,623)	(3,026)	(3,675)
Gross profit	**1,613**	**1,104**	**1,371**	**1,974**	**3,665**
SG&A	(511)	(465)	(511)	(588)	(751)
Employee share expense					
Operating profit	**1,102**	**638**	**860**	**1,386**	**2,914**
EBITDA	**1,171**	**753**	**988**	**1,534**	**3,077**
Depreciation	(69)	(114)	(128)	(147)	(163)
Amortisation					
EBIT	**1,102**	**638**	**860**	**1,386**	**2,914**
Net interest expense	(40)	(181)	(539)	(558)	(534)
Associates & JCEs	7	83	201	132	134
Other income	(36)	(23)	108	(59)	(59)
Earnings before tax	**1,033**	**518**	**630**	**902**	**2,456**
Income tax	(489)	(234)	(284)	(406)	(1,105)
Net profit after tax	**544**	**284**	**347**	**496**	**1,351**
Minority interests	(172)	(93)	(200)	(250)	(367)
Other items					
Preferred dividends					
Normalised NPAT	**372**	**190**	**147**	**246**	**984**
Extraordinary items					
Reported NPAT	**372**	**190**	**147**	**246**	**984**
Dividends	(81)	(97)	(59)	(29)	(49)
Transfer to reserves	**291**	**94**	**88**	**217**	**935**
Valuation and ratio analysis					
FD normalised P/E (x)	17.0	30.9	46.3	27.7	6.9
FD normalised P/E at price target (x)	24.8	45.1	67.5	40.4	10.1
Reported P/E (x)	17.0	30.9	46.3	27.7	6.9
Dividend yield (%)	1.3	1.6	0.9	0.4	0.7
Price/cashflow (x)	6.6	24.0	na	25.3	7.3
Price/book (x)	4.8	4.4	3.5	3.2	2.2
EV/EBITDA (x)	6.4	10.8	8.9	6.2	2.9
EV/EBIT (x)	6.8	12.5	9.9	6.8	3.0
Gross margin (%)	47.7	34.3	34.3	39.5	49.9
EBITDA margin (%)	34.7	23.4	24.7	30.7	41.9
EBIT margin (%)	32.6	19.8	21.5	27.7	39.7
Net margin (%)	11.0	5.9	3.7	4.9	13.4
Effective tax rate (%)	47.4	45.2	45.0	45.0	45.0
Dividend payout (%)	21.7	50.7	40.3	11.9	5.0
Capex to sales (%)	21.9	16.5	12.0	6.0	4.1
Capex to depreciation (x)	10.7	4.7	3.7	2.0	1.8
ROE (%)	32.5	14.4	8.7	12.1	37.8
ROA (pretax %)	28.7	11.6	13.5	18.1	35.4
Growth (%)					
Revenue	49.1	(4.7)	24.1	25.2	46.8
EBITDA	148.6	(35.7)	31.2	55.3	100.6
EBIT	171.3	(42.1)	34.7	61.3	110.2
Normalised EPS	(52.9)	(48.8)	(22.8)	67.4	299.9
Normalised FDEPS	(52.9)	(48.8)	(22.8)	67.4	299.9
Per share					
Reported EPS (US$)	0.018	0.009	0.007	0.012	0.047
Norm EPS (US$)	0.018	0.009	0.007	0.012	0.047
Fully diluted norm EPS (US$)	0.018	0.009	0.007	0.012	0.047
Book value per share (US$)	0.056	0.071	0.092	0.103	0.148
DPS (US$)	0.004	0.005	0.003	0.001	0.002

Source: Nomura estimates

Cashflow (US$mn)					
Year-end 31 Dec	FY08	FY09	FY10	FY11	FY12F
EBITDA	1,171	753	988	1,534	3,077
Change in working capital	745	(612)	(377)	(51)	(137)
Other operating cashflow	(958)	105	(666)	(1,214)	(2,006)
Cashflow from operations	**959**	**246**	**(56)**	**269**	**934**
Capital expenditure	(741)	(532)	(480)	(300)	(300)
Free cashflow	**219**	**(286)**	**(535)**	**(31)**	**634**
Reduction in investments	(396)	(554)	(352)	-	-
Net acquisitions					
Reduction in other LT assets	(920)	(1,425)	(27)	40	40
Addition in other LT liabilities	354	(116)	136	(136)	-
Adjustments	15	1,031	(32)	92	94
Cashflow after investing acts	**(729)**	**(1,351)**	**(810)**	**(35)**	**768**
Cash dividends	(81)	(97)	(59)	(29)	(49)
Equity issue	-	-	360	-	-
Debt issue	992	1,527	440	(68)	(268)
Convertible debt issue					
Others	(154)	(191)	200	250	367
Cashflow from financial acts	**758**	**1,239**	**940**	**153**	**50**
Net cashflow	**28**	**(112)**	**131**	**117**	**818**
Beginning cash	144	172	60	191	308
Ending cash	172	60	191	308	1,126
Ending net debt	1,094	3,431	3,740	3,555	2,469

Source: Nomura estimates

Balance sheet (US$mn)					
As at 31 Dec	FY08	FY09	FY10	FY11	FY12F
Cash & equivalents	172	60	191	308	1,126
Marketable securities	299	229	343	343	343
Accounts receivable	272	747	1,005	1,081	1,258
Inventories	153	199	199	199	199
Other current assets	738	817	817	817	817
Total current assets	**1,633**	**2,052**	**2,555**	**2,748**	**3,744**
LT investments	232	857	1,094	1,094	1,094
Fixed assets	879	1,140	1,496	1,648	1,785
Goodwill	919	366	347	329	310
Other intangible assets					
Other LT assets	1,572	2,997	3,024	2,983	2,943
Total assets	**5,235**	**7,411**	**8,516**	**8,803**	**9,876**
Short-term debt	398	422	141	341	823
Accounts payable	257	370	251	276	315
Other current liabilities	1,448	1,324	1,324	1,324	1,324
Total current liabilities	**2,103**	**2,115**	**1,716**	**1,940**	**2,462**
Long-term debt	767	2,305	3,026	2,758	2,008
Convertible debt	101	764	764	764	764
Other LT liabilities	746	629	766	629	629
Total liabilities	**3,716**	**5,814**	**6,272**	**6,092**	**5,864**
Minority interest	353	126	325	575	942
Preferred stock					
Common stock	1,524	1,472	1,832	1,832	1,832
Retained earnings	877	970	1,058	1,275	2,209
Proposed dividends					
Other equity and reserves	(1,235)	(971)	(971)	(971)	(971)
Total shareholders' equity	**1,165**	**1,471**	**1,919**	**2,135**	**3,070**
Total equity & liabilities	**5,235**	**7,411**	**8,516**	**8,803**	**9,876**
Liquidity (x)					
Current ratio	0.78	0.97	1.49	1.42	1.52
Interest cover	27.5	3.5	1.6	2.5	5.5
Leverage					
Net debt/EBITDA (x)	0.93	4.56	3.79	2.32	0.80
Net debt/equity (%)	93.9	233.3	194.9	166.5	80.4
Activity (days)					
Days receivable	30.9	57.8	80.0	76.1	58.3
Days inventory	25.6	30.4	27.7	24.0	19.9
Days payable	38.6	54.1	43.2	31.7	29.4
Cash cycle	17.9	34.1	64.6	68.4	48.7

Source: Nomura estimates

Debts starting to come down

ANALYST CERTIFICATIONS

Analyst Certification

I, Isnaputra Iskandar, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

Issuer Specific Regulatory Disclosures

Issuer	Ticker	Price (as at last close)	Closing Price Date	Rating	Disclosures
Adaro Energy	ADRO IJ	2475.00 IDR	11 Jan 2011	Not Rated	
Bumi Resources	BUMI IJ	2950.00 IDR	11 Jan 2011	Not Rated	
Indo Tambangraya Mega	ITMG IJ	52200.00 IDR	11 Jan 2011	Not Rated	
Tambang Batubara Bukit Asam	PTBA IJ	22100.00 IDR	11 Jan 2011	Not Rated	

Previous Ratings

Issuer	Previous Rating	Date of change
Adaro Energy	Not Rated	
Bumi Resources	Not Rated	02 Aug 2006
Indo Tambangraya Mega	Not Rated	
Tambang Batubara Bukit Asam	Not Rated	

Important Disclosures

Conflict-of-interest disclosures

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Explanation of Nomura's equity research rating system for Asian companies under coverage ex Japan published prior to 30 October 2008

STOCKS

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Nomura Asian Equity Research Group

Hong Kong	Nomura International (Hong Kong) Limited 30/F Two International Finance Centre, 8 Finance Street, Central, Hong Kong Tel: +852 2536 1111 Fax: +852 2536 1820
Singapore	Nomura Singapore Limited 5 Temasek Boulevard #11-01, Suntec Tower Five, Singapore 038985, Singapore Tel: +65 6433 6288 Fax: +65 6433 6169
Taipei	Nomura International (Hong Kong) Limited, Taipei Branch 17th Floor, Walsin Lihwa Xinyi Building, No.1, Songzhi Road, Taipei 11047, Taiwan, R.O.C. Tel: +886 2 2176 9999 Fax: +886 2 2176 9900
Seoul	Nomura Financial Investment (Korea) Co., Ltd. 17th floor, Seoul Finance Center, 84 Taepyeongno 1-ga, Jung-gu, Seoul 100-768, Korea Tel: +82 2 3783 2000 Fax: +82 2 3783 2500
Kuala Lumpur	Nomura Securities Malaysia Sdn. Bhd. Suite No 16.5, Level 16, Menara IMC, 8 Jalan Sultan Ismail, 50250 Kuala Lumpur, Malaysia Tel: +60 3 2027 6811 Fax: +60 3 2027 6888
India	Nomura Financial Advisory and Securities (India) Private Limited Ceejay House, Level 11, Plot F, Shivsagar Estate, Dr. Annie Besant Road, Worli, Mumbai- 400 018, India Tel: +91 22 4037 4037 Fax: +91 22 4037 4111
Indonesia	PT. Nomura Indonesia Suite 209A, 9th Floor, Sentral Senayan II Building Jl. Asia Afrika No. 8, Gelora Bung Karno, Jakarta 10270, Indonesia Tel: +62 21 2991 3300 Fax: +62 21 2991 3333
Sydney	Nomura Australia Ltd. Level 25, Governor Phillip Tower, 1 Farrer Place, Sydney NSW 2000 Tel: +61 2 8062 8000 Fax: +61 2 8062 8362
Tokyo	Equity Research Department Financial & Economic Research Center Nomura Securities Co., Ltd. 17/F Urbannet Building, 2-2, Otemachi 2-chome Chiyoda-ku, Tokyo 100-8130, Japan Tel: +81 3 5255 1658 Fax: +81 3 5255 1747, 3272 0869