

Gudang Garam (GGRM IJ)

1 November 2016

Results Note

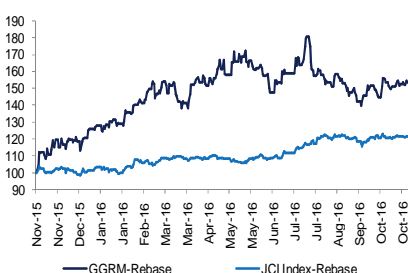
HOLD (Downgraded)

Stock Data

Target price (Rp)	Rp68,000
Prior TP (Rp)	Rp73,000
Shareprice (Rp)	Rp66,000
Upside/downside (%)	+3.0
Sharesoutstanding (m)	1,924
Marketcap. (US\$ m)	9,727
Free float (%)	26.9
Avg. 6m dailyT/O (US\$ m)	7.1

Price Performance

	3M	6M	12M
Absolute (%)	-4.1	-2.8	37.2
Relative to JCI (%)	-4.8	-15.0	18.7
52w high/low (Rp)	77,500 - 46,400		



Major Shareholders

PT Suryaduta Investama	69.3%
PT Suryamitra Kusuma	6.3%

Estimate Change; Vs. Consensus

	2016F	2017F
Latest EPS (Rp)	3,485	3,931
Vs. Prior EPS (%)	(9.3)	(17.5)
Vs. Consensus (%)	(1.0)	(1.1)

Source: Bloomberg

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Milder Earnings on Higher A&P

- **9M16 profit up 12% yoy, in-line with consensus.**
- **Gross margin normalized but contraction seen in operating margin.**
- **We downgrade earnings by 10.9% in FY16F on higher A&P cost.**
- **Downgrade to HOLD (from BUY) with new TP of Rp68,000.**

Earnings below our expectation. Gudang Garam (GGRM) reported earnings of Rp4.6tn in 9M16 (+12% yoy), representing only 63%/69% of our/consensus estimates, on the back of 10.2% yoy revenue growth in 9M16. The hand-rolled cigarettes (SKT), which accounted for 9% of total sales in 9M16, reported growth of 15.5% yoy, followed by machine-made cigarette (SKM) by 9.6% yoy growth in 9M16. In 3Q16, SKM still reported growth of 8.0% yoy while SKT grew 10.7% yoy. We expect the double digit growth in SKT still indicates a slow recovery in consumer purchasing power. As of 3Q16, the tobacco market in Indonesia still reported decline of 13.5% QoQ.

High A&P spending hurt operating profit. GGRM reported stable gross margin of 20.8% with gross profit of Rp3.9tn in 3Q16. Excise duty cost grew 21.7% yoy in 3Q16. Meanwhile, raw material costs only grew 2.1% yoy, which accounted for 16.4% of total sales in 3Q16 (vs. 3Q15: 17.4%). Operating expense grew 20% yoy in 3Q16 on higher A&P sales. A&P expense increased by 35.7% yoy to reach Rp378.7bn in 3Q16 (accounting for 27.6% of total OpEx in 3Q16). We expect the company's higher spending on A&P expense will continue until year-end in order to maintain brand awareness among Indonesian consumers. The operating margin contracted by 80bps yoy to 13.6% in 3Q16, while net margin also declined to 9.0% in 3Q16 from 9.6% in 3Q15.

Earnings downgrade on higher operating costs. Despite positive revenue growth, we reduce our FY16F and FY17F earnings by 10.9% and 13.2% yoy, respectively, due to higher than expected operating cost in 3Q16. We forecast gross margin in FY16F and FY17F to be at 20.8% and 20.4%, respectively. As a result of higher A&P expense, we expect operating margin to decline slightly to 13.0% in FY16F (vs. FY15: 14.1%). For the next two years, we maintained our volume sales to remain relatively flat. However, we still expect GGRM's earnings to continue growing at 11.2% CAGR in 2015-2017F on the back of 12.2% revenue growth during the same period.

Downgrade to HOLD (from BUY) with new TP of Rp68,000. Our new DCF-based target price (key assumptions: 10.1% WACC, 7% risk free rate), implies FY17F P/E of 17.3x. We believe intensifying A&P cost to solidify its brand positioning will hurt GGRM's profitability. Given the expected flat volume in the next two years, we believe the Indonesia tobacco industry will face a more challenging backdrop. Therefore, we downgrade the stock to HOLD from BUY.

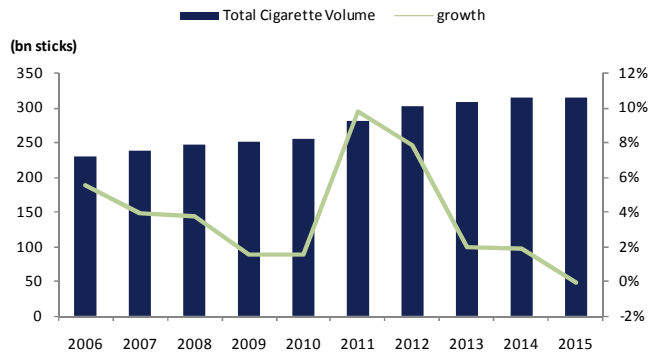
Year To 31 Dec	2014A	2015A	2016F	2017F	2018F
Revenue(RpBn)	65,186	70,366	78,242	87,753	100,192
EBITDA(RpBn)	10,018	11,654	12,034	12,854	14,253
EBITDA Growth (%)	29.1	16.3	3.3	6.8	10.9
Net Profit(RpBn)	5,369	6,436	6,705	7,567	8,668
EPS (Rp)	2,790	3,345	3,485	3,933	4,505
EPS Growth (%)	24.0	19.9	4.2	12.9	14.5
Net Gearing (%)	49.8	46.7	20.2	6.4	11.1
PER (x)	23.7	19.7	18.9	16.8	14.7
PBV (x)	3.8	3.3	3.0	2.7	2.4
Dividend Yield (%)	1.2	1.2	1.9	1.9	2.2
EV/EBITDA (x)	11.0	9.4	9.8	9.6	8.5

Source: GGRM, IndoPremier

Share Price Closing as of : 28 October 2017

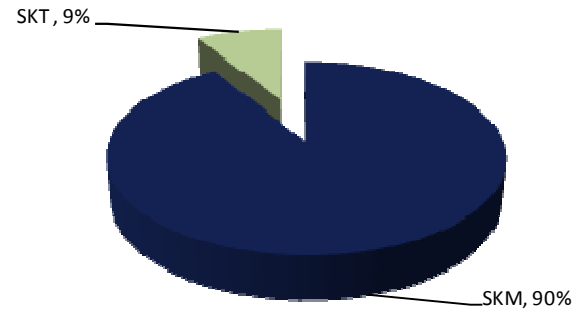
GGRM Results Note

Fig. 1: Historical Cigarette Sales Volume (2006-2015)



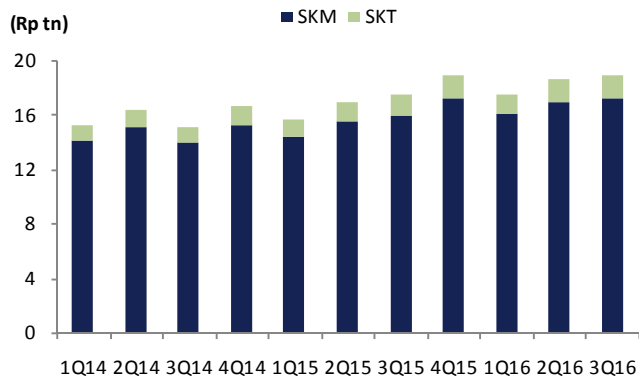
Source: PMI, Indo Premier

Fig. 2: SKM segments still dominated total sales in 3Q16



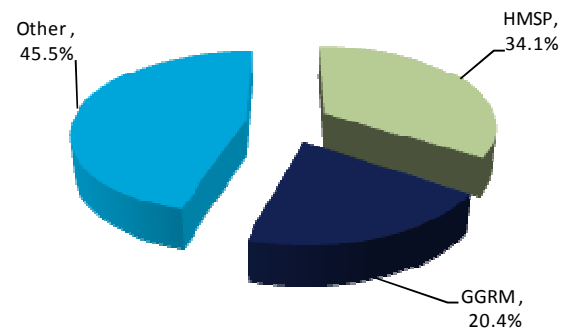
Source: GGRM, IndoPremier

Fig. 3: Revenue Trend per division on quarterly basis



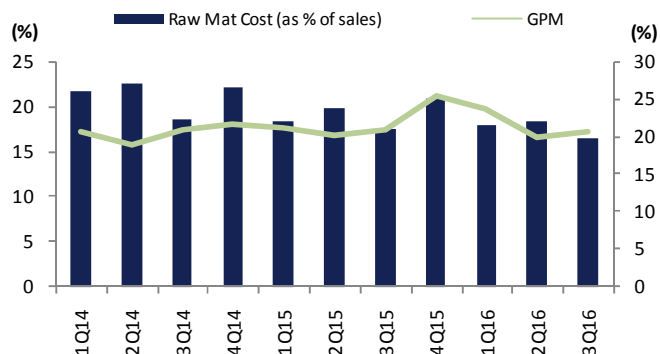
Source: GGRM, IndoPremier

Fig. 4: Cigarette Manufacturer Market Share as of 1H16



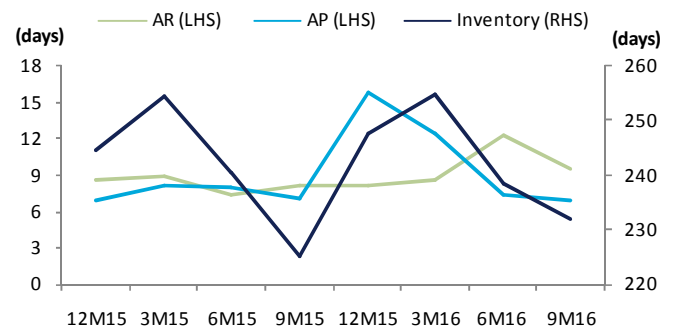
Source: GGRM, IndoPremier

Fig. 5: Gross Margin and Raw Material Cost Trend Quarterly



Source: GGRM, IndoPremier

Fig. 6: Working Capital Trend (days)



Source: GGRM, IndoPremier

GGRM Results Note

Fig. 7: Earnings Result

(in Rp bn)	3Q16	3Q15	YoY	3Q16	2Q16	QoQ
Revenue	19,249	17,786	8.2%	19,249	18,970	1.5%
SKM (Machine Made Cigs)	17,329	16,040	8.0%	17,329	17,008	1.9%
SKT (Hand rolled Cigs)	1,641	1,482	10.7%	1,641	1,655	-0.8%
Gross Profit	3,998	3,708	7.8%	3,998	3,773	6.0%
Operating Profit	2,626	2,564	2.4%	2,626	1,707	53.9%
Net Profit	1,732	1,705	1.6%	1,732	1,176	47.3%
Gross Margin (%)	20.8%	20.8%		20.8%	19.9%	
Operating Margin (%)	13.6%	14.4%		13.6%	9.0%	
Net Margin (%)	9.0%	9.6%		9.0%	6.2%	

Source: GGRM, IndoPremier

Fig. 8: Earnings Revision

In Rp bn	Old		New		Change (%)	
	FY16F	FY17F	FY16F	FY17F	FY16F	FY17F
Sales	78,950	90,195	78,242	87,753	-0.9%	-2.7%
Gross profit	17,369	20,119	16,297	17,909	-6.2%	-11.0%
Operating profit	11,048	12,965	10,161	10,902	-8.0%	-15.9%
Net profit	7,350	9,175	6,670	7,564	-9.3%	-17.6%
Margins						
Gross margin	22.0%	22.3%	20.8%	20.4%	-1.2%	-1.9%
Operating margin	14.0%	14.4%	13.0%	12.4%	-1.0%	-2.0%
Net margin	9.3%	10.2%	8.5%	8.6%	-0.8%	-1.6%

Source: GGRM, IndoPremier

GGRM Results Note

Year To 31 Dec (RpBn)	2014A	2015A	2016F	2017F	2018F
Income Statement					
Net Revenue	65,186	70,366	78,242	87,753	100,192
Cost of Sales	(51,806)	(54,880)	(61,945)	(69,844)	(79,767)
Gross Profit	13,380	15,486	16,297	17,909	20,426
SG&A Expenses	(4,855)	(5,579)	(6,133)	(7,003)	(8,192)
Operating Profit	8,525	9,906	10,164	10,906	12,234
Net Interest	(1,304)	(1,305)	(1,167)	(739)	(588)
Forex Gain (Loss)	17	72	0	0	0
Others-Net	(32)	(38)	0	0	0
Pre-Tax Income	7,206	8,635	8,997	10,167	11,646
Income Tax	(1,811)	(2,182)	(2,274)	(2,570)	(2,943)
Minorities	(27)	(17)	(18)	(31)	(35)
Net Income	5,369	6,436	6,705	7,567	8,668
Balance Sheet					
Cash & Equivalent	1,588	2,829	6,282	6,155	4,062
Receivable	1,532	1,568	1,715	1,827	1,982
Inventory	34,739	37,256	37,260	38,350	49,095
Other Current Assets	673	1,019	1,049	1,188	1,342
Total Current Assets	38,533	42,672	46,306	47,520	56,480
Fixed Assets - Net	18,973	20,106	19,660	18,993	18,128
Goodwill	0	0	0	0	0
Non Current Assets	649	639	711	797	910
Total Assets	58,221	63,505	66,769	67,415	75,638
ST Loans	18,147	20,561	14,866	9,214	10,019
Payable	989	2,370	0	1,871	2,099
Other Payables	4,647	1,114	6,592	7,470	8,549
Current Portion of LT Loans	0	0	0	0	0
Total Current Liab.	23,783	24,045	23,147	18,555	20,668
Long Term Loans	0	0	0	0	0
Other LT Liab.	1,209	1,452	1,186	1,281	1,458
Total Liabilities	24,992	25,498	24,333	19,836	22,126
Equity	1,003	1,000	1,016	1,016	1,016
Retained Earnings	32,091	36,900	41,249	46,362	52,260
Minority Interest	135	108	171	201	236
Total SHE + Minority Int.	33,229	38,008	42,435	47,579	53,512
Total Liabilities & Equity	58,221	63,505	66,769	67,415	75,638

Source: GGRM, IndoPremier

GGRM Results Note

Year to 31 Dec	2014A	2015A	2016F	2017F	2018F
Cash Flow					
Net Income (Excl.Extraordinary&Min.Int)	5,395	6,453	6,723	7,597	8,703
Depr. & Amortization	1,400	1,715	1,871	1,948	2,019
Changes in Working Capital	(3,565)	(1,322)	(677)	(1,012)	(10,660)
Others	2,569	(408)	(2,991)	6,191	1,474
Cash Flow From Operating	5,799	6,438	4,926	14,726	1,536
Capital Expenditure	(4,915)	(2,839)	(1,496)	(1,368)	(1,267)
Others	68	125	141	188	182
Cash Flow From Investing	(4,847)	(2,714)	(1,354)	(1,180)	(1,085)
Loans	5,169	2,414	(5,695)	(5,652)	805
Equity	0	0	0	0	0
Dividends	(1,583)	(1,568)	(2,355)	(2,454)	(2,769)
Others	(1,389)	(1,459)	(1,230)	(897)	(734)
Cash Flow From Financing	2,197	(613)	(9,281)	(9,002)	(2,699)
Changes in Cash	3,149	3,111	(5,709)	4,543	(2,248)
Financial Ratios					
Gross Margin (%)	20.5	22.0	20.8	20.4	20.4
Operating Margin (%)	13.1	14.1	13.0	12.4	12.2
Pre-Tax Margin (%)	11.1	12.3	11.5	11.6	11.6
Net Margin (%)	8.2	9.1	8.6	8.6	8.7
ROA (%)	9.9	10.6	10.3	11.3	12.1
ROE (%)	17.1	18.1	16.7	16.8	17.1
ROIC (%)	11.6	12.0	11.8	13.6	14.8
Acct. Receivables TO (days)	10.4	8.0	7.7	7.4	6.9
Acct. Receivables - Other TO (days)	0.0	0.0	0.0	0.0	0.0
Inventory TO (days)	1.6	1.5	1.7	1.8	1.8
Payable TO (days)	6.3	11.2	12.0	9.3	9.1
Acct. Payables - Other TO (days)	0.0	0.0	0.0	0.0	0.0
Debt to Equity (%)	54.6	54.1	35.0	19.4	18.7
Interest Coverage Ratio (x)	0.2	0.1	0.1	0.1	0.1
Net Gearing (%)	49.8	46.7	20.2	6.4	11.1

Source: GGRM, IndoPremier

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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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