

CHAPTER 3

COMPANY BACKGROUND

3.1 Company Profile

PT Adaro Energy Tbk was established under name of PT Padang Karunia based on Notarial Deed No. 25 of Sukawaty Sumadi dated July 28, 2004. This deed was approved by the Minister of Justice of the Republic of Indonesia in Decree No. C-21493 HT.01.01.TH.2004 dated August 26, 2004.

Later on, for Initial Public Offering purposes, the Company changed its name from PT Padang Karunia to PT Adaro Energy during Extraordinary Shareholders Meeting dated April 17, 2008. This meeting was recorded in the Notarial Deed No. 62 of Robert Purba dated April 18, 2008.

PT Adaro Energy Tbk is Indonesia's biggest integrated coal-based energy company, focusing on coal and power business in Indonesia, integrating coal mining, mining contractor, coal logistic and infrastructure, coal trading and coal-operated power plant. Each of the operating business is positioned to be a solid and independent profit center, thus making the Company's coal a unique product and excellent services and support to customers have made the Company a world class mining and an innovative leader within the energy industry.

PT Adaro Energy Tbk operates under a Coal Cooperation Agreement with the Government of Indonesia which gives it the right to mine coal within its Agreement Area in the Tanjung district of South Kalimantan Province until the year 2022 with Rights to extend by mutual agreement are available.

There are three deposits within the Agreement Area which contain total coal resources of approximately 2.8 billion tons of open cut coal characterized by extremely thick seams of up to 50 meters with relatively low overburden. Production commenced in 1991 and has increased steadily since that time with sales to both export and domestic markets reaching 36.1 million tons in 2007 making PT Adaro Energy Tbk's largest coal producer from a single mine.

Currently PT Adaro Energy Tbk consists of three main business activities. First, PT Adaro Indonesia and Coaltrade International Services Pte Ltd that operates in coal mining and trading. Second, PT Sapta Indra Sejati and PT

Indonesia Bulk Terminal that operates in logistic, infrastructure and mining services. Third, PT Makmur Sejahtera Wisesa and PT Jasa Power Indonesia that operates in power plant. Each unit is positioned to be an independent profit centre enabling the Company to have a reliable and competitive coal supply chain which will create optimum value added for its stakeholders.

3.2 Vision and Mission

PT Adaro Energy Tbk aims to be the largest and most efficient integrated coal mining and energy company in South East Asia. PT Adaro Energy Tbk has several missions to make sure the Company's vision is achievable as follows:

- Mineable coal reserves of approximately 928 million tons
- Integrated and reliable coal supply chain
- World class customers base

3.3 Organization Structure

Based on Notarial Deed No. 62 of Robert Purba, S.H. dated April 18, 2008 the Company's Board of Directors and Board of Commissioners was as follow:

Board of Commissioners:

President Commissioner : Mr. Edwin Soeryadjaya
 Vice President Commissioner: Mr. Theodore Permadi Rachmat
 Commissioner : Mr. Subianto
 Independent Commissioner : Mr. Djoko Suyanto
 Independent Commissioner : Mr. Palgunadi T. Setyawan

Board of Directors:

President Director : Mr. Garibaldi Thohir
 Vice President Director : Mr. Christian Ariano Rachmat
 Director : Mr. Sandiaga Salahuddin Uno
 Director : Mr. Andre Johannes Mamuaya
 Unaffiliated Director : Mr. Ah Hoo Chia
 Unaffiliated Director : Mr. David Tendian
 Unaffiliated Director : Mr. Alastair Bruce Grant

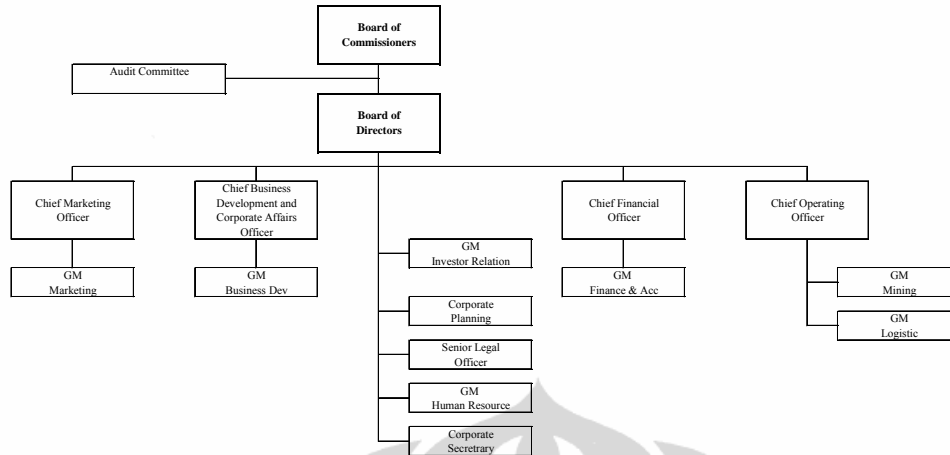


Figure 3.1. Organization Structure

Sources: November 4, 2008. <http://www.adaro.com/content.php?channel=contents&cid=4&scid=8>

3.4 Business Activities

The coal exporting countries are expanding their production volumes due to the increasing global demand on alternative energy resources. Due to increasing mine costs, tighter SO₂ emissions regulations and higher global demand, coal prices have become more volatile since 2000. The demand for environmental friendly coal has been increasing throughout Europe, Asia and America for use in industrial centers where environmental restrictions are stringently controlled or as a blending coal with more common high ash, high sulphur coals and results have consistently shown considerable environmental, economic and technical benefits from its utilization.

As mentioned earlier, PT Adaro Energy Tbk consists of three main business activities that support the coal mining activities. These strategic business units have opportunities to grow alongside with the increasing global demand on coal products and hence create a synergy between the three main activities of the Company. Here are the brief explanations for each of the business activities.

3.4.1 Coal Mining and Trading

PT Adaro Indonesia is one of the world's largest coal producers with major sales to both domestic and international customers. The Company has been mining coal since 1991 and has steadily expanded its market reaching sales of 36.1 million tons in 2007.

PT Adaro Indonesia's coal is one of the cleanest fossil fuels in the world because of its very low sulphur, ash and nitrogen contents and has been trademarked internationally as Envirocoal. The coal is widely used in countries with strict environmental regulations either as a direct feed or to blend with other coals to improve their environmental qualities, with more than 50 major utilities in 18 countries worldwide now using Envirocoal. PT Adaro Indonesia is also the largest supplier to the Indonesia domestic market with sales of 10 million tons in 2007.

Envirocoal is mined by open cut methods from PT Adaro Indonesia's resource area near Tanjung in South Kalimantan. In support of its coal sales, PT Adaro Indonesia provides a wide range of services and technical assistance to customers and prospective clients through representatives in most coal importing countries worldwide.

Coaltrade International Services Pte Ltd, a Singapore based coal trading company, was established in 2000 to participate in this growing trade thermal coal with emphasis on sourcing from Indonesia. The company has specialized in trading of Indonesia's sub-bituminous ultra clean coal's as it was recognized that there was a growing global market for this type of coal.

Coaltrade International Services Pte Ltd also work closely with terminal operator such as PT Indonesia Bulk Terminal, who has the capacity to stockpile and blend coal and by using the facilities, Coaltrade International Services Pte Ltd can supply coal from a variety of producers and blend to meet customer's strict quality requirements.

3.4.2 Logistic, Infrastructure and Mining Services

Since the re-emerge of coal mining in Indonesia in late 1980's, contract mining has played an important role in the industry, assisting many producers where mining companies do not have the internal resources in mining equipment and manpower to support developments.

PT Sapta Indra Sejati, a mining contractor company that was established in 2000 and has grown to become Indonesia's third largest company in this service sector with the country's major coal producers being amongst its clients. PT Sapta

Indra Sejati started its commercial operations in April 2002. PT Sapta Indra Sejati currently handling around 22 percent of PT Adaro Indonesia's production and plans to gradually increase to 50 percent of the future production.

While PT Sapta Indra Sejati focuses on contract mining, the Company also provides other services to the mining industry including exploration and mine planning, infrastructural engineering and development and logistic support. With a dedicated and highly skilled workforce of more than 2,000 and a large fleet of heavy equipment, PT Sapta Indra Sejati is more than able to meet the challenges faced daily in today's demanding mining environment.

PT Indonesia Bulk Terminal is the developer and operator of a major coal terminal on the southern tip of Pulau Laut, a large island located of South Kalimantan. With its strategic location, PT Indonesia Bulk Terminal's coal terminal not only offer a secure, reliable and sustainable source of supply, but also a cost effective means of blending and loading Indonesian coal to meet this demand.

PT Indonesia Bulk Terminal currently has an annual capacity of approximately 12 million tons. The Company also in the process of building and operating fuel storage and handling facility with capacity of 60 million liters. This facility will be used to support and secure fuel requirement in PT Adaro Energy Tbk's operations.

3.4.3 Power Plant

PT Makmur Sejahtera Wisesa is a specialist power development company, established in 2001 which is now developing a 60 Mega Watts coal fired power station near Tanjung, South Kalimantan, in support of coal mine production and infrastructural growth from PT Adaro Indonesia and other developing coal mines in the area.

The project will be a mine mouth development which will utilize low grade, ultra clean coal from PT Adaro Indonesia's massive Wara deposit under a long term fuel supply agreement. The Wara deposit is a large resource of lower heat value sub-bituminous coal which located in South Kalimantan.

The project is being supported by the International Finance Corporation and is scheduled to commence construction by mid 2008 and be in commercial operation before the end of 2010 when the first power will be required for a 70 km overland conveyor which will become the main transport system for moving PT Adaro Indonesia's coal to the Barito River with annual capacity of 40 million tons.

Besides providing electricity to PT Adaro Indonesia, the power plant will also be linked to the local electricity network and will provide approximately 10 percent of its power output to augment the power supply to local villages and town that currently comes from PT Perusahaan Listrik Negara (PLN), a state-owned company that provides electricity, operated small diesel fuelled power stations.

PT Jasa Power Indonesia is an independent coal fired power production company. Coal for PT Jasa Power Indonesia's projects will come from low rank coal reserves currently being developed within the Group's mining operations. Use of this coal will not only provide long term fuel supply security to its projects, but it will substantially increase production from the country's huge low rank coal reserves which have been greatly under-utilized to date.

3.5 Business Industry

Indonesia is the world's third largest exporter of steaming coal after Australia and China. In addition to that, Indonesia is one of the leading exporters of sub-bituminous coal which represents the bulk of Indonesian coal production. Indonesia's coal production rose by 11.1 percent in 2003 to 114.6 million tons and exports increased by 18.3 percent to 85.7 million tons. Indonesia has approximately 35 billion tons of coal resources, of which 23 billion tons is proven. Most of Indonesia's coal reserves are situated in Kalimantan. Coal quality varies, with lower grade lignite (59 percent), sub bituminous (27 percent) and high grade bituminous and anthracite (14 percent).

PT Adaro Energy Tbk will be focusing on coal industry by maintaining sales to customers under term contracts of one year or longer in order to guarantee the highest level of customer support in handling, storage and utilization of

Envirocoal. Partnership relationships are sought with clear communications between PT Adaro Energy Tbk and its customers.

PT Adaro Energy Tbk will continue to focus on increased productivity, enhancement of mining practices including environmental rehabilitation and workforce training and development to ensure that PT Adaro Energy Tbk's standards continue to meet international best mining practices. The Company will also continue to expand its community development programs to ensure that long term sustainability of local economies is guaranteed.

Local main competitor of PT Adaro Energy Tbk is PT Bumi Resources Tbk who owns PT Kaltim Prima Coal and PT Arutmin Indonesia, both are coal producers, with combined coal reserves of 1.4 billion tons. PT Bumi Resources Tbk, owned by Bakrie Group, is the largest coal producer in Indonesia and currently controls 10% of global coal market share. PT Bumi Resources Tbk also has market capitalization of USD 14 billion, only second after PT Telekomunikasi Indonesia Tbk (Telkom) of USD19 billion.

3.6 Business Strategies

PT Adaro Energy Tbk has 5 main business strategies as follows:

- a) Cost efficiency
- b) Infrastructure development
- c) Develop long-term customers
- d) Strong community development programs
- e) Increase proven reserves

In order to create and sustain growth, PT Adaro Energy Tbk also has 3 main areas to develop. First, production and trading growth, where the Company plans to expand its coal production from 40 million tons to 80 million tons in the next 5 years. Second, acquisition, where the Company continuously search for and conduct attractive acquisitions in coal related resources, mining services, logistics and infrastructure. Third, value added products, where the Company will be continuing in upgrading brown coal, Coal Bed Methane (CBM), coal liquefaction and power generation.

3.7 Pricing Calculation

International coal prices come from negotiation between buyers and sellers. From the buyer side, the price represents equilibrium between the coal demands from the buyer with the coal supply availability from the coal producers and variations on other low cost coal supplies. On the other hand, from the seller side, the price represents the margins required by the coal producers to satisfy the stockholders are met and to make sure that they have enough funds for new investments. In short-run, the main factor in the coal price calculation is the perception of the supply and demand equilibrium, while in long-run the coal price depends on the cost of production.

In Indonesia, the coal price is usually follows Australian Barlow Jonker and ACR Asian index. The coal price calculation depends on the energy level from the coal, where current defined price is set at 6,700 kcal/kg airdried basis and after that is adjusted using prorated method.

Based on current higher demand on environmental friendly coal and due to the limitation of coal resources, Barlow Jonker predicts that in the next 10 to 15 years the environmental friendly coal price is still command premium price. This will certainly impact positively on coal producer companies in Indonesia and Asia.

During the period of PT Adaro Energy Tbk's Initial Public Offering, the coal price fall from USD194 per ton to USD180 per ton in the beginning of the July to mid July respectively. Some analysts predict that the coal price will continue to decrease in the future due to the lowering oil prices.

However, PT Adaro Energy Tbk still believes that the coal price decrease will not heavily impact on the financial performance of the Company due to the projected 2008 and 2009 coal prices are set around USD45 per ton and USD58 per ton respectively. This will leave pretty much room for the Company to absorb coal price decrease.

The sales in the first semester of 2008 amounting to USD725 million are already in line with the Company's projection or increase 10.6 percent compared to 2007 first semester performance.

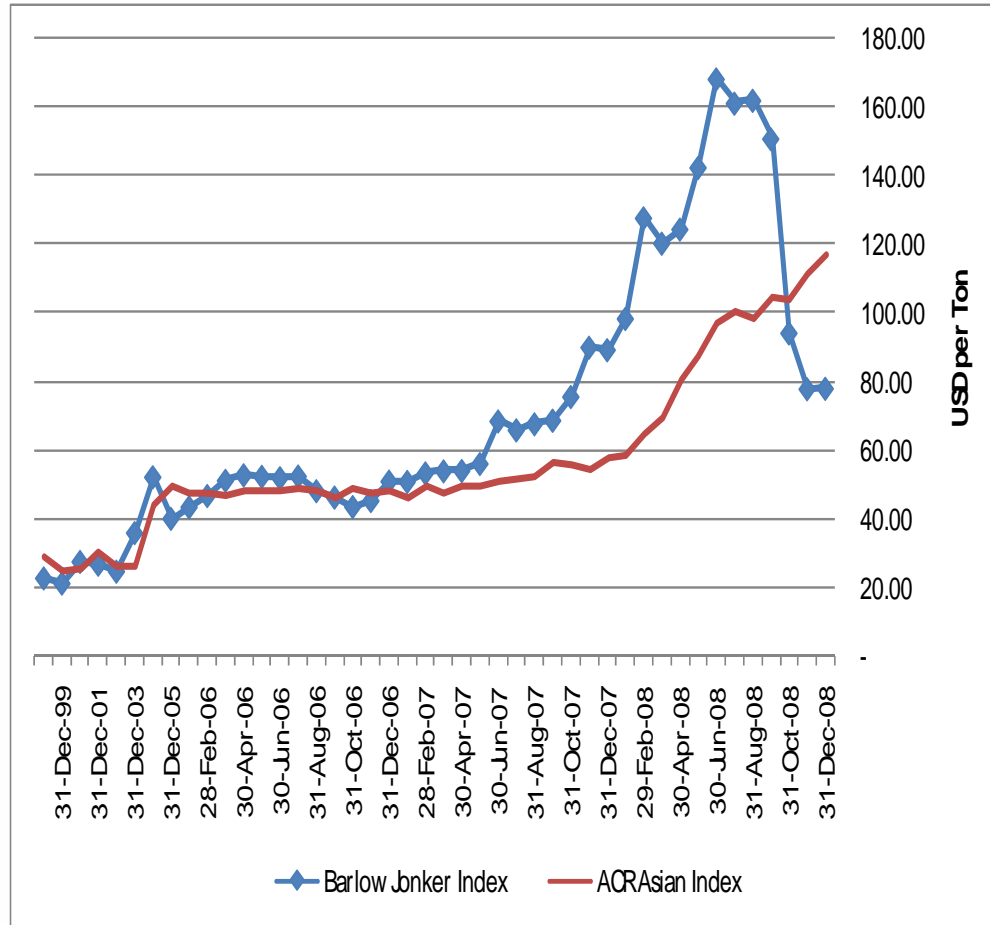


Figure 3.2. Month End Coal Prices from 1998 to 2008

Sources: November 25, 2008. <http://www.coalportal.com/indices.cfm>

3.8 Business Risks

Before making any investments on public listed company, investors must understand that most of business operations are depending on a lot of external factors that are not within the control of the company. Therefore, analyzing those business risks is a must for new investors, otherwise if one of the risks materialized, the price of the share will decrease and creating losses to the investors.

On day-to-day operations itself, PT Adaro Energy Tbk and its subsidiaries have other business risks that must be anticipated and carefully dealt with or otherwise it could negatively affected the margins of the Company and its subsidiaries.

Business risks that affected PT Adaro Energy Tbk and its subsidiaries can be classified as follow:

- a) Risk related to sales and market condition
 - Coal price fluctuation that extremely impact on the revenues of the Company.
 - Business competition.
 - Loss on contract deals with existing customers.

- b) Risk related to production activities
 - The dependency of the Company and its subsidiaries to existing contractors.
 - The dependency of the Company and its subsidiaries to main installation, equipments, production facilities and other supporting facilities to run the mining site and other operations.
 - The ability of the Company and its subsidiaries to get and main the supply of fuel, spare parts and other materials that support the operations.
 - Fuel price increase.
 - The limitation of services and transportation infrastructure that could unfavorably impact on coal distribution and other operational activities.
 - The coal mining site is located on remote area.
 - Natural disasters, climate and accidents.
 - The real coal production could differ from the projection because of changes in geology estimation.
 - The proven and probable coal reserves are derived from appraisal and estimation based on science, knowledge and industry practices where every adjustment on the proven and probable coal reserves estimation could negatively impact on future projection and development of mining operations of the Company.

- c) Risk related to provisions of the Law and Social Environment
- Based on certain condition, Perjanjian Karya Pengusahaan Pertambangan Batubara (PKP2B) that gives the mining authority to the Company could be terminated or suspended by the government.
 - One of the Company's subsidiaries in coal mining operations has net off its royalty payable against prepaid Value Added Tax. However this treatment could be rejected by the government.
 - The government could adjust the tax liability of the Company.
 - The Company's subsidiary in coal mining operations is bounded by forest and environmental laws.
 - Risk on mining area border due to the Company's subsidiary in coal mining operations is located near other mining and non mining areas.
 - The ongoing concern of the Company and its subsidiaries lie in the ability to obtain, maintain and renew the mining rights and other licenses.
 - New laws and regulations on mining, environment, custom, sea shipment, finance, forest and others; or new interpretations and implementations of those laws and regulations could adversely impact on licenses and operations of the Company and its subsidiaries.
 - Relationship with the society within the area of the operations.
 - Based on Perjanjian Karya Pengusahaan Pertambangan Batubara (PKP2B) regulations, every fixed asset purchased for the mining activities and the coal reserves are owned by the government.
- d) Risk related to Company Management
- The dependency of the Company to its subsidiaries.
 - There are lawsuits against one of the Company's subsidiaries, PT Dianlia Setyamukti, over the legitimacy of PT Adaro Indonesia and PT Indonesia Bulk Terminal takeover.

- The ability of the Company and its subsidiaries to operate effectively could be jeopardized by losing its key employees or if the Company and its subsidiaries could not recruit and maintain skilled labors.
- Foreign exchange exposures on the consolidated financial statements of the Company.
- Interest rate fluctuation on loan in subsidiaries.
- Control by the Ultimate Shareholders.

3.9 Notes on Initial Public Offering

PT Adaro Energy Tbk's success in USD1.32 billion Initial Public Offering deal, on 11.14 billion shares offered, was back up by five times oversubscription during its offering period. Moreover, several big foreign investors active in Asia have grumbled that they were shut out of Indonesia's biggest-ever IPO despite heavy overseas interest in what is seen as an attractively priced deal.

PT Danatama Makmur, the lead underwriter, has succeeded to sell 74.77 percent and 25.23 percent of the shares to foreign and domestic investors respectively. Most of those shares have been allocated to a number of parties connected to the company, including five firms who had stakes in PT Adaro Energy Tbk's coal mining unit, PT Adaro Indonesia. They are Farallon Capital Management LLC, Shamrock Mineral Corporation (Kerry Coal), the Government of Singapore Investment Corp (GIC), Citigroup and Goldman Sachs.

Those five firms hold 69.15 percent of the total shares offered, while retail investors hold 4.01 percent of the share, leaving the rest of 26.84 percent of the shares allocated to domestic and international institutional shareholders including mutual funds, asset management, insurance companies and pension funds.

The road to Initial Public Offering itself is not smooth from the start. There are three major issues concerning the coal royalties, transfer pricing and ownership of PT Adaro Energy Tbk itself. None of those issues were settled when the shares start trading in the Indonesia Stock Exchange (IDX) on July 16, 2008.

First issue about the coal royalties amounting to IDR150 billion are payable to Indonesia government for mining the coal resources. The Company has defended their decision not to pay the royalties, citing that the government has not

reimbursed them the Value Added Tax (VAT) as they are required to do so under the contract. The coal royalties were finally paid by the Company to the government on September 2, 2008 or 2 months after the Initial Public Offering.

Second issue about the transfer pricing that results in tax shortfall amounting to USD93.5 million is payable to the tax office. The shortfall mainly comes from lower-than-market price for coal sales to Coaltrade International Services Pte Ltd, PT Adaro Energy Tbk's affiliated trading company based in Singapore. The tax office stated that coal mining companies are not allowed to sell their output, at below market price, to affiliated trading companies. The tax office stated that the maximum price difference allowed is only 5%. The company has already paid USD44 million and will pay the remaining balance before the end of this year.

Third issue about PT Adaro Energy Tbk's ownership has been the subject of a decade-long bitter legal dispute between two of Indonesia's wealthiest businessmen, pulp and paper tycoon Mr. Sukanto Tanoto and investor Mr. Edwin Soeryadjaya. Deutsche Bank, which had held a stake in PT Adaro Indonesia as collateral for a loan to a Tanoto linked firm, sold the shares when the borrower defaulted during the 1997 - 1998 financial crisis to several companies, one of them is PT Dianlia Setyamukti, a Soeryadjaya linked firm.

Beckett Pte Ltd, Mr. Sukanto Tanoto's Singapore-based investment firm, took Deutsche Bank to court over the deal in a bid to recover the PT Adaro Indonesia stake. However on September 21, 2007 Singapore's High Court ruled that Deutsche Bank did not conspire to sell the shares for less than they were worth. Mr Sukanto Tanoto is now appealing that decision.