

Gudang Garam Tbk (GGRM)

Despite soaring costs, earnings are sound

Company Report | Jul 11, 2018

Buy

Dec 2018 TP (IDR)	88,650
Consensus Price (IDR)	85,741
TP to Consensus Price	+3.4%
vs. Last Price	+24.9%

Shares data

Last Price (IDR)	70,975
Price date as of	Jul 10, 2018
52 wk range (Hi/Lo)	85,275/60,150
Free float (%)	23.8
Outstanding sh.(mn)	1,924
Market Cap (IDR bn)	136,562
Market Cap (USD mn)	9,496
Avg. Trd Vol - 3M (mn)	0.91
Avg. Trd Val - 3M (bn)	63.83
Foreign Ownership	8.2%

Consumer Goods

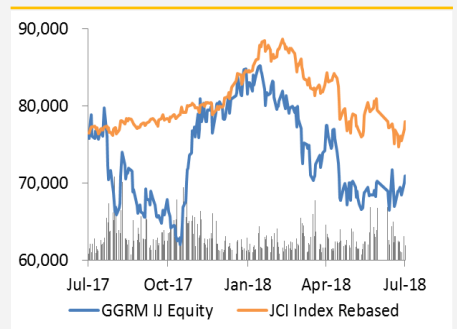
Cigarettes

Bloomberg	GGRM.IJ
Reuters	GGRM.JK

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Share Price Performance



	YTD	1M	3M	12M
Abs. Ret.	-12.9%	1.0%	-8.4%	-7.2%
Rel. Ret.	-5.7%	2.9%	-1.4%	-9.1%

Sound Sales Growth

GGRM succeeded to post the growth of 10.1% in sales from IDR19.97 trillion in 1Q17 into IDR21.98 trillion in 1Q18. The sound sales performance was not followed by its peer — HMSP posted the lower sales growth of 2.5% y-y in 1Q18. The success of machine-made clove cigarette (SKM) — the biggest contributor of 90% to the overall sales — in posting the growth of 10.1% from IDR17.94 in 1Q17 into IDR19.76 in 1Q18 was the potent driver for GGRM's sound sales performance.

Soaring COGS Stunting Profit Growth

Despite the growth of 10.1% in top line, GGRM's net profit only nudged up 0.1% from IDR1.890 trillion in 1Q17 into IDR1.892 trillion in 1Q18. Its gross margin whittling away from 22% in 1Q17 into 20% in 1Q18 stunted its profit growth. The soaring COGS stemmed from the higher use of finished goods by 3.8% y-y in 1Q18.

SKM Segment: Potent Driver for Sales Growth

We estimate that GGRM's 2018 sales likely enjoys the growth of 9.3% thanks to the SKM segment posting sales of 70 billion cigarettes and the hike of 7% in average selling price (ASP) outside the hike in cigarette excise.

Target Price of IDR88,650

We use an estimate of forward P/E of 18.0x (1 SD higher than the 3-year average of 16.3x) as the basis of valuation method for obtaining the target price). The target price implies a 2018E P/E of 19.7x. Now, GGRM is traded at a 2018E P/E of 15.8x.

Gudang Garam Tbk | Summary (IDR bn)

	2016/12A	2017/12A	2018/12E	2019/12E
Sales	76,274	83,306	91,075	99,626
<i>Sales growth</i>	8.4%	9.2%	9.3%	9.4%
EBITDA	12,113	13,122	14,425	15,959
Net profit	6,677	7,754	8,643	9,551
EPS (IDR)	3,470	4,030	4,492	4,964
<i>EPS growth</i>	3.8%	16.1%	11.5%	10.5%
BVPS (IDR)	20,563	21,926	23,818	26,182
EBITDA margin	15.9%	15.8%	15.8%	16.0%
NPM	8.8%	9.3%	9.5%	9.6%
ROE	17.2%	19.0%	19.6%	19.9%
ROA	10.6%	12.0%	12.7%	13.3%
ROIC	12.7%	13.7%	14.5%	15.5%
P/E	18.4x	20.8x	15.8x	14.3x
P/BV	3.1x	3.8x	3.0x	2.7x
EV/EBITDA	11.7x	13.7x	10.6x	9.5x
DPS (IDR)	2,600	2,600	2,600	2,600
<i>Dividend yield</i>	4.1%	3.1%	3.7%	3.7%

Source: Company Data, Bloomberg, NHKS Research

Please consider the rating criteria & important disclaimer

A Glance at GGRM

GGRM is the leading producer of clove cigarettes (kretek) identical with Indonesia. As the world's fourth most populous nations inhabited by around 250 million people, Indonesia is home to the biggest and most varied consumers markets with the significant adult smoker percentage—67% of Indonesian adult men are smokers. GGRM dominates 20.8% domestic market shares with its well-known products; and has 67 area offices with 279 distribution points across Indonesia as well as 7,000 vehicles as sale units, including motorcycles to serve its markets.

Its two kretek factories are located in Kediri and Gempol. Home to 249,000 inhabitants, Kediri is the regional trade heartland and the location of GGRM's headquarters. Meanwhile, its second kretek factory situated in Gempol, East Java, is only 50 km from Surabaya. The two factories prove a boon to responding to the demand for cigarettes.

GGRM's Competitiveness in the Asia Pacific

Categorized into Cigarette Company with topping—9-billion market capitalization, GGRM has the third cheapest P/E after KT&G Corp. and Japan Tobacco. However, being potential for the higher growth in net profit and ROE of 19.6%, GGRM becomes a preferred stock pick.

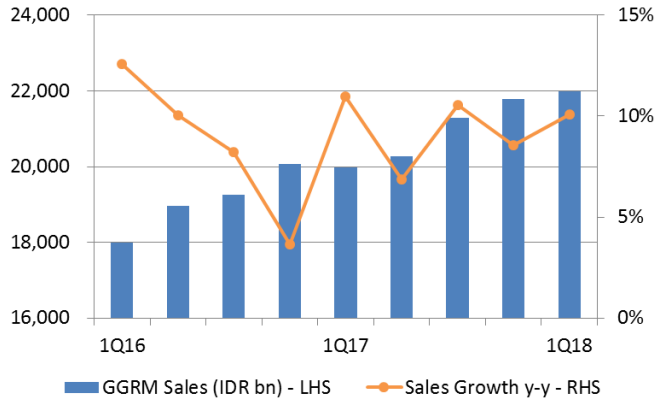
Asia Pacific Cigarette Company

Company	Market Cap (USD mn)	Total Asset (USD mn)	Net Profit Growth	Net Profit Margin	ROE	P/E	P/BV	Dividend Yield
GGRM	9,357	4,913	11.5%	9.5%	19.6%	15.8x	3.0x	3.7%
HMSP	30,589	3,175	1.9%	12.1%	37.3%	34.7x	12.9x	2.8%
India								
ITC Ltd	49,409	9,869	9.5%	26.1%	22.8%	30.1x	6.5x	1.8%
VST Industries Ltd	636	163	8.8%	19.2%	32.5%	24.1x	7.5x	2.6%
Godfrey Phillips India Ltd	554	379	16.2%	6.9%	9.2%	24.0x	2.1x	1.1%
Malaysia								
British American Tobacco Bhd	2,383	257	-29.3%	16.4%	128.5%	20.4x	27.0x	4.8%
Japan								
Japan Tobacco Inc	53,676	46,380	2.4%	18.3%	15.5%	13.6x	2.0x	4.9%
South Korea								
KT&G Corp	13,052	9,346	-0.2%	24.9%	16.5%	11.4x	1.8x	3.8%
Sri Lanka								
Ceylon Tobacco Co Plc	1,316	162	19.1%	46.1%	201.2%	13.9x	25.2x	5.8%

Source: Bloomberg, NHKS research

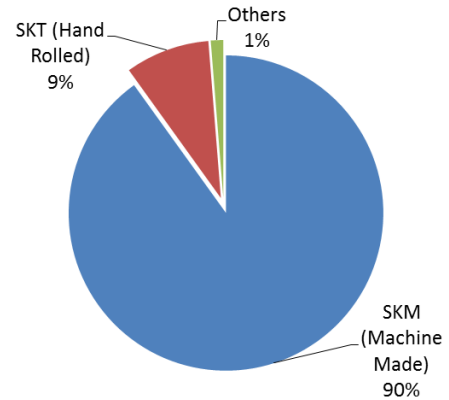
Performance Highlights

GGRM Sales Trend | 2016 - 2018



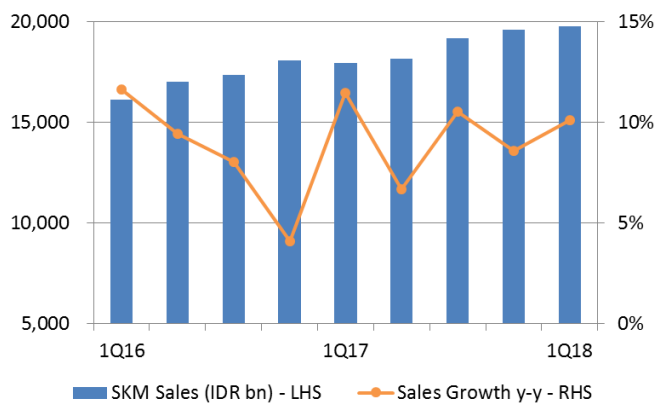
Source: Company, NHKS Research

GGRM Revenue Breakdown | FY 2018E



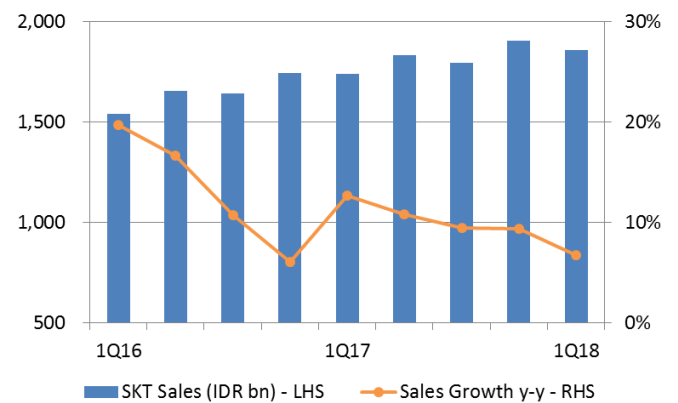
Source: Company, NHKS research

SKM (Machine Made) Sales Trend | 2016 - 2018



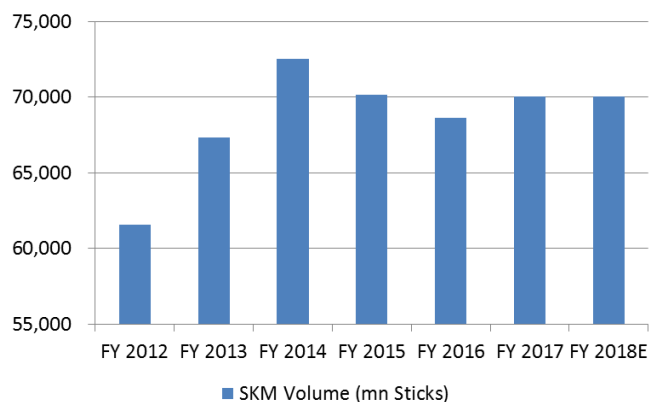
Source: Company, NHKS Research

SKT (Hand Rolled) Sales Trend | 2016 - 2018



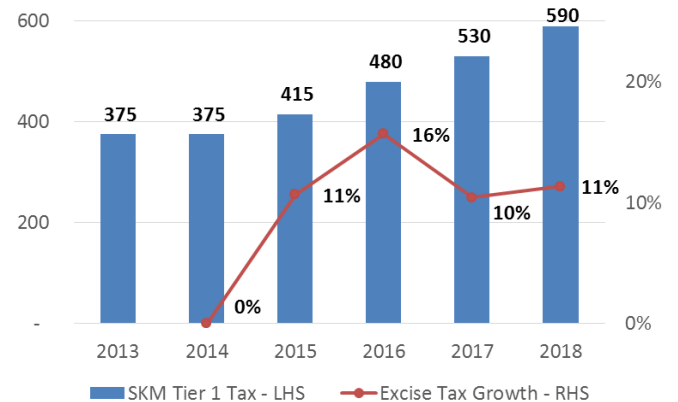
Source: Company, NHKS Research

GGRM SKM Volume (mn sticks) | FY2012 - FY2018E



Source: Company, NHKS research

SKM Tier 1 Excise Tax (IDR) | FY 2013 - FY 2018



Source: Ministry of Finance, NHKS research

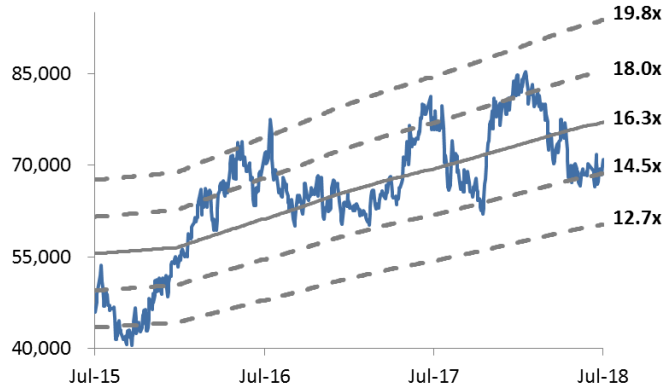
Multiple Valuation

Forward P/E band | Last 3 years



Source: NHKS research

Dynamic Forward P/E band | Last 3 years



Source: NHKS research

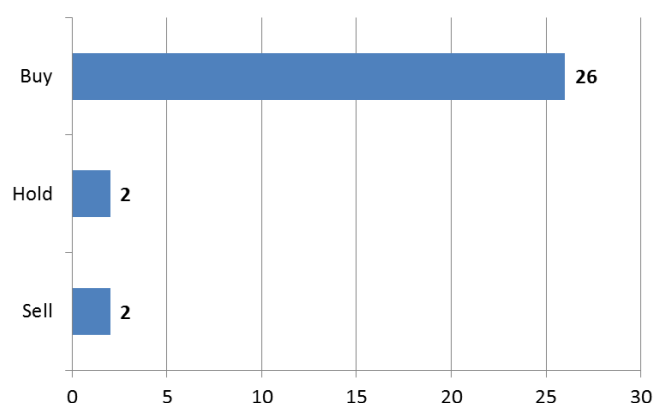
Rating and target price update

Target Price Revision

Date	Rating	Target Price	Last Price	Consensus	vs Last Price	vs Consensus
09/07/2017	Buy	83,550 (Dec 2018)	66,700	77,479	+25.3%	+7.8%
11/22/2017	Buy	97,825 (Dec 2018)	80,375	80,375	+21.7%	+18.5%
04/13/2018	Buy	88,650 (Dec 2018)	74,200	88,527	+19.5%	+0.1%
07/11/2018	Buy	88,650 (Dec 2018)	70,975	85,741	+24.9%	+3.4%

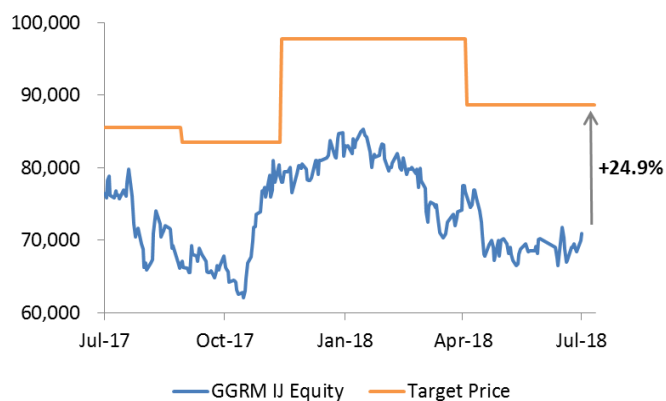
Source: NHKS research, Bloomberg

Analyst Coverage Rating



Source: Bloomberg

Closing and Target Price



Source: NHKS research

NH Korindo Sekuritas Indonesia (NHKS) stock ratings

- Period: End of year target price
- Rating system based on a stock's absolute return from the date of publication
 - Buy : Greater than +15%
 - Hold : -15% to +15%
 - Sell : Less than -15%

Summary of Financials

GGRM Summary			
Last Price (IDR)	July 10, 2018		70,975
Target Price (IDR)	Dec 2018		88,650
Analyst: Joni Wintarja	Rating:		Buy

INCOME STATEMENT

in IDR Bn	2016/12A	2017/12A	2018/12E	2019/12E
Sales	76,274	83,306	91,075	99,626
Growth (% y/y)	8.4%	9.2%	9.3%	9.4%
Cost of Sales	(59,657)	(65,084)	(71,129)	(77,808)
Gross Profit	16,617	18,222	19,945	21,818
Gross Margin	21.8%	21.9%	21.9%	21.9%
Operating Expenses	(6,589)	(6,970)	(7,548)	(8,257)
EBIT	10,028	11,252	12,397	13,562
EBIT Margin	13.1%	13.5%	13.6%	13.6%
Depreciation	2,086	1,870	2,028	2,398
EBITDA	12,113	13,122	14,425	15,959
EBITDA Margin	15.9%	15.8%	15.8%	16.0%
Interest Expenses	(1,191)	(801)	(858)	(817)
EBT	8,931	10,437	11,534	12,738
Income Tax	(2,258)	(2,681)	(2,889)	(3,184)
Minority Interest	4	(2)	(2)	(2)
Net Profit	6,677	7,754	8,643	9,551
Growth (% y/y)	3.8%	16.1%	11.5%	10.5%
Net Profit Margin	8.8%	9.3%	9.5%	9.6%

BALANCE SHEET

in IDR bn	2016/12A	2017/12A	2018/12E	2019/12E
Cash	1,595	2,329	2,635	3,234
Receivables	2,090	2,229	2,437	2,666
Inventories	37,545	37,920	37,930	37,867
Total Current Assets	41,933	43,764	44,186	45,002
Net Fixed Assets	20,499	21,409	23,755	27,335
Other Non Current Assets	520	1,587	1,555	1,555
Total Assets	62,952	66,760	69,497	73,892
Payables	1,118	1,214	1,326	1,451
Total Debt	19,753	20,600	19,628	19,057
Other Current Liab.	767	797	862	943
Other Non Current Liab.	1,749	1,961	1,852	2,064
Total Liabilities	23,387	24,572	23,668	23,515
Shareholders' Equity	39,564	42,188	45,828	50,377

CASH FLOW STATEMENT

in IDR bn	2016/12A	2017/12A	2018/12E	2019/12E
Net Income	6,677	7,754	8,643	9,551
Deprec & Amortization	2,086	2,244	2,028	2,398
Chg. In Working Capital	(1,825)	(1,793)	62	(12)
CFO	6,938	8,205	10,732	11,937
Capex	(2,335)	(3,396)	(4,358)	(5,978)
CFI	(2,226)	(3,240)	(4,435)	(5,765)
Dividends Paid	(5,003)	(5,003)	(5,003)	(5,003)
Net Borrowing (PMT)	(808)	847	(972)	(571)
CCF	(5,842)	(4,232)	(5,974)	(5,573)
Net Changes in Cash	(1,130)	733	323	599

OWNERSHIP

By Geography	% Shareholders	%
Indonesia	91.8	Suryaduta Investama 69.3
United States	2.8	Suryamitra Kusuma 6.3
Luxembourg	2.3	Fil Limited 1.8
United Kingdom	0.8	Vanguard Group 0.9

PROFITABILITY & STABILITY

	2016/12A	2017/12A	2018/12E	2019/12E
ROE	17.2%	19.0%	19.6%	19.9%
ROA	10.6%	12.0%	12.7%	13.3%
ROIC	12.7%	13.7%	14.5%	15.5%
EBITDA/Equity	31.2%	32.1%	32.8%	33.2%
EBITDA/Assets	10.6%	12.0%	12.7%	13.3%
Cash Dividend IDR bn)	5,003	5,003	5,003	5,003
Dividend Yield (%)	4.1%	3.1%	3.7%	3.7%
Payout Ratio (%)	77.7%	74.9%	64.5%	57.9%
DER	49.9%	48.8%	42.8%	37.8%
Net Gearing	50.1%	48.9%	42.9%	37.9%
Capitalization Ratio	33.3%	32.8%	30.0%	27.4%
Equity Ratio	62.8%	62.2%	65.9%	68.2%
Debt Ratio	31.4%	30.9%	28.2%	25.8%
Financial Leverage	163.7%	154.0%	151.7%	144.5%
Current Ratio	193.8%	193.6%	202.5%	209.8%
Quick Ratio	17.0%	20.2%	23.3%	27.5%
Cash Ratio	7.4%	10.3%	12.1%	15.1%
Cash Conversion Cycle	232.9	215.6	197.6	180.6
Par Value (IDR)	500	500	500	500
Total Shares (mn)	1,924	1,924	1,924	1,924
Share Price (IDR)	63,900	83,800	70,975	70,975
Market Cap (IDR tn)	122.9	161.2	136.6	136.6

VALUATION INDEX

	2016/12A	2017/12A	2018/12E	2019/12E
Price /Earnings	18.4x	20.8x	15.8x	14.3x
Price /Book Value	3.1x	3.8x	3.0x	2.7x
Price/Sales	1.6x	1.9x	1.5x	1.4x
PE/EPS Growth	4.9x	1.3x	1.4x	1.4x
EV/EBITDA	11.7x	13.7x	10.6x	9.5x
EV/EBIT	14.1x	16.0x	12.4x	11.2x
EV (IDR bn)	141,168	179,495	153,541	152,371
Sales CAGR (3-Yr)	11.2%	8.5%	9.0%	9.3%
EPS CAGR (3-Yr)	15.5%	12.8%	10.3%	12.7%
Basic EPS (IDR)	3,470	4,030	4,492	4,964
Diluted EPS (IDR)	3,470	4,030	4,492	4,964
BVPS (IDR)	20,563	21,926	23,818	26,182
Sales PS (IDR)	39,642	43,296	47,334	51,778
DPS (IDR)	2,600	2,600	2,600	2,600

DCF, RIM & EVA

	2016/12A	2017/12A	2018/12E	2019/12E
DCF (IDR bn)				
NOPAT	7,492	8,361	9,292	10,171
+Depr./Amor.	2,086	2,244	2,028	2,398
-CAPEX	(2,335)	(3,396)	(4,358)	(5,978)
-Incr. (Decr.) in Working Cap.	(1,825)	(1,793)	62	(12)
(Unlevered) FCFF	5,417	5,416	7,024	6,580
WACC				
Cost of Debt (Tax Adj.)	8.1%	5.4%	5.5%	5.7%
Cost of Equity (COE)	9.5%	11.7%	12.1%	12.1%
WACC (%)	9.3%	11.0%	11.3%	11.3%
RIM				
Spread (FROE-COE) (%)	8.0%	7.9%	8.4%	8.8%
Residual Income (IDR bn)	3,054	3,111	3,546	4,015
Equity Charge	3,623	4,643	5,097	5,536
EVA				
Invested Capital (IDR bn)	58,569	59,317	62,788	65,456
ROIC-WACC (%)	3.5%	3.1%	3.5%	4.2%
EVA (IDR mn)	2,023	1,827	2,225	2,773

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