# Delta Dunia

## Rp1,660 - BUY


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**25 August 2009**

## Indonesia
## Miscellaneous

| | |
|---|---|
| Reuters | DOID.JK |
| Bloomberg | DOID IJ |

**Priced on 25 August 2009**
Jakarta Comp @ 2,375.9

**12M hi/lo** Rp1,810/460

| | |
|---|---|
| **12M price target** | Rp2,450 |
| **±% potential** | +48% |
| **Target set on** | |

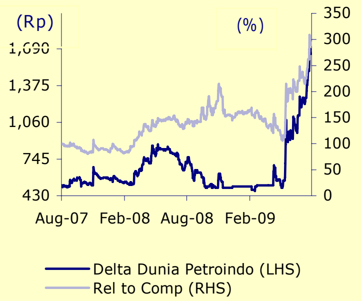
| | |
|---|---|
| **Shares in issue** | 6,790.4m |
| **Free float (est.)** | 19.0% |
| **Market cap** | US$1,121m |

**3M average daily volume**
Rp7.5bn (US$0.7m)

**Major shareholders**
PT Texta Indonesia 50.1%
Benny Wirawansa 12.8%

**Stock performance (%)**

| | 1M | 3M | 12M |
|---|---|---|---|
| Absolute | 39.5 | 196.4 | 133.8 |
| Relative | 28.3 | 135.4 | 109.3 |
| Abs (US$) | 39.4 | 204.6 | 114.2 |




Source: Bloomberg

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# Moving to mining

Initiating coverage

**Asia's hunger for power will fuel Indonesian coal demand which spells opportunity for Delta Dunia. This shell company is acquiring Indonesia's second largest coal mining contractor in a debt funded deal that should be complete by October. Bukit Makmur has a proven track record with long-term relationships and a low cost base. The company will be a key beneficiary of the growing demand for Indonesian thermal coal. We forecast 74% earnings cagr for BUMA until 2011. The stock trades at a deep discount to peers; our fair value has 48% upside. BUY**

### Material corporate action pending

Delta has announced plans to acquire Bukit Makmur (BUMA), a coal mining contractor, for a total consideration of US$550m. Post acquisition, BUMA will be the company's sole operating subsidiary. The proposed acquisition values BUMA at 2.7x 2009 EV/Ebitda and 1.3x P/BV. Fully debt funded, the acquisition has an expected completion date of Oct-09. BUMA management will continue run existing operations.

### BUMA – Indonesia's second largest coal contractor

BUMA is the second largest coal mining contractor in Indonesia with 19% market share. The company has a proven track record, with coal extraction increasing 35% per annum since 1999. Management has been in the industry for over 15 years, working on 16 sites across Indonesia. Cost are low compared to peers reflecting scale, lower sub-contracting, and fleet flexibility.

### More mining services required

Within five years, Indian and Chinese thermal-coal demand could expand by 700m tonnes - equivalent to today's global seaborne thermal-coal market. As the world's largest exporter of this resource, Indonesia will play a crucial role, with production forecast to grow 35% to 310m tonnes by 2013, and this would still be a moderate assumptions. This will be a catalyst for mining services. BUMA will be a key beneficiary of these trends.

### Financials and valuation

Prior to this corporate action, Delta was essentially a shell company with immaterial earnings. Future earnings growth will be rapid; we forecast 74% earnings cagr for BUMA to 2011. Net gearing will also drop aggressively. On our forecast, Delta trades at a 40% discount to DCF and a 30% discount to peer EV/Ebitda, based on 2010 multiples. Using a blended valuation approach, our fair value suggests 48% upside.

### Financials

| Year to 31 Dec | 07A | 08A | 09CL | 10CL | 11CL |
|---|---|---|---|---|---|
| Revenue (Rpbn) | 1,003 | 10 | 1,590 | 7,845 | 9,385 |
| Ebitda (Rpbn) | 47 | 6 | 521 | 3,028 | 3,639 |
| Net profit (Rpbn) | 6 | 4 | 222 | 1,364 | 1,724 |
| EPS (Rp) | 2 | 1 | 33 | 201 | 254 |
| EPS (% YoY) | | (63.4) | 5350.4 | 514.8 | 26.4 |
| PEx (@Rp1,660) | 1,013.0 | 2,769.9 | 50.8 | 8.3 | 6.5 |
| EV/Op Ebitda (x) | 249.2 | 1,766.1 | 29.5 | 5.0 | 4.0 |
| Dividend yield (%) | - | - | - | - | 2.4 |
| ROAE (%) | | 1.1 | 42.3 | 98.5 | 61.8 |
| Price/book (x) | 31.1 | 32.5 | 16.1 | 5.5 | 3.2 |
| Net gearing (%) | 91 | 14 | 586 | 180 | 94 |

Source: CLSA Asia-Pacific Markets

# Material corporate action pending

### The proposed acquisition

**Delta to acquire BUMA for total EV of US$550m**

Delta Dunia Petroindo (Delta) has announced it plans to acquire Bukit Makmur Mandiri Utama (BUMA) for total consideration of US$550m. Upon the completion of the acquisition, BUMA will be main operating subsidiary of Delta (which is currently a property holding company). Delta plans to divest all property investments and other assets. Delta has thus far had limited operating activities with net profit last year of a mere Rp4.1bn on 9.6bn of revenue.

**The acquisition is valuing BUMA at around 1.3x book value and 2.2x Ebitda only**

We understand that BUMA's book value, as of Apr09, was around Rp1.8tn, with total debt of US$310m and thus the transaction is valuing BUMA at 1.3x book value of equity. We also estimate that BUMA could generate US$206m and US$305m of Ebitda in 2009 and 2010 and therefore, the proposed acquisition values BUMA at EV/Ebitda of 2.7X and 1.8x, respectively, cheap compared to United Tractors (UNTR IJ - Rp13,000 - BUY) which is valued at 6.6x to 6.2x Ebitda. This acquisition will be entirely debt financed, with no new equity issuance. The deal is expected to be completed by Oct-09.

**Existing BUMA management would continue running the operation**

Mr. Johan Lensa, the founder of BUMA, will continue to be involved in management of Delta as President Commissioner for, at least, the next two years. To ensure the continued growth of BUMA, the acquisition will also provide for a lock-up mechanism and incentive scheme, such as an employee stock option, to retain the existing BUMA management.

# BUMA – Indonesia's second largest coal contractor

### How BUMA got to where it is now

**Started as sub-contractor in 1994**

Mr. Johan Lensa and his family were involved in the construction business through PT Unico Utama back in the 1980s. He was then able to leverage his experience into other contracting-related works, starting with land clearing for palm plantation companies, including Astra Agro Lestari and Sinar Mas Group. This experience then led to becoming a sub-contractor in coal mining for Astra Group's mining contractor, PAMA, in 1994, before eventually establishing BUMA in 1999.

Figure 1

**A brief history of BUMA**

| | Events / Accomplishments |
|---|---|
| Pre-1994 | Mr. Lensa was heavily involved in construction contracting and palm oil contracting businesses |
| 1994 | Mr. Lensa and family expanded their contracting businesses into coal mining contracting, as PAMA's subcontractor |
| 1998 | Mr. Lensa and family established PT Mentari Bukit Makmur as the main coal mining contractor at Lati site for Berau Coal |
| 1999 | BUMA was found to start mining contracting for Berau - Binungan |
| 2001 | BUMA became Adaro's mining contractor |
| 2004 | BUMA became the third largest mining contractor in Indonesia, with 16.6% market share |
| 2005 | BUMA jumped past Thiess to become the second largest mining contractor with 18.9% market share |
| 2006 | Lati contract and equipments were transferred to BUMA from MBM |
| 2008 | BUMA's Adaro, Kideco, Lati, and IMK sites obtained OHSAS 18001 certification |
| 2009 | Delta proposes to acquire 100% stake in BUMA |

Source: BUMA

Berau Coal's mine at Binungan site was the first project for BUMA, before other mine owners, Adaro and Lanna Resources, started their relationship with BUMA in 2001.

**Seasoned management team**

### Experience and expertise

Seasoned with 15 years of experience in mining contracting and a total of 25 years experience in contracting business, Mr. Johan Lensa was the driving force behind BUMA. Mr. Lensa then hired experienced managers in early 2000 that include Mr. Budikwanto Kuesar, hired from PAMA and currently BUMA managing director. They have since turned BUMA into a more professionally run company. Rapid growth on coal extraction was evident since these professionals joined in 2001. Note also most of the senior management staffs have been in the industry for an average of 15 years.

Figure 2

**Experienced management team**

| Senior Management | Profile |
|---|---|
| Johan Lensa (President Director) | As the founder of the company, Mr. Lensa has been heavily involved in the contracting business since 1980. From 1988 to 2000, he was involved as contractor for Astra Agro Lestari, Salim Group and Sinar Mas Grous. He was then acted as subcontractor for PAMA before focusing on BUMA. |
| Budikwanto Kuesar (Managing Director and Operation Director) | Mr. Kuesar graduated from Akademi Pendidikan Kejuruan in 1973 and began his career with United Tractors as Administration Department Head. In 1992, he was transferred to PAMA as Operations Director until 2001 before he joined BUMA as Managing Director. |
| Rusmin (Finance Director) | Mr. Rusmin has worked closely with Mr. Johan Lensa since 1988. He has an extensive experience and responsible for financial, purchasing, and logistic matters in contracting businesses. Mr. Rusmin is the brother of Mr. Lensa. |
| Christian Wijayanto (General Manager Finance and Accounting) | Before joining BUMA, Mr. Wijayanto served as Deputy Director at Astra Agro Lestari for over 10 years. Mr. Wijayanto graduated from Trisakti University of Jakarta with a bachelor's degree in Engineering. He has more than 17 years of experience in accounting and finance. |
| William Surnata (General Manager Business Development) | Mr. Surnata has enjoyed long tenure at Bank Bali, Bank Universal, and Bank Danamon for almost 16 years prior to joining BUMA in 2004. He graduated from Universitas Parahyangan of Bandung with a degree in civil engineering. |
| A. Kharis (General Manger Operation) | Mr. Kharis is responsible for the day-to-day mining operation and BUMA's marketing efforts. Prior to 1998, Mr. Kharis worked as an operational manager at PAMA. He graduated from Universitas Gajah Mada of Yogyakarta with a degree in geological engineering. |
| Zulfikar (General Manager Plant) | Mr. Zulfikar worked at United Tractors for over 14 years before joining BUMA in 1994. With more than 24 years of experience, he is responsible for maintenance and workshop facilities. |
| Kristiyanto W (Deputy General Manager HR and General Affairs) | Prior to joining BUMA in 2005, Mr. Kristiyanto was a Project Manager at PAMA. He graduated with a degree in Geology from UPN University. |
| Herriman T (General Manager Material Management) | Mr. Herriman joined BUMA in 2005 and is responsible for procurement and logistics issue. He has 8 years of experiences as Parts Manager in a heavy equipment dealer and 4 years of experience as system and EDP. |

Source: BUMA

**Vast experience in working in various sites in different locations**

Since its formal inception in 1999, BUMA has been working with 14 different customers in 16 mine sites, gaining significant expertise in working in different mine conditions in various locations. BUMA's working sites are all located in Kalimantan Island, the key coal-producing region in Indonesia.

Figure 3

**BUMA main operation is concentrated in key coal producing region, Kalimantan**


Source: CLSA Asia-Pacific Markets, BUMA

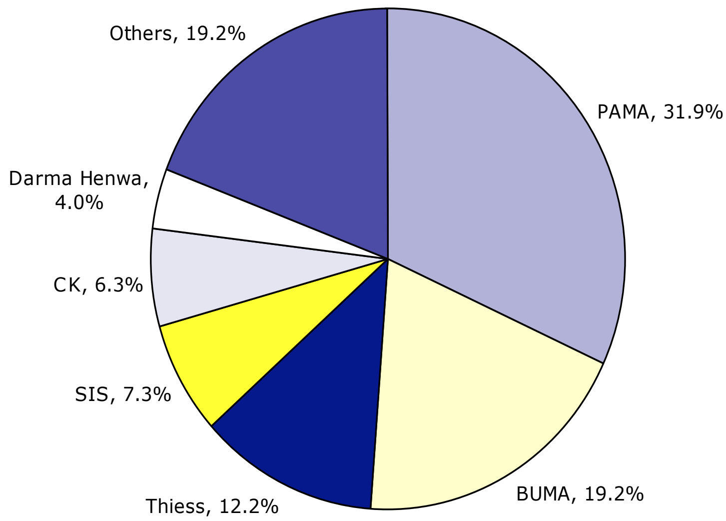
**Ranks as the 2nd biggest coal mining contractor in the country**

## Catching up fast

Despite its modest beginning as a sub-contractor to PAMA back in 1994, BUMA has grown rapidly, climbing to the 2nd spot in 2005, and currently holds around 19% share in the Indonesian coal mining contracting market.

Figure 4

**Buma is the top two mining contractors**




Source: CLSA Asia-Pacific Markets, BUMA

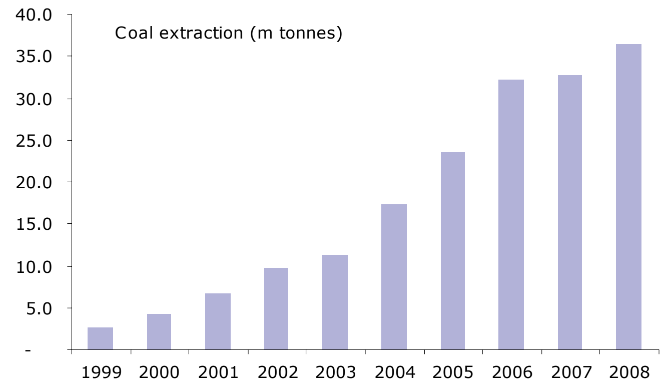
**Coal extraction rate was up by 35% per annum over the past 10 years**

BUMA has been able to deliver what have been targeted by its customers, with its coal extraction growing by 35% per annum over the past 10 years to around 35m tonnes in 2009. As a result, BUMA has been able to secure contract extensions from customers, with 10 out of 14 existing mining contracts have been amended or extended. We also understand that the company has been consistently adding new customers each year since 2003.

In some cases, BUMA was able to replace underperforming competitors, sometimes even foreign mining contractors, for example in sites owned by Bukit Baiduri, Straits Asia, and Bayan Resources in 2001, 2003, and 2008, respectively. BUMA also claims to have never experienced any early termination of a contract due to underperformance or any other reasons and customers refusing to renew contracts based on the same terms.

Figure 5

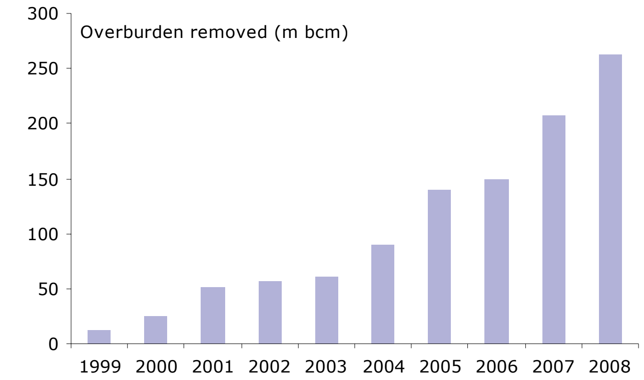
**Rapidly growing coal extraction…**




Source: BUMA

Figure 6

**…and overburden removal**




Source: BUMA

## Strong customer base

### Sizeable and credible customers

**Customers are among the major coal producers in Indonesia**

Adaro, Kideco, Arutmin, Berau, and Bayan are among the major customers of BUMA. These are some of the biggest coal producers in Indonesia with solid reputation, highly marketable coal, and significant reserves that could allow BUMA to grow along with.

Figure 7

**Customers have sizeable production, reserves, and marketable coal quality**

| Rank in Indonesia | Coal mine owners | 2008 Production (m tonnes) | Reserves (m tonnes) | Reserves life (years) | Coal quality (kcal/kg, ar) |
|---|---|---|---|---|---|
| 2 | Adaro (Adaro Energy) | 38.0 | 870 | 22.9 | 5,100 |
| 3 | Kideco Jaya (Indika) | 22.0 | 416 | 18.9 | 4,900 |
| 4 | Arutmin (Bumi Resources) | 52.0 | 2,904 | 55.8 | 5,735 |
| 6 | Berau Coal | 13.0 | 300 | 23.1 | 5,000 |
| 8 | Bayan Resources | 6.0 | 477 | 79.5 | 4,900 |
| 12 | Sebuku (SAR) | 8.0 | 16 | 2.0 | 5,700 |
| 18 | Bukit Baiduri Energi | 2.0 | 10 | 4.9 | 5,300 |
| 23 | Lanna Harita Indonesia | 1.5 | 29 | 19.1 | 5,100 |
| 25 | Marunda Graha Mineral | 1.5 | 65 | 43.6 | 7,150 |

Source: CLSA Asia-Pacific Markets, BUMA

**Coal is sold to quality coal consumers under term contract**

Note that these coal producers are also selling their output to high-quality consumers, mainly the North Asian power producers. Meanwhile, pricing for the coal is set, mostly, under one-year term contract, ensuring cash flows generated by these coal mine owners.

**Significant contributor to customers**

Worth highlighting that BUMA is a significant contributor to these customers' total productions, delivering around 10% to 100% of total output. This gives BUMA some leverage in dealing with its customers, particularly when it comes to contract renewals. Note that switching cost to other contractors would be significant.

Coal mine owners are highly profitable, lowering risk of BUMA's investments

Figure 8

**BUMA is key contributor to customers' production**

| Customers | 2008 production (m tonnes) | BUMA's contribution |
|---|---|---|
| Adaro (Adaro Energy) | 38.0 | 20% |
| Kideco (Indika) | 22.0 | 30% |
| Trubaindo (ITM) | 18.0 | 11% |
| Berau Coal | 13.0 | 79% |
| Sebuku (SAR) | 8.0 | 53% |
| Bayan Resources | 6.0 | 18% |
| Bukit Baiduri Energi | 1.5 | 93% |
| Lanna Harita Indonesia | 1.5 | 100% |
| Marunda Graha Mineral | 1.5 | 93% |

Source: CLSA Asia-Pacific Markets, BUMA

## With profitable operations

BUMA's key customers are profitable mine owners. We highlighted below the Ebitda margins for some of BUMA's key customers, which range from 13% to 38% for the next three years. We also understand that some of these customers, most notably Adaro and Kideco, are among the lowest cost producers in Indonesia, allowing them to weather volatility in commodity prices. These should reduce risk of bad receivables and capital investments for BUMA.

Figure 9

**Customers are profitable**

| Ebitda margin | 07A | 08A | 09CL | 10CL | 11CL |
|---|---|---|---|---|---|
| Bumi Resources | 20.7 | 35.3 | 33.8 | 31.7 | 38.3 |
| Adaro | 22.2 | 32.2 | 42.5 | 35.0 | 36.2 |
| Indika (Kideco) | 26.6 | 40.6 | 40.3 | 27.7 | 28.0 |
| Bayan Resources | 19.9 | 10.3 | 15.4 | 14.6 | 13.2 |

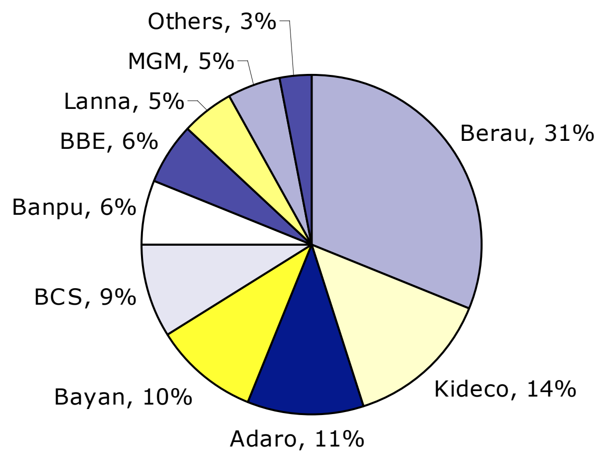
Source: CLSA Asia-Pacific Markets

## Well-distributed revenue stream

As BUMA working on 14 contracts, the company does not rely on one single customer to generate its revenue. As shown on the chart below, Berau Coal is the biggest customer, contributing to around 31% of revenue, while other customers are contributing nicely to around 5% to 15% of total revenue. The five largest customers account for 75% of revenue.

Figure 10

**Revenue contribution per customers**




Source: BUMA

**More contracts from mid-size customers with growth potential**

Note that BUMA have been securing able to more contracts from mid-size coal companies with growth potential such as Lanna Resources, Bukit Baiduri Energy, and Marunda Graha Mineral. This should reduce risk from depending too much on the bigger customers.

## Long term contract offers stability and growth

**Securing US$5.3bn contracts, securing 70% volume for the next 5 years**

BUMA works under long-term contracts with its customers, ranging between three to ten years. BUMA has locked-in 14 active contracts with total value of USD$5.3bn, almost eight times of its 2008 revenue. Therefore around 70% of production volume for the next five years has been secured from the customers.

Figure 11

**Current contracts**

| No | Customers | Contracted volume | | Period |
|---|---|---|---|---|
| | | OB (m bcm) | Coal (m tonne) | |
| 1 | Adaro Energy | 250 | 50 | 2009-2013 |
| 2 | Kideco (Indika) | 24 | 3 | 2008-2010 |
| 3 | Kideco (Indika) | 39 | 5 | 2008-2010 |
| 4 | Kideco (Indika) | 600 | 90 | 2010-2020 |
| 5 | Berau Coal | 974 | 125 | 1998-2018 |
| 6 | Berau Coal | - | - | 2003-2018 |
| 7 | Berau Coal | 349 | 46 | 2003-2018 |
| 8 | Marunda Graha Mineral | 45 | 5 | 2003-2012 |
| 9 | Lanna Harita | 13 | 2 | 2007-2009 |
| 10 | Indo Muro Kencana | - | - | 2005-2009 |
| 11 | Bukit Baiduri Energi | 16 | 2 | 2008 - onwards |
| 12 | Bayan Resources | 43 | 10 | 2007-2012 |
| 13 | Bayan Resources | 212 | - | 2007-2013 |
| 14 | Arutmin (Bumi Resources) | 31 | 3 | 2008-2011 |
| | **Total** | **2,596** | **340** | |

Source: CLSA Asia-Pacific Markets, BUMA

**There is upside on future volume**

We would like to highlight that more projects are in the pipeline. BUMA is in the final process to work on projects for Arutmin, KPC, Lanna, and Suprabahari. These projects could start contributing in 2010 to 2012. The total expected overburden removed is 517m bcm with approximate extraction of 70.5m tonnes of coal. Two projects for Berau Coal are also in finalization and they could start in 2011 and 2012.

Figure 12

**Project pipeline**

| No | Customers | Contracted volume | | Period |
|---|---|---|---|---|
| | | OB (m bcm) | Coal (m tonne) | |
| 1 | Arutmin | 115 | 24 | 2010 |
| 2 | Lanna Harita | 50 | 10 | 2010 |
| 3 | Arutmin | 132 | 12 | 2011 |
| 4 | Berau Coal | 53 | 8 | 2011 |
| 5 | Suprabahari Mapapindo | 100 | 10 | 2011 |
| 6 | Berau Coal | 53 | 8 | 2012 |
| 7 | Kaltim Prima Coal | 120 | 15 | 2012 |
| | **Total** | **622** | **86** | |

Source: BUMA

## Low cost operator

### Scale leads to bargaining power

**Scale of operation, less sub-contracting, and fleet flexibility resulted in relatively low- cost structure**

As the 2nd largest mining contractors in Indonesia, BUMA has some bargaining power over its main suppliers. We understand that some heavy equipment producers and distributors have been giving special rates for BUMA in the form of free down payment when placing orders and only need to pay up to 20% of order value when the equipment is brought-in assembled, reducing working capital needs.

**Less sub-contracting**

Buma employs only 2% of its overall activities to sub-contractors and this has allowed the company to lower its costs and hence retain the profit margin. Note that mining contractors like PAMA or Thiess could sub-contract 15% to 20% of their activities.

**Fleet flexibility**

Being an independent coal mining contractor, BUMA has more flexibility to select equipment from various suppliers to meet the specification required. Note that mining contractors like PAMA, a subsidiary of United Tractors that distributes Komatsu, or CK Mining, a subsidiary of Trakindo that sells Caterpillar, are generally less flexible in choosing equipment.

# Financials and valuation

## Outlook for robust profit growth

**Delta net profit would jump, driven by BUMA growing its earnings by 73% Cagr over 2008-2011**

Following acquisition of BUMA, Delta net profit would jump from Rp4bn to Rp1.7tn in 2011. This growth, however, is not a true picture on profitability of Delta as BUMA acquisition would only be completed in Oct09. Looking at BUMA on a stand alone basis, we forecast its net profit to grow at 74% Cagr over 2008-2011 in US Dollar terms, driven by factors as follow.

1. **Higher coal extraction and overburden removal.** We forecast BUMA coal extraction rate would grow at 12% while overburden removal would expand at 16% Cagr 2008-2011, respectively. This is in line with existing contracts that BUMA has already secured while the company is also finalizing several new contracts that will start delivering in 2010.

2. **Unit rate adjustment.** Following the spike in input prices back in 2007 and 2008, BUMA has managed to secure some unit rate adjustment from customers for most of its contract, ranging from 5% to 15% in 2008, to compensate for cost escalation. The full impact of this rate adjustment would be mostly felt in 2009 onward.

3. **No more equipment rental.** The company would no longer rent heavy equipment starting mid 2009 as it decided to acquire this rented equipment to lower operating costs. Note that rental, historically, represented some 3% to 5% of net revenue.

4. **Some forex gain in 2009.** As the company is carrying US$550m of debt while financial reporting is in Rupiah, we expect around Rp390bn of forex gain to be booked in 2009 as Rupiah strengthened. No gain or loss is assumed post 2009 as we have assumed flat Rupiah.

5. **Lower tax rate.** This is in line with corporate tax rate in Indonesia and we have assumed the rate to fall from 28% in 2009 to 25% afterward.

6. **Interest expenses would negate the upside**. Note also that the net impact of these operating improvements would be reduced by higher interest expenses as additional leverage would be incorporated into BUMA. We forecast interest expenses to double from US$22m in 2008 to US$49m in 2010.

**Should exclude fuel component in looking at revenue**

7. **A note on revenue.** Total revenue booked by BUMA incorporated fuel cost components that are passed through to customers. As are resulting, we are forecasting 8% YoY lower total revenue in 2009. Revenue less fuel cost component, net revenue, would probably give a better idea on the overall operating performance, in addition to total coal extracted and overburden removed. Note also that revenue from overburden removal represent some 80% of the total revenue, followed by revenue from coal extraction with 18% and others, mostly equipment rental, with 2%.

Figure 13

**Key forecast assumptions and estimates**

| | 2007A | 2008A | 2009E | 2010E | 2011E |
|---|---|---|---|---|---|
| **BUMA - stand alone basis** | | | | | |
| Coal extraction (m tonnes) | 32.4 | 36.2 | 35.5 | 44.0 | 50.5 |
| YoY | 0% | 12% | -2% | 24% | 15% |
| Overburden removal (m bcm) | 207.0 | 262.1 | 290.9 | 351.0 | 406.3 |
| YoY | 8% | 27% | 11% | 21% | 16% |
| Unit rate - coal (US$/t) | 2.5 | 2.6 | 1.6 | 1.8 | 1.9 |
| YoY | | 3% | -38% | 13% | 6% |
| Unit rate - overburden (US$/bcm) | 1.6 | 1.9 | 1.8 | 1.8 | 1.9 |
| YoY | | 21% | -9% | 2% | 4% |
| Hauling rate - coal (US$/t) | 2.6 | 3.1 | 3.4 | 3.7 | 3.7 |
| YoY | | 22% | 9% | 9% | 0% |
| Net revenue (US$/bcm) | 1.69 | 1.85 | 1.80 | 1.89 | 1.94 |
| YoY | 8% | 10% | -3% | 5% | 3% |
| Coal extraction revenue (US$m) | 110 | 131 | 113 | 138 | 162 |
| Overburden revenue (US$m) | 329 | 506 | 513 | 632 | 762 |
| Others (US$m) | 31 | 56 | 10 | 15 | 15 |
| Total revenue (US$m) | 470 | 693 | 636 | 784 | 938 |
| YoY | 16% | 47% | -8% | 23% | 20% |
| Net revenue (US$m) - excl. fuel | 349 | 486 | 525 | 664 | 788 |
| YoY | 16% | 39% | 8% | 27% | 19% |
| EBITDA (US$m) | 149 | 199 | 208 | 303 | 364 |
| YoY | -6% | 33% | 5% | 45% | 20% |
| EBITDA margin | 32% | 29% | 33% | 39% | 39% |
| Net profit (US$m) | 34.8 | 32.8 | 88.8 | 137.1 | 172.8 |
| YoY | -50% | -6% | 171% | 54% | 26% |
| | | | | | |
| **Delta - consolidated** | | | | | |
| Revenue (Rpbn) | 1,003 | 10 | 1,590 | 7,845 | 9,385 |
| YoY | 65% | -99% | 16490% | 393% | 20% |
| EBITDA (Rpbn) | 47 | 6 | 521 | 3,028 | 3,639 |
| YoY | 15% | -86% | 8024% | 481% | 20% |
| Net profit (Rpbn) | 6 | 4 | 222 | 1,364 | 1,724 |
| YoY | 149% | -27% | 5350% | 515% | 26% |

Source: CLSA Asia-Pacific Markets

**Earnings are most sensitive to coal extraction and unit rate for overburden**

## Earnings sensitivity

Our sensitivity analysis shows that earnings for BUMA, and therefore Delta, would be most sensitive to changes in coal extraction and unit rate for overburden.

Figure 14

**Earnings sensitivity**

| Earnings sensitivity | Net profit changes | |
|---|---|---|
| | 2009E | 2010E |
| +1% change in coal extraction | 2.0% | 2.0% |
| +1% change in overburden removal | 1.7% | 1.9% |
| +1% change unit rate for coal | 0.5% | 0.5% |
| +1% change unit rate for overburden | 2.5% | 2.2% |

Source: CLSA Asia-Pacific Markets

## Generating strong return

**BUMA has been a robust ROE generator**

Delta would generate robust ROE, averaging around 70%, driven by the strong performance of BUMA. Note that BUMA as a stand alone company generated strong ROE in the past three years, averaging around 30%, largely attributable to its high margin, fast asset turnover, and financial leverage.

Figure 15

**ROE assessment**

| | 2006A | 2007A | 2008A | 2009E | 2010E | 2011E |
|---|---|---|---|---|---|---|
| **Delta – ROE** | 1% | 42% | 99% | 62% | 45% | 34% |
| | | | | | | |
| BUMA - ROE breakdown | | | | | | |
| Net Income/EBT | 66% | 72% | 75% | 75% | 75% | 75% |
| EBT/EBIT | 29% | 96% | 80% | 84% | 86% | 88% |
| EBIT/Sales | 18% | 20% | 29% | 29% | 28% | 27% |
| Sales/Total assets | 120% | 84% | 80% | 82% | 83% | 81% |
| Total Assets/Equity | 374% | 378% | 317% | 256% | 214% | 184% |
| **ROE** | 15% | 44% | 44% | 38% | 32% | 27% |

Source: CLSA Asia-Pacific Markets

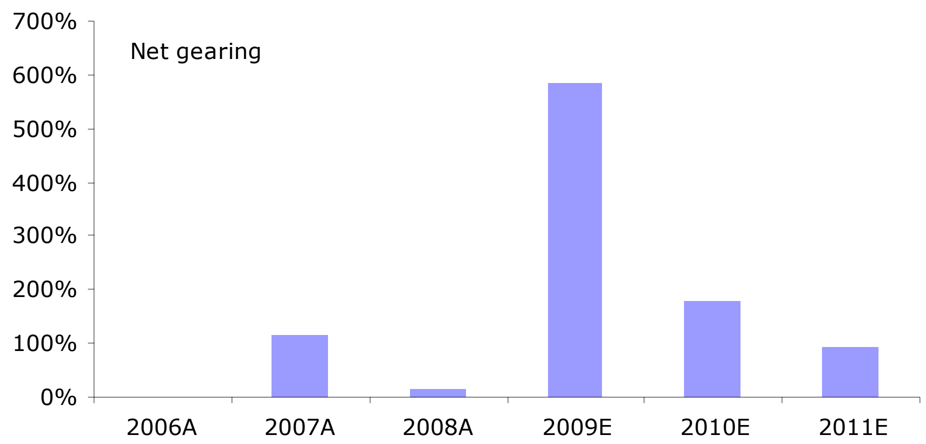
## Rapidly declining gearing

**Net gearing should fall from 600% in 2009 to 95% in 2011**

With the completion of acquisition, total debt would reach US$550m, comprising of BUMA debt refinancing and portion required to acquire BUMA equity. As a result, Delta net gearing could jump from 14% in 2008 to 590% in 2009. Nonetheless, gearing level would be declining fast over the next two years to 94% in 2011, as Delta paying down its debt while retaining its profit.

Figure 16

**Gearing should fall sharply in two years time**




Source: CLSA Asia-Pacific Markets

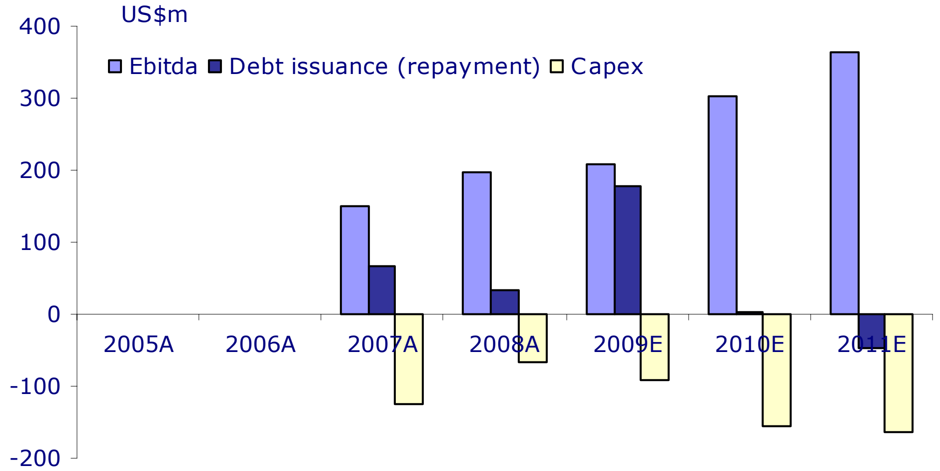
**BUMA is generating sufficient cash flows to repay its debt and finance capex**

We believe BUMA, on a stand alone basis, would have sufficient cash flows to finance its expansion program. Capex is estimated to range between

US$150m to US$170m over the next two years while Ebitda would hover around US$300m to US$360m over the same period, hence BUMA should have little problem to finance its future expansion.

Figure 17

**BUMA, stand alone, generates cash flows to meet debt repayment and capex**




Source: CLSA Asia-Pacific Markets

# Attractively valued

**Set target price at Rp2,450, suggesting 48% upside**

We initiate Delta with a BUY rating. The company is trading at a steep 40% discount to our DCF estimate, and 20% and 30% discounts to peers' 2010 PE and EV/Ebitda, reasonably cheap. We have applied a blended valuation approach to arrive at our target price of Rp2,450, suggesting 48% upside. We believe blended approach better captures both long-term prospects and its short-term earnings momentum.

Figure 18

**How we derive our target price**

| Blended valuation | 2010 (x) | Value/share (Rp) |
|---|---|---|
| NPV | 1.0 | 2,800 |
| PER | 11.9 | 2,400 |
| EV/EBITDA | 6.0 | 2,100 |
| **Average** | | **2,450** |

Source: CLSA Asia-Pacific Markets

## Relative approach

**PAMA generates 60% of Ebitda for United tractors, comparison is compelling with BUMA**

One company that we, and also investors in general, would compare Delta or BUMA with would be United Tractors and its mining contracting subsidiary, PAMA. We understand that United Tractors is a more diversified company than Delta with revenue generated from three divisions, construction machinery, mining contracting, and own coal mining. Nonetheless, mining contacting unit generates 45% of revenue and 60% of EBITDA for United tractors and the fact that PAMA is the number one mining contractors in the country makes comparison with Delta, the number two, as compelling.

Figure 19

**Comparison with United Tractors**

| | 2007A | 2008A | 2009E | 2010E | 2011E |
|---|---|---|---|---|---|
| Ebitda growth (YoY) | | | | | |
| Delta | 15% | -86% | 8024% | 481% | 20% |
| BUMA | -6% | 33% | 5% | 45% | 20% |
| United Tractors | 58% | 58% | 12% | 3% | 16% |
| | | | | | |
| Net profit growth (YoY) | | | | | |
| Delta | 149% | -27% | 5350% | 515% | 26% |
| BUMA | -50% | -6% | 171% | 54% | 26% |
| United Tractors | 60% | 78% | 25% | 11% | 24% |
| | | | | | |
| ROE | | | | | |
| Delta | 2% | 1% | 42% | 99% | 62% |
| BUMA | 25% | 15% | 44% | 44% | 38% |
| United Tractors | 68% | 44% | 31% | 23% | 20% |
| | | | | | |
| PER (x) | | | | | |
| Delta | 714.0 | 834.3 | 50.8 | 8.3 | 6.5 |
| United Tractors | 26.3 | 16.0 | 13.8 | 12.5 | 10.0 |
| | | | | | |
| EV/Ebitda | | | | | |
| Delta | 92.9 | 537.0 | 29.5 | 5.0 | 4.0 |
| United Tractors | 13.0 | 8.0 | 6.9 | 6.5 | 5.3 |

Source: CLSA Asia-Pacific Markets

**BUMA could grow faster than United Tractors, but liquidity, size, and gearing suggest discount on valuations**

Trading at 2010 PE of 8.3x and EV/Ebitda of 5.0x, Delta looks cheap as compared to United Tractors that trades at 12.5x and 6.5x, respectively. Note that Delta would generate stronger profit growth for both Ebitda and net profit, as compared to United Tractors while generating higher return as well, as shown above. Nonetheless, given its lower liquidity, smaller size, and much higher leverage, we have assumed 15% discount to the target multiples of United Tractors, applied 2010 PE of 12x and EV/Ebitda of 6.0x to arrive at target price.

**A comparison with PAMA suggest similar upside to our target price**

On the table below, we have also shown the implied equity value of PAMA based on its contribution to United Tractors' total Ebitda, 60%, and net profit, 49%. We arrive at implied equity value of around US$2.2bn for 100% of PAMA. Assuming that BUMA's Ebitda and net profit are 70% to 80% of PAMA, equity value for Delta should be in a range of US$1.6bn to US$1.7bn, and therefore in line with our target price for Delta.

Figure 20

**What is implied equity value for PAMA?**

| Pama (US$m) | 2009F | 2010F |
|---|---|---|
| Revenue | 1,261 | 1,368 |
| EBIT | 229 | 238 |
| Depreciation | 146 | 150 |
| EBITDA | 374 | 388 |
| Net interest | - 14 | - 11 |
| Pre-tax profit | 215 | 228 |
| Tax | - 60 | - 57 |
| Net profit | 155 | 171 |
| | | |
| United Tractors market cap (US$m) | 4,574 | 4,574 |
| Pama net profit contribution | 44% | 49% |
| Pama implied market cap (US$m) | 2,025 | 2,225 |
| Pama implied PER (x) | 13.1 | 13.0 |
| | | |
| United Tractors EV (US$m) | 4,235 | 4,235 |
| Pama EBITDA contribution | 58% | 60% |
| Pama implied EV (US$m) | 2,442 | 2,533 |
| Net debt | 300 | 300 |
| Pama implied market cap (US$m) | 2,150 | 2,225 |
| Pama implied EV/EBITDA (x) | 6.5 | 6.5 |

Source: CLSA Asia-Pacific Markets

Figure 21

**Delta (BUMA) head to head against PAMA**

| 2010 forecast (US$m) | Delta (BUMA) | PAMA | Delta Vs PAMA |
|---|---|---|---|
| Coal production (m tonnes) | 44 | 67 | 65% |
| Coal overburden (m bcm) | 351 | 539 | 65% |
| Revenue | 784 | 1,368 | 57% |
| EBITDA | 303 | 388 | 78% |
| YoY | 45% | 4% | |
| EBITDA margin | 39% | 28% | |
| Net profit | 137 | 171 | 80% |
| YoY | 54% | 10% | |
| Net margin | 17% | 12% | |

Source: CLSA Asia-Pacific Markets

## What does DCF say?

We arrived at Rp2,800/share as our DCF estimate for Delta, 70% premium to the current share price. Our estimate is based on key assumptions that include WACC of 12% and 5% terminal growth. As shown below, our DCF estimate would be most sensitive to changes in discount rate and terminal growth assumptions, followed by changes in overburden removal assumptions.

Figure 22

**Breakdown of our DCF estimates**

| US$mn | 2010 |
|---|---|
| Sum of PV FCF | 496 |
| PV terminal value | 1,768 |
| Enterprise value | 2,265 |
| Net debt (cash) | 373 |
| Equity value | **1,900** |
| Number of shares (m) | 6,790 |
| **Equity value (Rp/share)** | **2,800** |

Source: CLSA Asia-Pacific Markets

Figure 23

**DCF sensitivity**

| Parameters | Base | New | Changes to DCF |
|---|---|---|---|
| +1% change in WACC | 2,800 | 2,400 | -14.3% |
| +1% change in terminal growth | 2,800 | 3,250 | 16.1% |
| +1% change in coal extraction | 2,800 | 2,900 | 3.6% |
| +1% change in overburden removal | 2,800 | 2,950 | 5.4% |
| +1% change unit rate for coal | 2,800 | 2,814 | 0.5% |
| +1% change unit rate for overburden | 2,800 | 2,900 | 3.6% |

Source: CLSA Asia-Pacific Markets

**Summary P&L forecast (Rpbn)**

| Year to 31 December | 2007A | 2008A | 2009CL | 2010CL | 2011CL |
|---|---|---|---|---|---|
| **Revenue** | **1,003** | **10** | **1,590** | **7,845** | **9,385** |
| Operating Ebitda | 47 | 6 | 521 | 3,028 | 3,639 |
| Operating Ebit | 10 | 6 | 321 | 2,278 | 2,739 |
| Interest income | 0 | 0 | 0 | 0 | 0 |
| Interest expense | (2) | (7) | (68) | (493) | (483) |
| Other items | 2 | 6 | 55 | 33 | 43 |
| **Profit before tax** | **10** | **6** | **308** | **1,818** | **2,299** |
| Taxation | (3) | (2) | (86) | (455) | (575) |
| Minorities and other | (2) | 0 | 0 | 0 | 0 |
| **Profit** | **6** | **4** | **222** | **1,364** | **1,724** |

**Summary cashflow forecast (Rpbn)**

| | 2007A | 2008A | 2009CL | 2010CL | 2011CL |
|---|---|---|---|---|---|
| **Operating Ebit** | **10** | **6** | **321** | **2,278** | **2,739** |
| Depreciation/amort | 37 | 0 | 200 | 750 | 900 |
| Working capital - trade | (329) | 228 | (1,180) | (158) | (189) |
| Other operating items | (47) | (100) | (362) | (437) | (223) |
| **Operating cashflow** | **(329)** | **135** | **(1,021)** | **2,433** | **3,228** |
| Net interest/taxes/other | (4) | (9) | 102 | (521) | (920) |
| **Cashflow** | **(332)** | **125** | **(919)** | **1,913** | **2,308** |
| Capital expenditure | (489) | 331 | (3,049) | (1,550) | (1,650) |
| Acq/inv/disposals | 0 | 0 | 0 | 0 | 0 |
| **Free Cashflow** | **(821)** | **456** | **(3,968)** | **363** | **658** |
| Ord div paid/Other items | 897 | (581) | 2,900 | 27 | (236) |
| Decrease in net debt | 76 | (125) | (1,068) | 390 | 422 |

**Summary balance sheet forecast (Rpbn)**

| | 2007A | 2008A | 2009CL | 2010CL | 2011CL |
|---|---|---|---|---|---|
| Cash & equivalents | 78 | 1 | 1,309 | 1,721 | 1,946 |
| Debtors - trade | 60 | 1 | 1,590 | 1,804 | 2,065 |
| Inventories - trade | 509 | 100 | 169 | 184 | 221 |
| Other current assets | 48 | 162 | 777 | 1,229 | 1,467 |
| Fixed assets | 451 | 120 | 2,970 | 3,770 | 4,520 |
| Intangible assets | 0 | 0 | 0 | 0 | 0 |
| Other term assets | 63 | 36 | 317 | 323 | 329 |
| **Total assets** | **1,209** | **420** | **7,131** | **9,031** | **10,547** |
| Short-term debt | 0 | 0 | 207 | 929 | 1,491 |
| Creditors - trade | 239 | 0 | 477 | 549 | 657 |
| Other current liabs | 1 | 0 | 257 | 683 | 822 |
| Long-term debt/CBs | 503 | 50 | 5,219 | 4,520 | 3,760 |
| Other long-term liabs | 1 | 15 | 269 | 283 | 299 |
| Minorities/other equity | 103 | 8 | 0 | 0 | 0 |
| Shareholder funds | 363 | 347 | 703 | 2,066 | 3,518 |
| **Total liabs & equity** | **1,209** | **420** | **7,131** | **9,031** | **10,547** |

**Ratio analysis**

| | 2007A | 2008A | 2009CL | 2010CL | 2011CL |
|---|---|---|---|---|---|
| Revenue growth (%) | | (99.0) | | 393.4 | 19.6 |
| Op Ebitda growth (%) | | (86.5) | | 481.1 | 20.2 |
| Op Ebit growth (%) | | (36.1) | | 609.5 | 20.2 |
| Op Ebitda margin (%) | 4.7 | 66.9 | 32.8 | 38.6 | 38.8 |
| Op Ebit margin (%) | 1.0 | 66.8 | 20.2 | 29.0 | 29.2 |
| Net profit margin (%) | 0.6 | 42.5 | 14.0 | 17.4 | 18.4 |
| Dividend payout (%) | 0.0 | 0.0 | 0.0 | 0.0 | 15.8 |
| Tax rate (%) | 25.9 | 32.3 | 28.0 | 25.0 | 25.0 |
| Ebitda/net int exp (x) | 26.6 | 1.0 | 7.6 | 6.1 | 7.5 |
| Net debt/equity (%) | 91.3 | 14.0 | 586.1 | 180.4 | 94.0 |
| Gross debt/equity (%) | 108.0 | 14.1 | 772.4 | 263.7 | 149.3 |
| Net debt/op Ebitda (x) | (1.6) | 7.7 | 2.1 | 0.2 | 0.1 |
| Gross debt/op Ebitda (x) | 10.6 | 7.8 | 10.4 | 1.8 | 1.4 |
| Return on equity (%) | | 1.1 | 42.3 | 98.5 | 61.8 |
| ROCE (%) | | 2.0 | 14.4 | 43.5 | 44.1 |
| Return on assets (%) | | 0.5 | 5.9 | 16.9 | 17.6 |

Source: CLSA Asia-Pacific Markets

**Key to CLSA investment rankings: BUY** = Expected to outperform the local market by >10%; **O-PF** = Expected to outperform the local market by 0-10%; **U-PF** = Expected to underperform the local market by 0-10%; **SELL** = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

 **Note: In the interests of timeliness, this document has not been edited.**