

Erajaya Swasembada Tbk (ERAA IJ)

Focuses on Strategic Growth Drivers

ERAA is a company whose business segments cover importing, distributing, and retail trading of varied brands of telecommunication devices, excluding local brands. To date, sales of smartphones are the first-largest contributor to revenues. Varied IoT products sold by ERAA have promising sales prospect as the digital ecosystem is today's world face.

Initiative Coverage of Buy Rating with the Price Target of IDR2,000 over PT Erajaya Swasembada Tbk (ERAA)

Our price target is based on the valuation estimate of a 19.1x P/E forward with the potential yield of 19.0% from the current stock price. Until 3Q19, ERAA was still the market leader in Indonesia as it dominated ~35% telecommunication-device market share. We are certain that its domination is supported by the successful sales of Chinese smartphone brands to win consumers' preference due to their affordable selling prices. It aggressively expands businesses by means of setting certain number of to be launched stores per year. Besides, IoT products to have a niche market are potential for significant growth as 4.0 digital revolution is today's face. Acknowledging the positive sentiments, we estimate ERAA to be capable of leveraging profitability along with the implementation of IMEI to actively take into force in 2020. Risks posed by our target price are soft consumption, black-market access, lower-than-estimate sales, lenient IME regulation.

WhatsApp Stops Supporting Some Operating Systems: A Boost for Earnings

WhatsApp, the most popular messaging application, on February 01, 2020 no longer supported smartphones operating systems of which are Windows, Android 2.3.7 Gingerbread, Apple iOS 7, and Apple iOS8. WhatsApp official withdrawal from some older mobile phones' operating systems is strengthened by the fact noting 0.3% of 2.5 billion people worldwide still use mobile phones supported with Android Gingerbread system, according to Google Android's mobile distribution number. WhatsApp warned its users to renew their smartphones' operating systems or buy smartphones with the latest operating systems. The later option stands for ERAA's benefit as ERAA can sell affordable smartphones with the latest operating systems targeting the low-end consumers.

IMEI Implementation Benefits ERAA

The Indonesian government, on October 18, 2019, enacted the Regulation of Minister of Communication and Information Number 11 Year of 2019 on Bans on illegal mobile phones distributed via black markets (BMs) by means of IMEI's number identification. The regulation takes into force on April 18, 2020 or six months after the official enactment. The Indonesia Cell Phone Association (APSI) states that 20% of total mobile phones sales in Indonesia have ASP to hover at IDR2.5 million; thus, we view that the prevailing IMEI regulation will benefit ERAA in term of smartphones sales growth with the rising ASP for FY20F to fall short in the range of IDR2.1 million from IDR1.8 million in 3Q19.

PT Erajaya Swasembada Tbk | Summary

	2018A	2019E	2020F	2021F
Sales	34,744	33,456	38,275	46,625
Growth (%)	43.4%	-3.7%	14.4%	21.8%
EBIT	1,527	792	816	974
Net Profit	846	331	374	493
EPS (IDR)	265	104	117	155
P/E	0.7x	0.6x	0.6x	0.6x
P/BV	0.5x	0.5x	0.4x	0.3x
EV/EBITDA	19.2x	5.5x	11.7x	12.9x
ROE (%)	17.2%	6.4%	6.9%	8.3%
ROA (%)	7.3%	2.9%	2.8%	3.3%
Dividend Yield	1.7%	3.3%	2.6%	3.1%

Unit: IDR bn, %, x

Source: Company Data, Bloomberg, NHKSI Research

Please consider the rating criteria & important disclaimer

Initiation Report | Feb. 17, 2019

BUY

Dec. 2020 Price Target (IDR)	2,000
Consensus Price (IDR)	1,982
TP to Consensus Price	0.9%
vs. Last Price	19.00%

Shares data

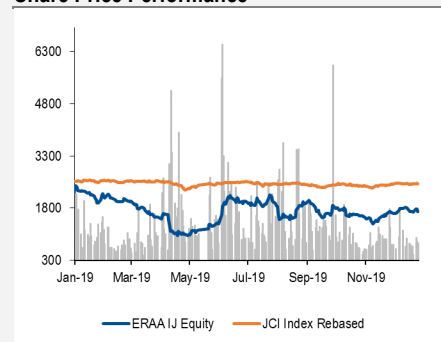
Last Price (IDR)	1,680
Price Date as of	Jan. 17, 2020
52 wk Range (Hi/Lo)	3,280 / 497
Free Float (%)	45.20
Outstanding sh.(mn)	3,190
Market Cap (IDR bn)	5,423
Market Cap (USD mn)	397
Avg. Trd Vol - 3M (mn)	21.63
Avg. Trd Val - 3M (bn)	36.07
Foreign Ownership	6.8%

Consumer Goods Industry

Cosmetics and Household

Bloomberg	ERAA IJ
Reuters	ERAAJK

Share Price Performance



	YTD	1M	3M	12M
Abs. Ret.	-7.1%	-0.6%	5.6%	-33.3%
Rel. Ret.	-7.1%	-1.7%	3.6%	-31.4%

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Summary of Financials

INCOME STATEMENT

(IDR bn)	2018/12A	2019/12F	2020/12F	2021/12F
Sales	34.744	34.348	38.756	44.511
<i>Growth</i>	43,4%	-1,1%	12,8%	14,8%
COGS	(31.575)	(31.627)	(35.732)	(41.083)
Gross Profit	3.169	2.721	3.025	3.427
<i>Gross Margin</i>	9,1%	7,9%	7,8%	7,7%
Operating Expenses	(1.852)	(2.198)	(2.491)	(2.855)
EBIT	1.527	819	826	933
<i>EBIT Margin</i>	4,4%	2,4%	2,1%	2,1%
Depreciation	90	108	128	93
EBITDA	673	1.617	928	954
Interest Expenses	(349)	(331)	(293)	(276)
EBT	1.199	504	534	656
Income Tax	(314)	(138)	(148)	(180)
Minority Interest	(39)	(14)	(4)	(12)
Net Profit	846	352	381	465
<i>Growth</i>	149,2%	-58,4%	8,2%	21,9%
<i>Net Profit Margin</i>	2,4%	1,0%	1,0%	1,0%

PROFITABILITY & STABILITY

	2018/12A	2019/12F	2020/12F	2021/12F
ROE	17,1%	6,8%	7,0%	7,9%
ROA	7,2%	3,1%	2,9%	3,3%
ROIC	6,6%	4,5%	4,2%	4,4%
Cash Dividend (IDR bn)	110	160	135	144
Dividend Yield	1,73%	3,27%	2,77%	2,96%
Payout Ratio	13%	19%	38%	38%
DER	33,8%	23,2%	15,9%	12,7%
Net Gearing	105%	58%	43%	36%
LT Debt to Equity	0,0%	0,0%	0,0%	0,0%
Capitalization Ratio	25,2%	18,8%	13,7%	11,3%
Debt Ratio	33,8%	23,2%	15,9%	12,7%
Financial Leverage	237,6%	223,4%	238,9%	240,4%
Current Ratio	129,9%	143,6%	132,8%	126,3%
Par Value (IDR)	100	100	100	100
Total Shares (mn)	2.900	2.900	2.900	2.900
Share Price (IDR)	2.200	1.680	1.680	1.680
Market Cap (IDR tn)	6,4	4,9	4,9	4,9

BALANCE SHEET

(IDR bn)	2018/12A	2019/12F	2020/12F	2021/12F
Cash	272	1.312	2.849	4.262
Receivables	1.417	1.739	1.531	1.273
Inventories	6.795	2.773	2.408	2.094
Total Current Assets	10.054	7.949	9.071	9.943
Net Fixed Assets	554	629	693	792
Other Non Current Asset	2.076	2.179	2.557	2.982
Total Assets	12.683	10.757	12.321	13.717
Payables	2.807	2.102	3.772	4.895
ST Bank Loan	4.284	2.495	1.957	1.739
LT Debt	-	-	-	-
Total Liabilities	7.857	5.716	7.032	8.106
Capital Stock + APIC	2.189	2.189	2.189	2.189
Retained Earnings	2.484	2.678	2.926	3.248
Shareholders' Equity	12.683	10.757	12.322	13.717

VALUATION INDEX

	2018/12A	2019/12F	2020/12F	2021/12F
Price/Earnings	0,7x	0,6x	0,6x	0,6x
Price/Book Value	0,5x	0,5x	0,4x	0,4x
Price/Sales	0,2x	0,1x	0,1x	0,1x
PE/EPS Growth	0,0x	0,0x	0,1x	0,0x
EV/EBITDA	19,2x	5,6x	11,3x	12,4x
EV/EBIT	8,5x	11,0x	12,7x	12,7x
EV (IDR bn)	12.950	9.001	10.524	11.857
Sales CAGR (3-Yr)	-	-	-	9,0%
EPS CAGR (3-Yr)	-	-	-	-18,1%
Basic EPS (IDR)	3.000	3.000	3.000	3.000
Diluted EPS (IDR)	3.000	3.000	3.000	3.000
BVPS (IDR)	4.373	3.709	4.249	4.730
Sales PS (IDR)	11.981	11.844	13.364	15.349
DPS (IDR)	38	55	46	50

CASH FLOW STATEMENT

(IDR bn)	2018/12A	2019/12F	2020/12F	2021/12F
Operating Cash Flow	(8.951)	5.660	2.755	2.363
Investing Cash Flow	(995)	(1.014)	(546)	(585)
Financing Cash Flow	8.943	(3.515)	(672)	(364)
Net Changes in Cash	(1.004)	1.130	1.537	1.414

Source: Company Data, NHKSI Research

TOP OWNERSHIP

By Geography	% Shareholders	%
Indonesia	93,2	PT Eralink International
United States	3,8	Dimensional Fund
United Kingdom	0,9	St James's Place PLC
Unknown	2,1	Schroder Investment

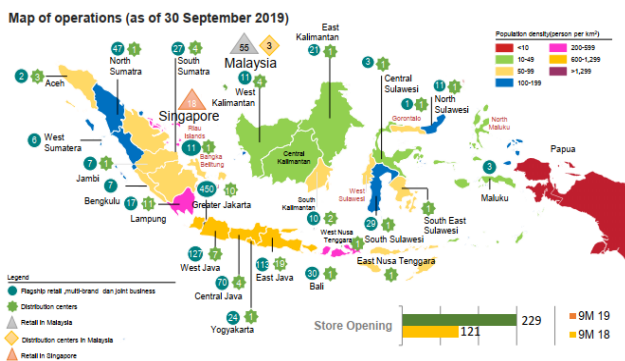
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Company Background

Established in 1996, PT Erajaya Swasembada Tbk (ERAA) is a leading retailer and distributor of mobile phones, IoT products, gadget and accessories. It also provides such value added services as TecProtec, a mobile protection, and mobile financing services in collaboration with financing companies. To date, ERAA dominates ~35% Indonesia’s market share with more than 1,100 stores, 83 distribution centres, and ~60,000 third-party resellers. ERAA as the leading retailer holds many educative and promotional events such as iBoxing Week, Gadget Invasion Week, Indocomtech, Pekan Raya Jakarta. In 2019, Samsung tied collaboration with Erajaya Group to hold the first Galaxy Land.

ERAA’s Operational Map



Source: Company Data, NHKSI Research

ERAA’s Events



Source: Company Data, NHKSI Research

ERAA Has Sorts of Business Portfolios

ERAA has such various store formats as Erafone Multibrand stores to sell imported smartphones in Monobrand stores (i.e., iBox, Samsung Experience Store, and Mi Store) and continues to expand retail networks across Indonesia. Besides, it aggressively penetrates retail markets in Singapore, Malaysia through Mi Authorized Stores, Huawei, Samsung Experience, Urban Republic, Erafone, and Singtel. It provides brick-and-mortar stores and virtual stores (i.e., Erafone.com to sell varied telecommunication devices, iBox.co.id to sell Apple’s telecommunication devices and accessories; and mi.co.id to sell Xiaomi’s products). To date, ERAA has 5 diversified business portfolios subsuming mobile handsets—the first’s contributor to revenues—IoT products, accessories, mobile vouchers, and contents.

ERAA’s Business Models

Mobile Communication User	
Apple	Oppo
Asus	Realme
Huawei	Samsung
Lenovo	Sony
LG	Smartfren
Motorola	Vivo
Nokia	Xiaomi

Mobile Operator Products & Content
Indosat Ooredoo
Telkomsel
XL Axiata

Lifestyle Accessories
Accessories
Internet of Things (IoT)

Source: Company Data, NHKSI Research

Company Background

ERAA's Retail Format

Erafone Megastore 3.0 in Bali



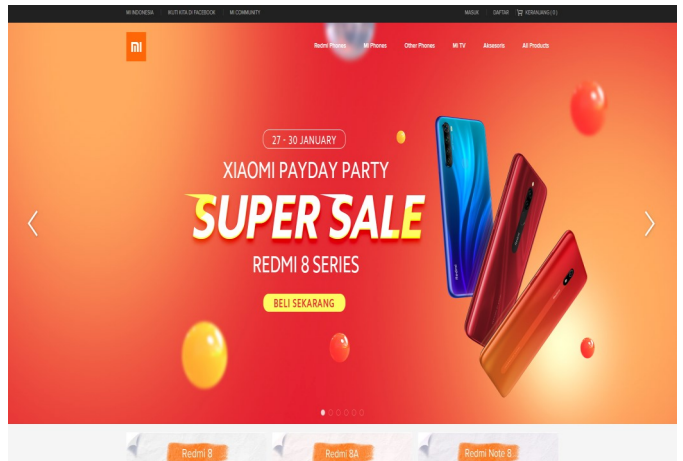
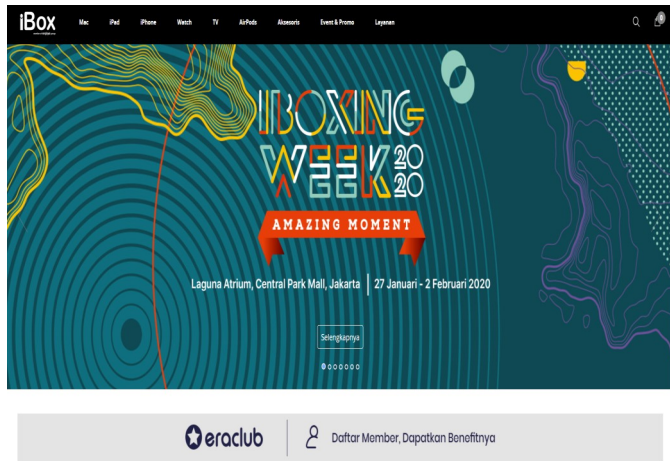
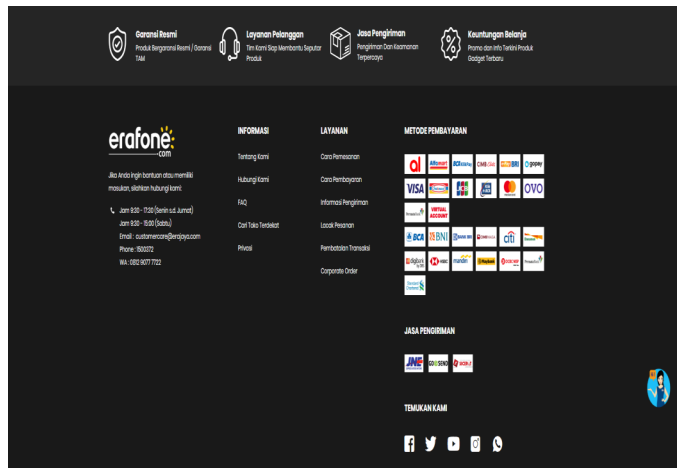
Source: Company Data, NHKSI Research

iBox Flagship Store at Senayan City



Source: Company Data, NHKSI Research

ERAA's E-Commerce

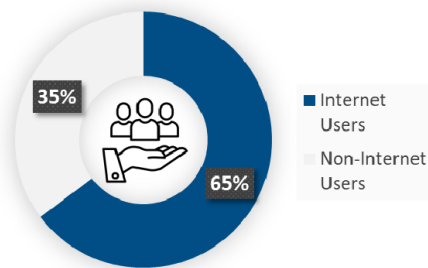


Industry Overview

Telecommunications Industry Occupies Greater Growth Opportunities

The 2020's telecommunication industry is estimated to grow by 5%-6% due to high demands for data services or internet providers. The Indonesia Cellular Telecommunications Association (ATSI) in 2018 estimated the average data usage to reach 3.5 gigabytes (GB) per month. The number grew higher to 4.8 GB in 2019 and is predicted to reach 6 GB in 2021. The rising demands for data services are driven by digital-based broad service coverage to include video streaming, e-commerce, and social media. Besides, a recent survey by the Indonesian Association of Internet Service Providers reveals that the Indonesia population to total 264.16 million people only account for 171.17 million internet users equal to 64.8%. The survey proves that many Indonesian still live with no internet access; that hinders the telecommunication industry to occupy greater rooms for growth. Another fact is internet users in Java Island to outnumber that of in other islands.

Indonesia's Internet Penetration



Source: Association of Internet Service Providers, NHKSI

Internet User Contribution per Region

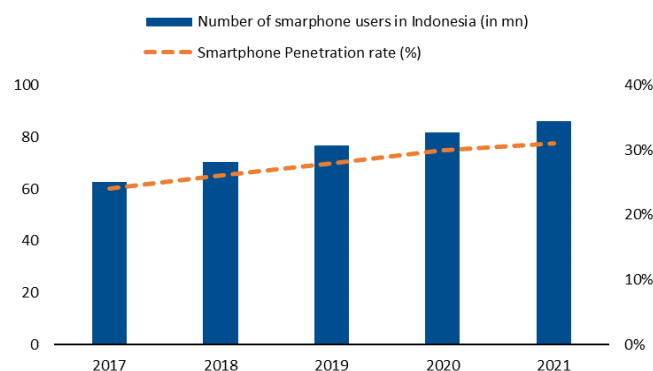
Regions	Percentage of Indonesian Internet Users
Java	55,70%
Sumatra	21,60%
Sulawesi, Maluku, Papua	10,90%
Kalimantan	6,60%
Bali, Nusa Tenggara	5,20%

Source: Association of Internet Service Providers, NHKSI Research

Chinese Smartphones Dominates Indonesia's Market Share

Smartphone users in Indonesia increase annually because smartphones with updated OS tech. and more attractive features keep flocking the markets. Their selling prices are mostly affordable so that all income segment can afford them. Canalis, in 3Q19, reported Indonesia's smartphone market share to post 11.5 million shipments or an annual increase of 29% , and Chinese-imported smartphones, Oppo and Xiaomi won the second-largest market share in Indonesia so that both brands kicked Samsung from its former first position. Chinese smartphone vendors beat other foreign vendors because they control the prices of smartphones sold in brick-and-mortar stores and virtual spaces.

Number of Smartphone Users in Indonesia



Source: Statista, NHKSI Research

Indonesia Smartphone Shipments of 3Q19

Vendor	3Q19 Shipments (in mn)	3Q19 Market Share	3Q18 Shipments (in mn)	3Q18 Market Share
Oppo	2,6	22,70%	1,8	20%
Xiaomi	2,5	21,60%	2	22,80%
Samsung	2,4	21,20%	2,1	23,60%
Vivo	1,9	16,60%	1,1	12,30%
Realme	1,3	11,20%	0	0%
Others	0,8	6,70%	1,9	21,30%
Total	11,5	100%	8,9	100%

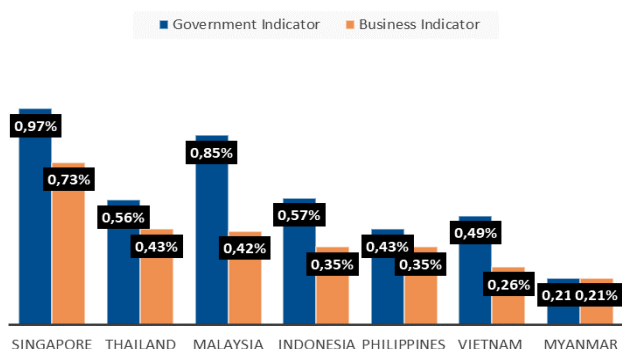
Source: Canalis Smartphone Analysis, NHKSI Research

Industry Overview

IoT Is Potential for Growth

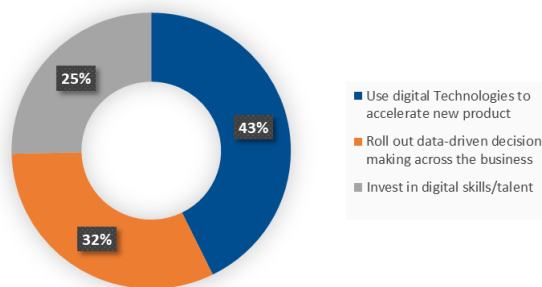
A.T. Kearney elaborates the 5 main tech. development in the 4.0 Industry system to cover Artificial Intelligence (AI), Internet of Things (IoT), Wearable (AR / VR), advanced robotics, and 3D Printings. The development of Making Indonesia 4.0 will be a potent driver for Indonesia to position as the world's 10 developed economies in 2030 as Indonesia is a lucrative smartphone market share for long-term periods. Asia IoT Business Platform (AIBP) research explains IoT products in Indonesia's market to be less than 10% at the early of 2019, while Indonesia's Association of Internet of Things explains IoT's 2020 market valuation to hover at IDR400 trillion or a significant increase from IDR100 trillion in 2019.

2019's Digital Adoption Index



Source: Asia IoT Business Platform, NHKSI Research

Top 3 Digital Transformation Priorities

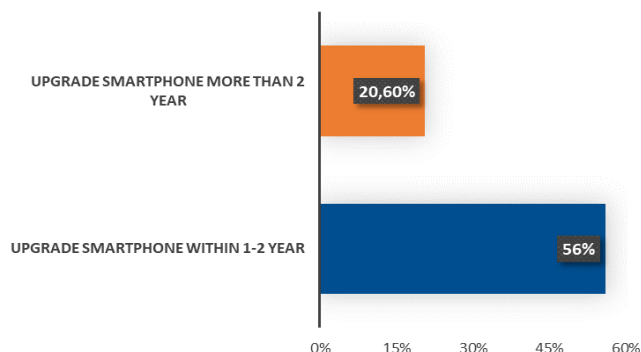


Source: Asia IoT Business Platform, NHKSI Research

Researches Reveal Average Lifespan of Smartphones

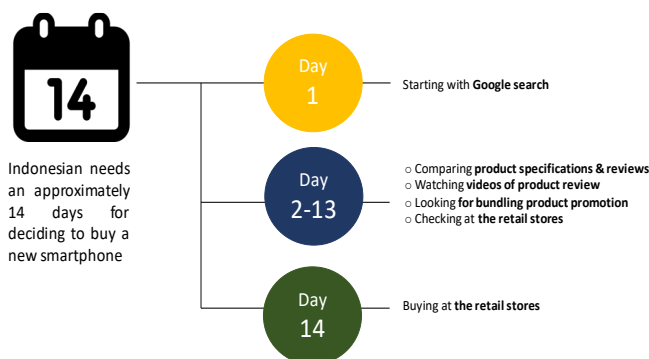
Counterpoint research analyzes Indonesia's smartphone market on an annual basis to grow by 7% in 3Q19 and Chinese smartphones to still dominate 65% of Indonesia's smartphone market share. The aggressive online marketing by means of various promotions and selling affordable ones is a strategy for dominating Indonesia's market share and beating Indonesian products. Indeed, Mars, a research agency, informs smartphones to have one to two years of lifespan as 56% Indonesian buyers will buy new ones after that average lifespan, while 20.6% of buyers are likely to buy new ones after more than two years of lifespan. Indonesian buyers are likely to spend 14 days on purchasing new smartphones as they need to research on, read reviews of, and look for any promotion of smartphones prior to direct tests and finally buy new ones in the retail stores.

Upgrade Smartphones



Source: MARS Research, NHKSI Research

Characteristics of Indonesian Users in Choosing Smartphones



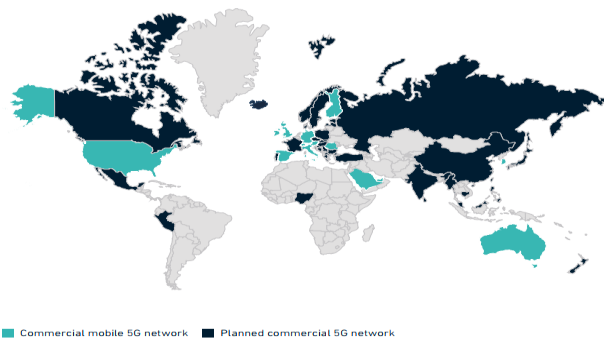
Source: Google , NHKSI Research

Industry Overview

5G Implementation Boosts for Higher Demands for New Smartphones

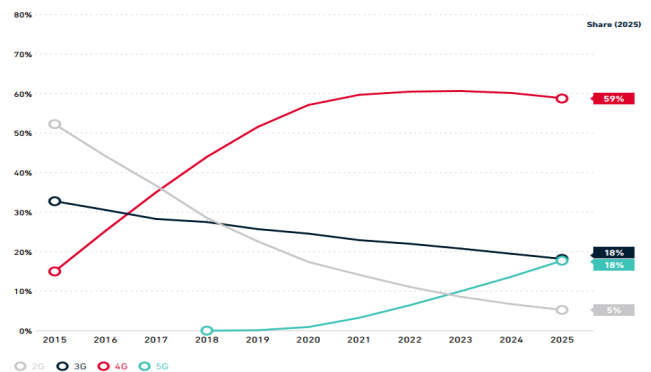
The Indonesian Telecommunications Service Providers Association (ATSI) states 5G implementation in 2022 and 5G network coverage to have positive impacts on many industrial sectors are the global development focus. The 5G implementation in Indonesia faces a major setback (i.e., inadequate frequencies and underdeveloped infrastructure). In contrast, China, the US, Japan, and Korea in 2025 will contribute more than half of 5G subscribers. GSMA Intelligent reports the four countries will lead the adoption of 5G networks. Subsequent to the shift from 4G to 5G is the launch of telecommunication devices operating systems of which support 5G tech. features as a number of brands (e.g., Samsung, Xiaomi, Huawei, and Oppo) will right away flock markets with smartphones compatible with 5G tech. The shift is most likely to boost new smartphone purchase in the Indonesia market only if Indonesia has braced its telecommunication infrastructure with 5G network coverage.

Confirmed 5G Operators Launch Plans



Source: GSMA Intelligence, NHKSI Research

Global Mobile Connections By Network Generation



Source: GSMA Intelligence , NHKSI Research

Investment Thesis

The Success of Apple's Flagship Products

ERAA, in FY18, outperformed as it recorded a 43% y-y increase in sales: a jump compared to the prior year sales performance. The jump in sales stands for ERAA's benefit as the sole distributor for Xiaomi and other Chinese smartphones. Of note, Chinese smartphones dominate 57% Asia's market share; Apple only dominates 12% of Asia's market share, and the rest is occupied by other brands.

Nevertheless, Indonesia's market share showed decreasing demands for smartphones in 2019 because 2019's fairly short time prime of smartphone sale compared to 2018's time prime. The 2019's sale time frame of iPhone XR, iPhone XS, and iPhone XS was held +/-10 days prior to Christmas celebration, while 2018's sale time frame of iPhone 8, iPhone 8 plus, dan iPhone X was held ahead of Christmas celebration so that the demands continued until 1Q19. Of note, Apple sells its new products in Indonesia's market after +/- 6 months of products' official launch. Other factors attributable to the declining demand was the global decline in smartphone demands. Statistics data of the world's semiconductor trade estimates FY19's total chip market to be worth of USD409 billion or a 12.8% decline from FY18, reflecting the declining demand for smartphones. In fact, Xiaomi as the leader on Indonesia's smartphone market share is likely to not launch many new products.

ERAA, in 2019, launched flagship products (i.e., Samsung Galaxy S10 & Note Series, Xiaomi Redmi Note Series, and Huawei P30 Pro). Meanwhile, Apple, in 2019, launched the latest iPhone such as iPhone 11, iPhone 11 Pro, and iPhone 11 Pro Max. ERAA through iBox outlets benefits from the high demand for the latest iPhone to record greater demand than former products, and Apple for the first time offered its latest iPhone prices to lower than prices of iPhone sold in the previous years. We expect iPhone latest products to improve sales volume and ASP in 2H19. The shorter time-frame differences between iPhone's global launch and iPhone launch in Indonesia will maintain buyers' enthusiasm for the products which in turn leads to increasing sales. ERAA also applies Registration of Interest to measure the number of buyers to have interests in buying the latest iPhone, and these two factors are effective drivers for higher sales.

iPhone 11 vs. iPhone X



Source: Apple Website, NHKSI Research

iPhone Price Differences Based on Launch Date

	iPhone 11	iPhone X
64GB	12.999.000	14.900.000
256GB	16.199.000	16.800.000

Source: Various Source , NHKSI Research

Investment Thesis

Domination Is Affirmed by Launch of 200-250 New Stores

ERAA, in 3Q19, launched 229 brick-and-mortar stores or an increase from 121 stores in 3Q18. After a discussion with the investor relations team of ERAA, we learn that ERAA, in 2020, targets to launch around 250-300 new stores to include mono-brand and multi-brand stores. The multi-brand stores on an annual basis record the domination of store launch, while the mono-brand stores tie cooperation with such leading smartphone brands as Apple, Samsung, Huawei, Oppo, and Vivo. ERAA, to date, accounts for 1,049 stores across Indonesia; each of stores has the average width of 300-400 sqm and from 2019 to 2020 focuses more on launching new retail stores in second and third-tier cities in order to expand its market share and balance well the solid sales it acquires in the first-tier cities and the second and third-tier cities. In 2019, ERAA kicked a new start by opening stores in Kuningan, Garut, Tasik, Purwakarta, Tuban, and Kudus; that business expansion in the second and third-tier cities is a strong footing strategy for sustaining its domination as the leader and leading distributor of telecommunication devices in Indonesia. ERAA's another distinct business strength is selling affordable products for all income groups scattered in the different city tiers.

ERAA sells a number of China-imported smartphone brands with competitive selling prices and excellent features so that those brands are increasingly popular with all segments of Indonesian buyers. Xiaomi is one of brands to acquire the second-largest market share in Indonesia after Oppo. In October 2019, Redmi Note 8 was officially sold at Authorized Mi Store, a brick-and-mortar store and Mi.com as well as Lazada, virtual stores. We believe that Redmi Note with the average selling prices of IDR2 million to IDR2.9 million, elegant design, and excellent features will be popular with the middle to low-income buyers. Xiaomi to launch Redmi Note 7 in March 2019 proves its agile and aggressive innovation only in a short time frame, and its agility shortens smartphones' lifespan.

Flagship Launch of Redmi Note 7



Source: Company Data, NHKSI Research

Flagship Launch of Redmi Note 8



Source: Various Source, NHKSI Research

E-Commerce Platform Eases Buying

ERAA is aggressive in launching not only brick-and-mortar stores but also virtual spaces; in fact, it implements Omni Channel to integrate between offline and online businesses (O2O services). The O2O services are accessible either online or offline by consumers to perform purchasing in online stores on ex/ erafone.com and determine Erafone's offline stores in which they can directly pick up the purchased products. The O2O transactions and the availability of digital platforms ease the purchasing processes, particularly the millennials native to the digital and improve consumers' satisfaction over ERAA's distribution services.

Investment Thesis

Developing the IoT Ecosystem

Internet of Things (IoT) rapidly turns into one of daily life fundamental aspects. Gartner articulates IoT networks to have 14.2 billion devices to consistently grow on an annual basis, and ERAA makes the best fortune from the ubiquitous IoT ecosystem to enrich its IoT units as it ties cooperation with some of tech. makers (i.e., GoPro, DJI, Garmin, Juul, Philips Hue, and WPS office). IoT products with their niche markets can only be marketed in first-tier cities braced by cutting-edge tech. infrastructure, but IoT's sales outlook is promising as today's tech. shapes world's tomorrow.

A. Xiaomi's Smart-Home Ecosystem Products

Xiaomi sells smartphones and IoT ecosystem devices to respond to today's cutting-edge tech. trends, and its affordable devices are popular with middle-class buyers. It offers IoT devices (i.e., smart TV, smartwatches, rice cookers, kettles, lamps, security cameras, and vacuum cleaners to detangle daily tangle activities because those devices are connected to users' smartphones. Nevertheless, Xiaomi only markets some of those devices in Indonesia in light of IoT's niche market, Indonesia's prevailing regulations having yet to support IoT's products marketing, and Indonesia's policy on the local content requirement (TKDN).

Smart TV Xiaomi



Source: Xiaomi Website, NHKSI Research

Mi Robot Vacuum Xiaomi



Source: Xiaomi Website, NHKSI Research

B. Lifestyle Products

To meet demands of dynamic lifestyle needs, ERAA as the gadget distributor cooperates with a number of gadget makers such as GoPro mini action cameras; DJI easy-to-fly drones, Garmin smartwatches. In 2019, ERAA cooperated with Juul Labs to sell electric cigarettes; Philips Hue to distribute IoT lamps; and WPS Office to penetrate software markets. Nevertheless, to date, IoT products still show no significant contribution due to shallow IoT penetration in Indonesia's markets.

Financial Outlook

3Q19 Performance

ERAA, in 9M19, posted revenues of IDR23.6 trillion or a -6.8% y-y from 9M18's achievement due to the soft consumption and the world's declining sales of smartphones. Besides, handset sales volume also showed declines from 12.3 million units in 3Q18 to 9.7 million units in 3Q19. Meanwhile, based on the revenue contribution, the cellular phones & tablet segment to post revenues of IDR11 trillion was the first-largest contributor of 81.5% to the total revenues, while the mobile operator segment was the second-largest contributor to the total revenues by posting sales of IDR1.6 trillion. Furthermore, computers & electronic devices and accessories segments respectively posted revenues of IDR662 billion and IDR687 billion. Margins on a quarterly basis were still stable, with gross and net profit margins to respectively stand at 7.3% and 3.7%, but EBIT margins declined to 1.6% attributable to the surging G&A costs by 87% to IDR271 billion. We analyze that handset's ASP, on an annual basis, shows consistent increases as its 3Q19's ASP reached IDR1.8 million or a 9.9% increase from IDR1.7 billion in 3Q18 and is likely to reach IDR1.9 billion in 4Q19E backed by Christmas and New Year momentum as well as the launch of flagship products. ERAA based on its historical financial statements accounted for the largest revenues in the fourth quarter; thus, we estimate ERAA to be capable of posting IDR10 trillion worth of top-line or a 14% y-y increase, while its bottom-line surged to IDR187 billion.

Significant Improvement in Inventories

The declining demands for smartphones left sales of new smartphones surpassing the estimate and inventories surging. However, we view the sharp declines in inventories to IDR3.45 trillion in 3Q19 from IDR6.46 trillion (-47% y-y, -25% q-q) in 3Q18, while the average days of inventory (Dol) declined ~10 days from 72 days in 2Q19 to 62 days in 3Q19. The significant declines in inventories started in 2Q19 attributable to the clearance sale, Xiaomi's products in particular and the export termination of Xiaomi's spare-parts in 2Q19 to most likely slash 3Q19's gross margins to 7.3% (vs. 7.9% in 3Q18). ERAA on a cumulative basis posted 9M19's surging OpEx of 16.3% to IDR1.56 trillion from 9M18's IDR 1.34 trillion due to the respective increase of 33% y-y in salaries and service rental costs driven by the massive launch of 229 stores in 3Q19 (vs. 121 stores in 3Q18).

Lower Financing Costs

ERAA, in 3Q19, posted declines of 31% y-y to IDR67 billion in financing costs; the declining trend started in 2Q19 fueled by Xiaomi to stop services of spare-parts assembly and the settlement of short-term loans. The declines also positively impacted on its balance sheet to record a 46% YTD decline to IDR2.6 trillion in short-term loans. It is a noteworthy to learn that to date ERAA still banks on short-term loans to finance its operational activities and uses internal cash flows to finance its business expansion. We analyze that banking loans are the most profitable financing alternative due to the trend of declining lending rates.

Earning Drivers

We estimate that ERAA, in 1H20, is capable of maintaining conservative growth even though Indonesia still faces macroeconomic challenges to weaken consumption. However, the high demand for smartphones will still a trend along with Indonesia to consistently post increasing number of smartphone users. Smartphone producers race for launching the latest products with the most sophisticated features and cutting-edge technologies; that stands for ERAA benefits in selling varied smartphones to entry, mid-range, and premium levels. IME regulation taking into force in 1H20 is most likely to slash sale of 2H20's illegal smartphones whose 1H20's sales reached 20% of total smartphone sales in Indonesia. The declining sales of illegal smartphones and the increasing ASP to IDR2.1 million are strong footings for solid earnings and FY20's hiking sales volume of 49 million units handset. Thus, ERAA will be capable of posting top-line and bottom-line growth of 13% and 8%, respectively.

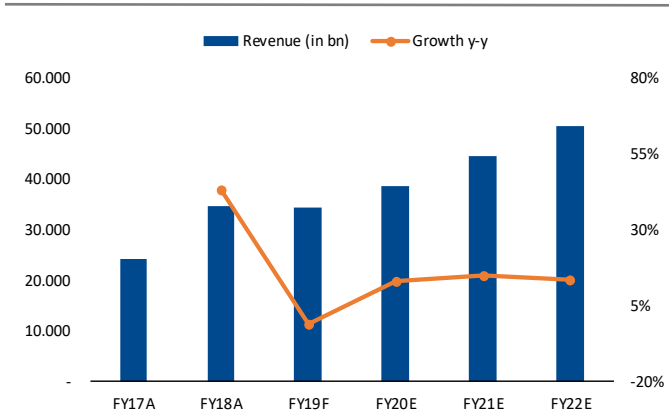
Financial Outlook

Valuation and Recommendation

ERAA as the largest distributor and retailer of telecommunication products in Indonesia enjoys Indonesia's demographic bonuses: the home to the world's fourth largest population and the country to mark consistent hikes in number of smartphones' users on an annual basis amid the trend of 4.0 industrial revolution. Another positive sentiment is its well diversified products to enrich its market segments, while its broader market penetration multiplies the number of its products distributed to retailers so that it depends less to the third parties. Furthermore, it has least exposure to exchange rate risks because most of its contracts are in the rupiah denomination. We to have analyze comprehensively the facts recommend BUY over stocks of PT Erajaya Swasembada Tbk (ERAA) with the price target of IDR2,000 and a 19.4x P/E.

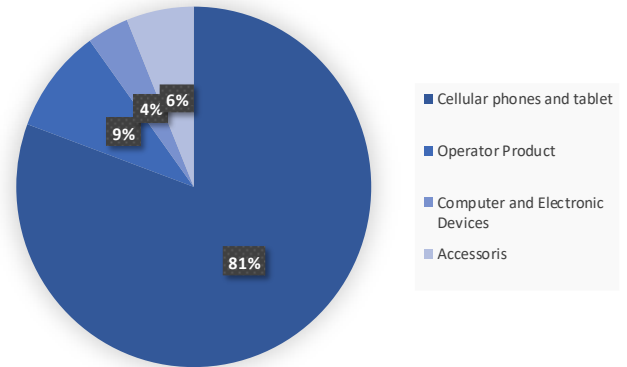
Key Charts

ERAA's FY17A—FY22E Revenues



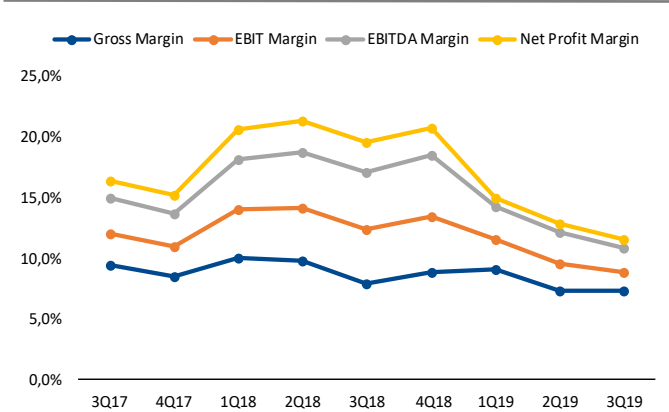
Source: Company Data, NHKSI Research

ERAA's Revenue Breakdown



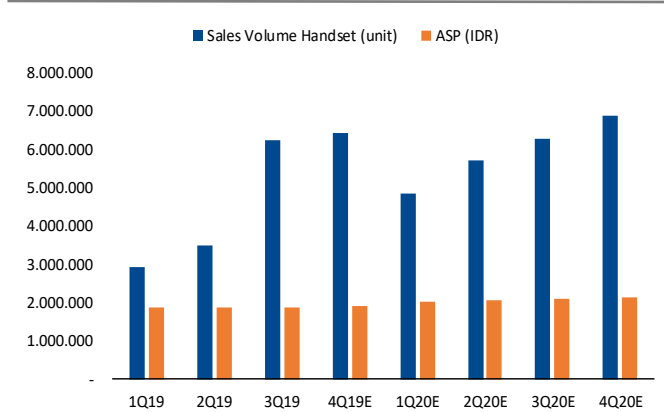
Source: Company Data, NHKSI Research

ERAA's Margin Ratios



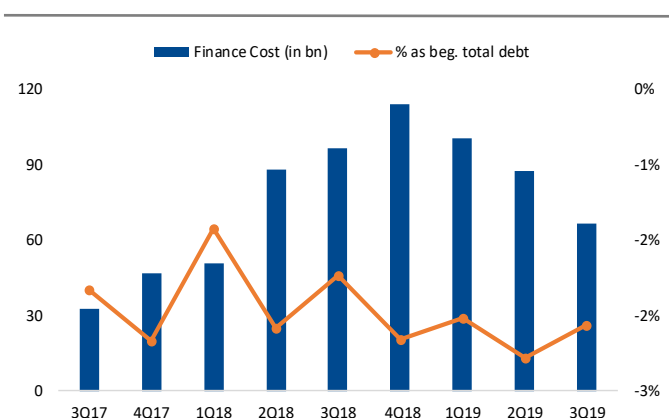
Source: Company Data, NHKSI Research

ERAA's ASP and Volume Handset



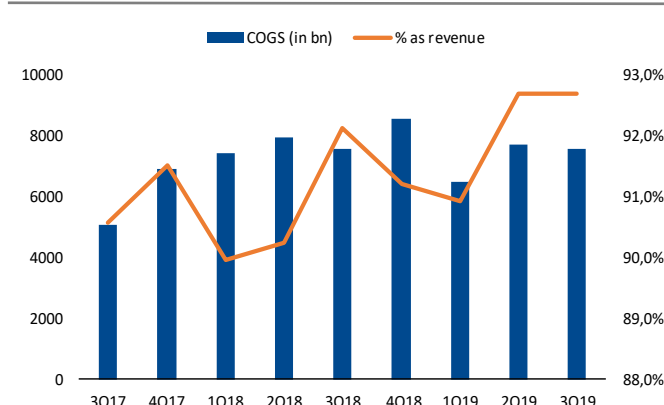
Source: Company Data, NHKSI Research

ERAA's Finance Costs



Source: Company Data, NHKSI Research

ERAA's COGS



Source: Company Data, NHKSI Research

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