

Gudang Garam Tbk (GGRM)

Bumpy Road Ahead for Tobacco Players

GGRM showed its ability to endure the tough quarter, even though the outlook is a bit more muted than last year. Our new estimates suggest lower growth in top line and bottom line for FY20F, as we factor in excise tax hikes issues linger coupled with softer purchasing power.

Earnings in Line with Our Estimate

Gudang Garam (GGRM) posted net profit of IDR1.3tn (-28.6% YoY, -43.8% QoQ) in 2Q20, translating into 6M20 earnings of IDR3.8tn (-10.7% YoY). We deem GGRM's 6M20 net profit in line with our expectation, forming 51% of FY20F. Meanwhile, GGRM booked revenue of IDR26.3 tn (0.6% YoY, -3.2% QoQ). Going forward, we remain positive on GGRM's outlook as they successfully delivered robust 2Q20 result compared to its main competitor. On the margins side, GGRM has recorded a steep decline in GPM to 14.1% in 2Q20 (vs. 19.0% in 2Q19), which mainly was due to the excise tax hike. Further, we noticed that GGRM's management has been undertaking action to curb operating expenses such as lower transportation cost and employee compensation, yet GGRM still recorded a decline in GPM and NPM by 278 bps to 7.2% and by 205 bps to 5.2%, respectively.

ASP is Expected to Continue Increase

Currently, cigarette sales have grown at a slower pace, especially since the Ministry of Finance rolled out the aggressive hike in cigarette excise tax and retail selling prices (HJE) which took effect on January 1st 2020 and along with the nationwide quarantine began in March 2020. Looking further into GGRM's segment, machine-rolled cloves (SKM) segment (i.e. GG international, GG Surya) noted -3% YoY decline in sales, while hand-rolled cloves (SKT) segment (i.e. GG Merah) saw 10% YoY sales growth. We consider this unfavorable condition will suppress revenue growth due to a decrease in sales volume. Thus, we forecast SKM will record a slight drop, but SKT will still record another modest growth in 2020F. Nonetheless, we believe GGRM will likely continue to increase ASP throughout this year as we assume the gov. had planned to raise the cigarette excise tax in 2021. One positive note, the government is taking measures to postpone payment of excise tax as stipulated in PMK No. 30/PMK.04/2020, which led GGRM to book strong quarterly cash flow.

Maintain BUY with TP Rp59,600/share

It seems like tobacco players have faced a serious challenge throughout this year such as the excise tax hike and followed by pandemic. This prompted us to revise down our revenue forecast by -8.7% and -12.4% in FY20F/21F, resulted in lower net income by -28.3% and -21.2%. However, we still maintain BUY recommendation, with target price IDR59.600 based on the estimate forward PE valuation 11.7x, as we consider that GGRM successfully delivered modest result in the toughest quarter and negative sentiment from the excise tax hike has been priced in. Risk to our call would be higher than expected excise tax and lower purchasing power.

Gudang Garam Tbk | Summary (IDR bn)

	2019A	2020E	2021F	2022F
Sales	110.524	107.151	109.945	116.870
<i>Sales growth</i>	15,5%	-3,1%	2,6%	6,3%
EBITDA	17.401	13.465	16.140	17.106
Net Profit	10.881	7.443	9.790	10.417
EPS (IDR)	5.655	3.868	5.088	5.414
<i>EPS growth</i>	39,6%	-31,6%	31,5%	6,4%
EBITDA margin	15,7%	12,6%	14,7%	14,6%
NPM	9,8%	6,9%	8,9%	8,9%
P/E	14,8x	13,1x	10,0x	9,4x
P/BV	3,2x	1,8x	1,7x	1,5x
EV/EBITDA	10,1x	8,3x	6,4x	5,7x
DPS (IDR)	2.600	2.600	2.600	2.600
<i>Dividend yield</i>	3,1%	5,1%	5,1%	5,1%

Source: Company Data, Bloomberg, NHKS Research

Please consider the rating criteria & important disclaimer

Buy

Target Price (IDR)	59,600
Consensus Price (IDR)	55,569
TP to Consensus Price	+7.2%
vs. Last Price	+17.5%

Shares data

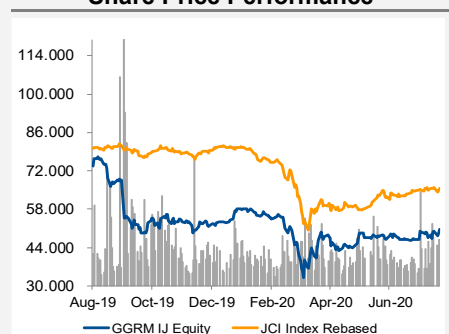
Last Price (IDR)	50,700
Price date as of	Aug 05, 2020
52 wk range (Hi/Lo)	77,000 / 32,900
Free float (%)	23.8
Outstanding sh.(mn)	1,924
Market Cap (IDR bn)	97,118
Market Cap (USD mn)	6,620
Avg. Trd Vol - 3M (mn)	1.26
Avg. Trd Val - 3M (bn)	60.95
Foreign Ownership	8.0%

Consumer Staples

Cigarette

Bloomberg	GGRM IJ
Reuters	GGRM.JK

Share Price Performance



	YTD	1M	3M	12M
Abs. Ret.	-5.0%	8.5%	13.9%	-38.2%
Rel. Ret.	13.4%	5.7%	3.1%	-20.0%

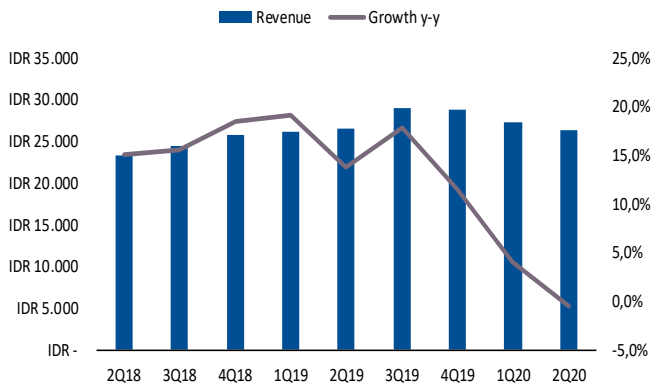
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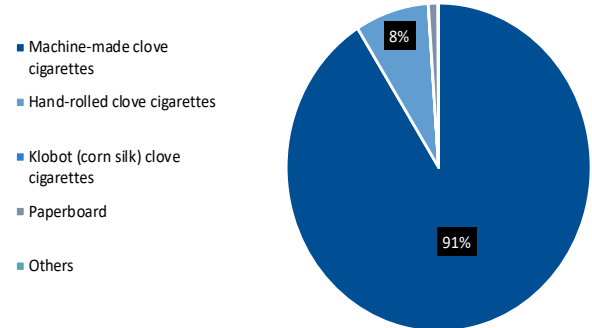
Performance Highlights

GGRM Quarterly Sales | 1Q18 - 2Q20



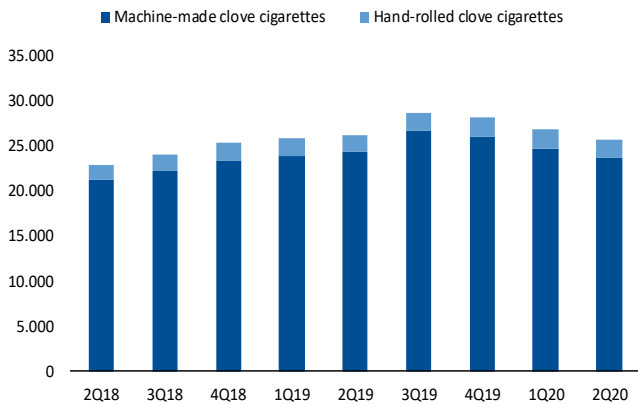
Source: Company Data, NHKSI Research

GGRM Sales Breakdown | 2Q20



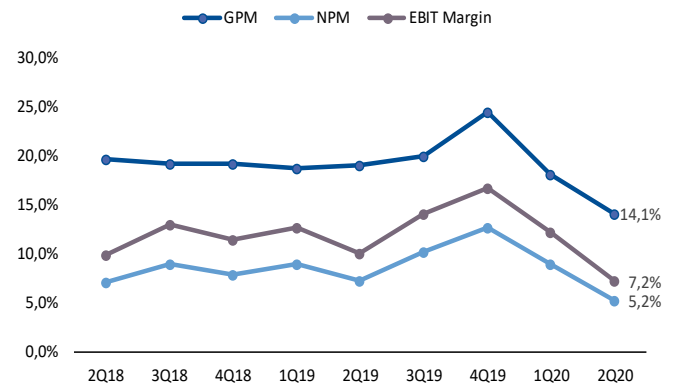
Source: Company Data, NHKSI Research

Machine and Hand Made Sales Trend | 1Q18 - 2Q20



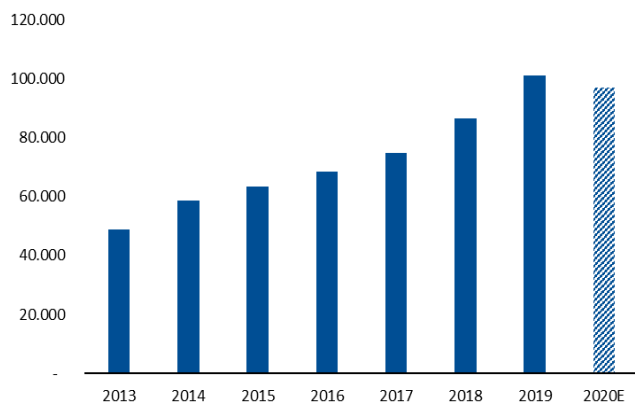
Source: Company Data, NHKSI Research

GGRM Quarterly Margins | 1Q18 - 2Q20



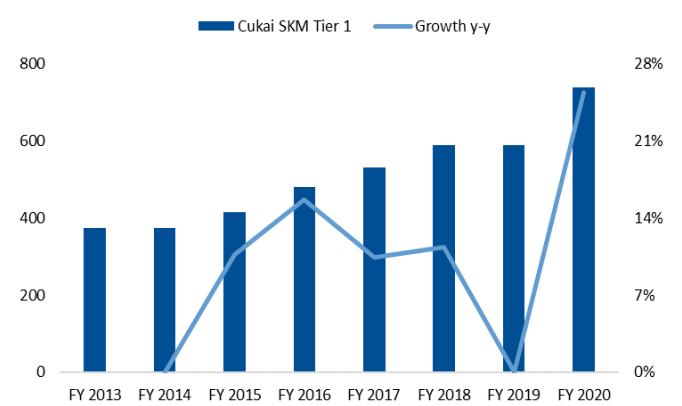
Source: Company Data, NHKSI Research

GGRM SKM Volume (mn sticks) | FY2013 - FY2020E



Source: Company Data, NHKSI Research

Excise Tax for Cigarettes in Indonesia



Source: Various Sources, NHKSI Research

2Q20 review (IDR bn)

	2Q19	3Q19	4Q19	1Q19	2Q20					3Q20E
					Actual	Estimate	y-y	q-q	surprise	
Sales	26.548	28.976	28.803	27.261	26.394	27.909	-0,6%	-3,2%	-5,4%	26.394
Gross Profit	5.039	5.779	7.046	4.942	3.719	4.399	-26,2%	-24,7%	-15,5%	3.719
<i>Gross Margin</i>	19,0%	19,9%	24,5%	18,1%	14,1%	15,8%	-4,9%	-4,0%	-1,7%	14,1%
EBIT	2.642	4.089	4.815	3.305	1.894	1.961	-28,3%	-42,7%	-3,4%	1.894
<i>EBIT Margin</i>	10,0%	14,1%	16,7%	12,1%	7,2%	7,0%	-2,8%	-4,9%	0,1%	7,2%
EBITDA	3.222	4.695	5.573	3.966	2.559	2.664	-20,6%	-35,5%	-3,9%	2.559
<i>EBITDA Margin</i>	12,1%	16,2%	19,4%	14,5%	9,7%	9,5%	-2,4%	-4,9%	0,2%	9,7%
Net Profit	1.926	2.962	3.637	2.447	1.374	1.350	-28,6%	-43,8%	1,8%	1.374
<i>Net Margin</i>	7,3%	10,2%	12,6%	9,0%	5,2%	4,8%	-2,0%	-3,8%	0,4%	5,2%

Source: Bloomberg, NHKSI research

Earnings revision (IDR bn)

		2020E	2021F	2022F
Sales	-Revised	107.151	109.945	116.870
	-Previous	117,334	125,508	133,793
	-Change	-8,7%	-12,4%	-12,6%
Gross Profit	-Revised	17.738	21.263	22.689
	-Previous	23,109	26,080	28,729
	-Change	-23,2%	-18,5%	-21,0%
Gross Margin	-Revised	16,6%	19,3%	19,4%
	-Previous	19,7%	20,8%	21,5%
	-Change	-28,0%	-21,6%	-25,3%
EBIT	-Revised	10.756	13.512	14.274
	-Previous	14,929	17,231	19,096
	-Change	-28,0%	-21,6%	-25,3%
EBIT Margin	-Revised	10,0%	12,3%	12,2%
	-Previous	12,7%	13,7%	14,3%
	-Change	-23,9%	-18,7%	-22,1%
EBITDA	-Revised	13.465	16.140	17.106
	-Previous	17,685	19,850	21,948
	-Change	-23,9%	-18,7%	-22,1%
EBITDA Margin	-Revised	12,6%	14,7%	14,6%
	-Previous	15,1%	15,8%	16,4%
	-Change	-28,3%	-21,2%	-25,0%
Net Profit	-Revised	7.443	9.790	10.417
	-Previous	10.385	12.416	13.884
	-Change	-28,3%	-21,2%	-25,0%
Net Margin	-Revised	6,9%	8,9%	8,9%
	-Previous	8,9%	9,9%	10,4%

Source: NHKSI research

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 266 million people, Indonesia is home to the largest and most varied consumers markets with the significant adult smoker percentage—67% of Indonesian adult men are smokers. GGRM dominates 23.1% domestic market shares with its well-known products; and has 66 area offices with 269 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 268,000 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.

Asia Pacific Cigarette Company

Company	Market Cap (USD mn)	Asset (USD mn)	Sales LTM (USD mn)	Net Profit LTM (USD mn)	Net Profit Growth LTM	Net Margin	ROE LTM	P/E LTM	P/BV
Indonesia									
Gudang Garam	6.620	5.680	7.779	727	22,33%	9,4%	21,0%	9,3x	1,8x
HM Sampoerna	13.122	3.676	6.986	826	-16,61%	11,8%	43,0%	16,2x	7,2x
India									
ITC Ltd	32.161	10.264	6.911	2.160	21,55%	31,3%	24,6%	15,7x	3,7x
VST Industries Ltd	719	185	175	43	34,05%	24,5%	41,9%	17,7x	6,9x
Godfrey Phillips India Ltd	655	437	433	54	47,82%	12,5%	18,2%	12,8x	2,2x
	24	373	580	5	-71,89%	0,8%	3,0%	5,1x	0,2x
Malaysia									
British American Tobacco	712	251	541	68	-32,98%	12,6%	79,3%	10,4x	8,4x
Pakistan									
Pakistan Tobacco Co Ltd	2.511	261	350	85	21,76%	24,3%	62,0%	31,5x	20,0x
South Korea									
KT&G CORP	9.988	9.275	4.199	859	4,56%	20,5%	13,0%	10,6x	1,3x
Sri Lanka									
Ceylon Tobacco Co Plc	964	147	198	96	-1,15%	48,2%	190,5%	10,4x	20,8x

Source: Bloomberg

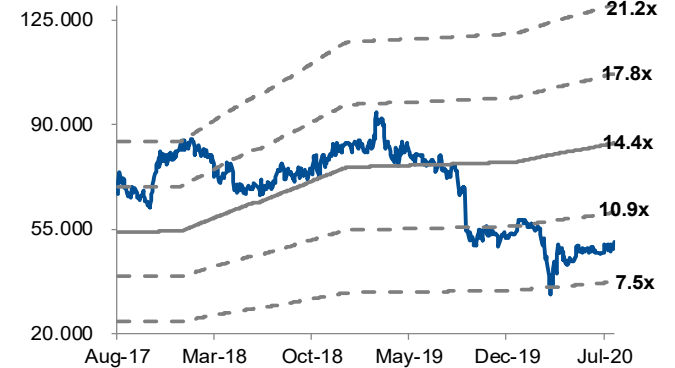
Multiple Valuation

Forward P/E band | Last 3 years



Source: NHKSI research

Dynamic Forward P/E band | Last 3 years



Source: NHKSI research

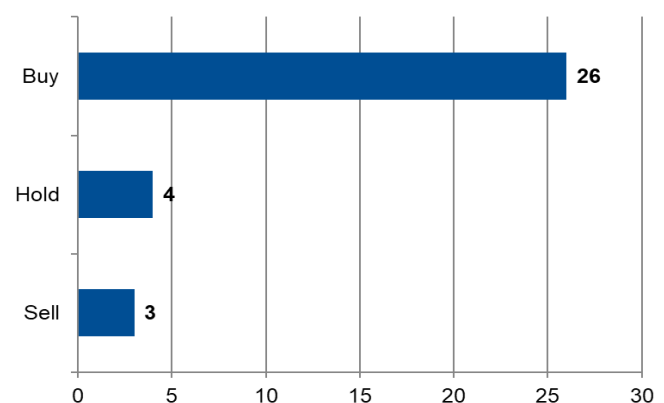
Rating and Target Price Update

Target Price Revision

Date	Rating	Target Price	Last Price	Consensus	vs Last Price	vs Consensus
09/18/2018	Buy	88,650	74,400	84,866	+19.2%	+4.5%
11/14/2018	Buy	100,000	75,700	86,915	+32.1%	+15.1%
09/24/2019	Buy	77,075	55,425	79,797	+35.5%	-5.9%
12/30/2019	Buy	61,800	52,400	59,865	+17.9%	+3.2%
05/26/2020	Buy	59,550	49,300	55,569	+20.8%	+7.2%

Source: NHKS research, Bloomberg

Analyst Coverage Rating



Source: Bloomberg

Closing and Target Price



Source: NHKSI research

NH Korindo Sekuritas Indonesia (NHKS) stock ratings

1. Period: End of year target price
2. 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

INCOME STATEMENT

(IDR bn)	2019/12A	2020/12E	2021/12E	2022/12E
Sales	110.524	107.151	109.945	116.870
<i>Growth</i>	15,5%	-3,1%	2,6%	6,3%
COGS	(87.741)	(89.413)	(88.681)	(94.181)
Gross Profit	22.783	17.738	21.263	22.689
<i>Gross Margin</i>	20,6%	16,6%	19,3%	19,4%
Operating Expenses	(7.912)	(6.983)	(7.751)	(8.415)
EBIT	14.872	10.756	13.512	14.274
<i>EBIT Margin</i>	13,5%	10,0%	12,3%	12,2%
Depreciation	2.530	2.709	2.628	2.832
EBITDA	17.401	13.465	16.140	17.106
<i>EBITDA Margin</i>	15,7%	12,6%	14,7%	14,6%
Interest Expenses	(599)	(749)	(374)	(293)
EBT	14.488	9.923	13.053	13.890
Income Tax	(3.607)	(2.481)	(3.263)	(3.472)
Minority Interest	0	-	-	-
Net Profit	10.881	7.443	9.790	10.417
<i>Growth</i>	39,6%	-31,6%	31,5%	6,4%
<i>Net Profit Margin</i>	9,8%	6,9%	8,9%	8,9%

PROFITABILITY & STABILITY

	2019/12A	2020/12E	2021/12E	2022/12E
ROE	21,4%	13,9%	16,8%	16,3%
ROA	13,8%	9,4%	12,0%	12,2%
ROIC	16,4%	12,4%	15,0%	15,4%
Cash Dividend (IDR bn)	5.003	5.003	5.003	5.003
Dividend Yield	3,1%	5,1%	5,1%	5,1%
Payout Ratio	64,2%	46,0%	67,2%	51,1%
DER	33,8%	21,8%	15,7%	9,3%
Net Gearing	33,9%	21,8%	15,7%	9,3%
LT Debt to Equity	0,0%	0,0%	0,0%	0,0%
Capitalization Ratio	25,3%	17,9%	13,6%	8,5%
Equity Ratio	64,8%	67,9%	71,6%	74,7%
Debt Ratio	21,9%	14,8%	11,2%	6,9%
Financial Leverage	153,8%	150,7%	143,3%	136,6%
Current Ratio	206,2%	222,7%	253,1%	288,2%
Par Value (IDR)	500	500	500	500
Total Shares (mn)	1.924	1.924	1.924	1.924
Share Price (IDR)	83.800	50.700	50.700	50.700
Market Cap (IDR tn)	161,2	97,6	97,6	97,6

BALANCE SHEET

(IDR bn)	2019/12A	2020/12E	2021/12E	2022/12E
Cash	3.572	5.617	8.327	11.399
Receivables	1.876	3.082	3.163	3.362
Inventories	42.847	40.297	38.947	38.318
Total Current Assets	52.081	50.392	51.804	54.419
Net Fixed Assets	25.374	26.817	28.038	29.296
Other Non Current Asset	1.192	1.627	1.644	1.660
Total Assets	78.647	78.836	81.485	85.375
Payables	1.297	1.200	1.191	1.264
ST Bank Loan	17.236	11.677	9.161	5.930
LT Debt	-	-	-	-
Total Liabilities	27.717	25.148	23.010	21.485
Capital Stock	1.016	1.016	1.016	1.016
Retained Earnings	49.948	52.582	57.369	62.784
Shareholders' Equity	50.931	53.564	58.352	63.766

VALUATION INDEX

	2019/12A	2020/12E	2021/12E	2022/12E
Price /Earnings	14,8x	13,1x	10,0x	9,4x
Price /Book Value	3,2x	1,8x	1,7x	1,5x
Price/Sales	1,5x	0,9x	0,9x	0,8x
PE/EPS Growth	0,4x	-0,4x	0,3x	1,5x
EV/EBITDA	10,1x	8,3x	6,4x	5,7x
EV/EBIT	11,9x	10,3x	7,7x	6,9x
EV (IDR bn)	176.493	111.182	103.578	98.352
Sales CAGR (3-Yr)	10,8%	13,2%	8,8%	4,7%
EPS CAGR (3-Yr)	6,6%	17,7%	-1,4%	7,9%
Basic EPS (IDR)	5.655	3.868	5.088	5.414
Diluted EPS (IDR)	5.655	3.868	5.088	5.414
BVPS (IDR)	26.470	27.839	30.327	33.141
Sales PS (IDR)	57.442	55.689	57.141	60.741
DPS (IDR)	2.600	2.600	2.600	2.600

CASH FLOW STATEMENT

(IDR bn)	2019/12A	2020/12E	2021/12E	2022/12E
Operating Cash Flow	10.948	17.077	14.067	15.352
Investing Cash Flow	(4.818)	(4.587)	(3.839)	(4.047)
Financing Cash Flow	(4.606)	(10.446)	(7.518)	(8.234)
Net Changes in Cash	1.524	2.045	2.710	3.072

OWNERSHIP

By Geography	% Shareholders	%
Indonesia	92,0	Suryaduta Investama 69,3
United States	2,9	Suryamitra Kusuma 6,3
Luxembourg	2,1	Fil Limited 1,5
Ireland	0,6	Vanguard Group 0,8

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