

Nippon Indosari (ROTI IJ; Hold)

Profit sinks due to higher OpEx

- Decelerating earnings growth in 2Q16, slightly below expectation.
- Margin narrows on slightly higher raw material costs
- Still maintains market leadership in Indonesia's bakery industry.
- Downgrade to HOLD (from BUY), TP unchanged at Rp1,650.

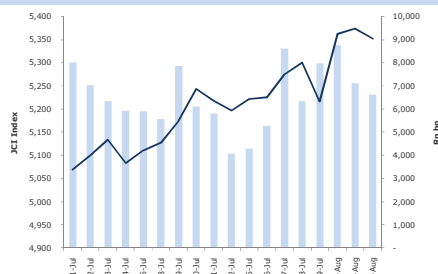
Earnings decelerate. Nippon Indosari's 2Q16 net profit was down 20.6% yoy to Rp42.5bn (1Q16: Rp86.3bn; -50.8% qoq) despite revenue growth of 11.9% yoy in 2Q16, which was mainly driven by volume growth. The white bread segment reported revenue growth of 16.9% yoy, while sweet bread reported earnings growth of only 4.5% yoy in 2Q16. Dorayaki reported the highest revenue growth of 70.6% yoy in 2Q16 albeit off a lower base. Return rate increased to 16% of net sales in 2Q16, from 14% in 1Q16. However, the return rate is still considered stable compared to 2Q15. As of 2Q16, white bread accounted for 70% of net sales, sweet bread accounted for 44% and Dorayaki accounted for only 2% of the net sales.

Pressure on gross margin. Although gross profit surged 7.2% yoy in 2Q16, gross margin shrunk by 220bps yoy to 50.3% in 2Q16 on slightly higher raw material and packaging costs. The raw material and packaging costs accounted for 30.8% of net sales in 2Q16 despite favorable wheat price, which has declined by c.33% since its peak in June 2015. Operating expense was 19% yoy higher due to growing expired/defective inventory at 6.9% of net sales in 2Q16 (vs 2Q15:6.1% of net sales) and higher direct labour costs (+17%yoy growth in 2Q16). Hence, operating margin was squeezed to 10.4% in 2Q16, from 15% in 2Q15.

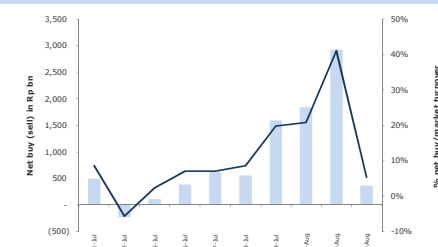
Maintains market leadership. Despite slower revenue growth in 2Q16, we expect the company to maintain its market leadership in the fragmented bakery market in Indonesia, especially given the company's strong distribution network. As of June 2016, the company reported 60,122 points of sales across Indonesia (from 59,295 points of sales in Aug 2015), which was mostly driven by growing number of modern trade retailers. In 1H16, modern trade channel still dominated 79% of total distribution channels, resulting in return rate jumping to 15.8% in 2Q16 (vs 10.5% in 3Q15 when modern trade accounted only for 75% of total distribution channels). However, the company has indicated its plan to shift the distribution mix towards more general trade channel to 40% by 2020.

HOLD at TP Rp1,650. Our DCF-based TP implies FY17F P/E of 21.6x. We like the company due to its robust capacity expansion and strong positioning in Indonesia's fragmented bakery industry. We also expect further potential growth to come from its new factory in the Philippines. However, we think the current valuation is slightly demanding. Therefore, we downgrade to HOLD.

JCI Index



Foreign net buy (sell)



Key Indexes

Index	Closing	1 day	1 year	YTD
JCI	5,352	-0.4%	11.9%	16.5%
LQ45	921	-0.7%	13.5%	16.2%
DJI	18,355	0.2%	4.6%	5.3%
SET	1,507	0.7%	5.3%	17.0%
HSI	21,739	-1.8%	-10.9%	-0.8%
NKY	16,083	-1.9%	-21.6%	-15.2%
FTSE	6,634	-0.2%	-0.8%	6.3%
FSSTI	2,828	-1.0%	-11.4%	-1.9%
EIDO	26	-0.3%	17.7%	25.8%

Commodity price

Commodities	Last price	Ret 1 day	Ret 1 year
(in USD)			
Oil/barrel (WTI)	40.8	3.3%	-9.6%
CPO/tonne	597.5	3.3%	10.0%
Soy/bushel	9.8	-1.0%	-1.4%
Rubber/kg	1.8	-0.4%	10.5%
Nickel/tonne	10,693	0.1%	0.0%
Tins/tonne	17,932	-0.3%	11.9%
Copper/tonne	4,881	0.3%	-6.5%
Gold/try.oz (Spot)	1,358	-0.4%	24.9%
Coal/tonne	67.6	-0.1%	12.1%
Corn/bushel	3.1	0.2%	-14.5%
Wheat/bushel*	157.5	-3.6%	-18.4%

* : 1 month change

Source : Bloomberg

Year To 31 Dec	2014A	2015A	2016F	2017F	2018F
Revenue(RpBn)	1,880	2,175	2,582	3,093	3,741
EBITDA(RpBn)	356	523	633	753	921
EBITDA Growth (%)	30.7	47.0	21.1	19.0	22.3
Net Profit(RpBn)	193	271	338	387	499
EPS (Rp)	38	54	67	76	98
EPS Growth (%)	21.1	40.8	24.7	14.4	28.8
Net Gearing (%)	18.4	-43.4	5.0	9.8	3.0
PER (x)	40.0	28.4	22.8	19.9	15.5
PBV (x)	8.0	6.5	5.2	4.2	3.4
Dividend Yield (%)	0.2	0.4	0.4	0.4	0.5
EV/EBITDA (x)	21.2	15.7	12.1	10.0	8.3

Source: ROTI, IndoPremier

Share Price Closing as of : 02 August, 2016

Refer to Important disclosures on the last of this report

News & Analysis

Corporates

ICBP: PT Indofood CBP Sukses Makmur (ICBP IJ; Rp8,800; Buy) plans to expand its dairy capacity. Last year, its dairy volume sales have hit 339,000 tons, with a maximum capacity of 375,000 tons. However, there is no further disclosure made regarding its capex, additional capacity, and planned date. (Bisnis Indonesia)

Comment: We are positive on this news as the management keeps expanding its second largest division. ICBP's dairy segment sales continue to grow at 11% of 5-years CAGR at 2010-15 and contribute 19% to total sales structure in FY15. Its operating margin of 10% comes second after noodles segment's margin of 17%. We reiterate Buy on ICBP.

PTPP: PT Pembangunan Perumahan (PTPP IJ; Rp3,930; Buy) reported earnings guidance with net income before minority interest of Rp280bn (+116% qoq, +139% yoy) which was caused by strong revenue growth of Rp3.8tn (+50.1%qoq, +20% yoy) in 2Q16. 6M16 net income before minority interest came strong of 40% of our estimates, while historical achievement only ranging 21-34%, respectively. New contract has reached Rp14.1tn (+5% yoy) or 45% of target and ours, thus inline with its historical achievement on the last two years. Construction business still contributes 77% of new contract, followed by precast 7% and EPC 7%. On separate news, three of PTPP's subsidiaries are scheduled to go on IPO next year. Those are PP Precast, PP equipment and energy with targeted proceed of 1.1tn, Rp1.15tn and Rp4tn, respectively. We like the strong achievement of PTPP and reiterate BUY at TP Rp4,800. (Company, Kontan)

WIKA: Wijaya Karya (WIKA IJ; Rp3,010; Buy) increased its earnings target to Rp 940bn, or 25% higher from its initial estimate of Rp750bn. According to WIKA's CFO, the increased target was contributed by robust new contract growth that has reached Rp22.7tn in first week of August or 43% of target. Furthermore, company expects to get HSR contract of Rp17tn in August, thus bring total contract to Rp40tn or 76% of company's target at the end of August. (Investor daily)

Comment: WIKA's new net profit guidance is 34% and 25% higher from ours and consensus estimates. We expect strong earnings momentum from WIKA in 3Q16 of which company should start recognize revenue from its HSR project.

WSKT: Waskita Karya's (WSKT IJ: Rp2,780; Buy) subsidiary, Waskita Beton will add two precast factory in 2H16. Company expects total capacity to be 2.65mn tonnes at the end of 2016. Two factories will be located in Palembang (Sumatra) and Klaten (Java). Waskita beton will go IPO in 3Q16. (Kontan)

Markets & Sectors

Telecommunication sector: The Ministry of Communication and Information has issued new interconnection regulation, lowering the interconnection tariff by 25%. This regulation will be effective starting 1 Sep16 to Dec18. Interconnection for voice was lowered to Rp204/minute from Rp250, while SMS down to Rp11/SMS from Rp24. Retail tariff for off-net is priced between Rp1500-2000/minute. (Investor Daily)

Comment: We think this new interconnection could be slightly negative to neutral to TLKM. Nevertheless in the long run interconnection tariff could become less relevant for the reason 1) growing data 2) lower usage of voice and SMS 3) bundled offers creating less transparency in tariff. In the 1H16, TLKM was a net receiver of Rp466bn or representing 3.3% of total EBITDA. Moreover the interconnection cost only represents 25% of the total retail price. Therefore the price sensitivity could be low and insignificant in changing telephony patterns.

Economic

State budget: The newly appointed finance minister Sri Mulyani Indrawati plans to undertake some budget cut of Rp133.8tn, of which Rp65tn will be deducted from central government budget and Rp68.8tn from local transfer. The move is taken after considering tax revenue will experience a shortfall of approximately Rp219tn. Coordinating minister for the economy Darmin Nasution confirms that the government will maintain the 3% budget ceiling, negating earlier speculation that the government is currently preparing a regulation to accommodate budget deficit to be below 3%.

Comment: The finance minister's move to cut budget further is realistic given current peril to tax revenue and despite the expected revenue increase from tax amnesty (last year's tax revenue performance was only 82% of target). However, this may impact economic growth as government spending's contribution to growth stood third after private consumption and investment, which gains spillover from the government spending.

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INVESTMENT RATINGS

BUY : Expected total return of 10% or more within a 12-month period
HOLD : Expected total return between -10% and 10% within a 12-month period
SELL : Expected total return of -10% or worse within a 12-month period

ANALYSTS CERTIFICATION.

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