INDOPREMIER

Equity | Indonesia | Cement

Baturaja (SMBR IJ)

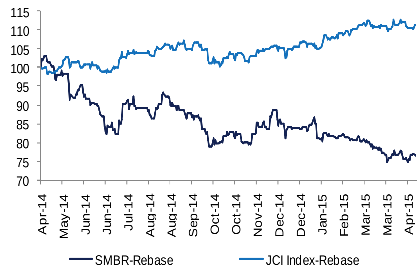
HOLD (Upgrade)

23 April 2015

Company Update

StockData	
Target price (Rp)	Rp360
Prior TP (Rp)	*340*
Shareprice (Rp)	Rp348
Upside/downside (%)	*+3.4*
Sharesoutstanding (m)	9,838
Marketcap. (US$ m)	266
Free float (%)	5.1
Avg. 6m dailyT/O (US$ m)	0.2

Price Performance			
	3M	6M	12M
Absolute (%)	-7.4	-7.7	-24.7
Relative to JCI (%)	-9.9	-15.2	-37.8
52whigh/low (Rp)	348 - 341		



Major Shareholders	
Government of Indonesia	76.2%
Eastspring	1.0%

Estimate Change; Vs. Consensus		
	2015F	2016F
Latest EPS (Rp)	17	19
Vs. Prior EPS (%)	38	43
Vs. Consensus (%)	(46.2)	(45.2)

Source: Bloomberg

Chandra Pasaribu
PT Indo Premier Securities
chandra.pasaribu@ipc.co.id
+62 21 5793 1168

Upgrade to Hold

- **New capacity to rely on infrastructure**
- **Stiff competition in home market**
- **Normalised margins sustainable**
- **Upgrade to Hold**

Adding new capacity… Semen Baturaja (SMBR) followed in the footsteps of the incumbent by adding new capacity of 1.85mn tons at a total investment of US$250mn. The new plant will be located in the current facility in South Sumatera and is expected to be completed in FY17. This is the first expansion since 2001, causing SMBR to miss fast-growing opportunities in the South Sumatra market. The expansion plan was initiated back in 2013 but was postponed due to fierce competition in South Sumatera. With infrastructure development around the corner, SMBR is determined on not losing any further growth opportunities.

… but losing market share. Back in FY13, it completed the installation of a new cement mill, which should have helped the company increase its capacity by 750k tons. The plan was to import clinker, mill the clinker to cement and sell it to the domestic market. However, this plan failed to work as Holcim Indonesia (SMCB IJ; Rp1,580; Hold) aggressively penetrated SMB's market. As a result, SMBR was not able to sell more than 1.2mn in FY13-14, despite having new milling capacity. Moreover, the company avoided a price war by maintaining the selling price. As a result, the company lost market share to its competitor even with a well-known brand. Expanding its capacity while yet to win market share raises SMBR's risk profile.

Margin compression from weak pricing. SMBR's EBITDA margin was eroded by 660bps to 27.3% in FY14 due to intensified competition, translating in its inability to increase selling price, cost pressure from increase in electricity tariff by 39%, hike in fuel cost due to removal of subsidy and a weaker Rupiah. In the beginning of the year, the industry faced another headwind as Semen Indonesia (SMGR IJ; Rp13,825; Buy) lowered selling price by 5%, as urged by the Government. SMBR being the price taker followed suit by lowering prices, but by only about 2-3% for retail while leaving bulk cement price unchanged. Management has indicated EBITDA margin of 25% in 1Q15, relatively weak due to a combination of price pressure, weak demand and cost increases.

Hold, all bad news priced in. We think that all bad news is priced in. Nevertheless, SMBR will need to justify its expansion program by regaining market share in its home market. Management has indicated it will not enter a price war just to win market share. Infrastructure development will be the key driver for future cement growth, which could boom in FY17, in time for the completion of the new plant. We upgrade to Hold, as we think all bad news has already been priced in; Target Price Rp360 (from Rp340).

Year To 31 Dec	2013A	2014A	2015F	2016F	2017F
Revenue(RpBn)	1,169	1,215	1,189	1,276	1,834
EBITDA(RpBn)	394	325	306	328	518
EBITDA Growth (%)	(5.3)	(17.6)	(5.7)	7.1	57.9
Net Profit(RpBn)	241	177	167	189	257
EPS (Rp)	24	18	17	19	26
EPS Growth (%)	(19.3)	(26.6)	(5.8)	13.2	36.5
Net Gearing (%)	(77.1)	(75.6)	(43.3)	8.4	(3.0)
PER (x)	14.2	19.3	20.5	18.1	13.3
PBV (x)	1.4	1.3	1.2	1.1	1.0
Dividend Yield (%)	1.7	2.3	1.4	1.3	1.6
EV/EBITDA (x)	13.5	16.8	15.2	9.6	6.8

Source : SMBR,IndoPremier *Share Price Closing as of : 22-April-2015*

Preparing for the future

The Government kicked off the development of Trans Sumatera toll road in March 2015. This is a mega project with a total investment of about of Rp360tn (US$30bn) to construct a 2,700km toll road connecting Sumatera from the tip to the end. The Government has appointed HutamaKarya, a non-listed SOE construction company, to start the development of four sections (of a total 24 sections) namely, Bakauheni-TerbanggiBesar (150km), Palembang-Indralaya (22km), Pekanbaru-Dumai (135km), and Medan Binjai (15.8km).

In fact, the Government had the blueprint of this toll road project since the previous administration under SusiloBambangYudhoyono. Nonetheless, the main issues for toll road development are financing availability and land acquisition. Due to low financial feasibility, the current Government has become the initiator for the development of this toll road by appointing HutamaKarya as the concession holder. This company is allowed to sell off its assets once the toll roads are operational and sellable.

The two stretches, Bakauheni-TerbanggiBesar and Palembang-Indralaya, are located in South Sumatera. SMBR should benefit if the construction of these toll roads start. SMBR could be the preferred partner as this project is Government-driven and should, hence, enjoy the benefits of SOE synergies. However, we have witnessed poor execution in land acquisition in Java. The implementation of the new land bill needs to be seen. Financial concerns should be relatively minimal, as the Government has injected fresh capital of Rp3.6tn in HutamaKarya.

Fig. 1: Proposed Trans Sumatera Toll Road

Source : Ministry of Public Works

The development of infrastructure such as toll road usually leads to new economic activity centers such as housing, trade centers, warehousing or industrial estates. This creates further demand for cement. SMBR's management is optimistic of such a scenario, when the development a new plant in South Sumatera concludes. The new factory is expected to be completed in FY17, probably a perfect timing if we include all the delays in infrastructure development. SMBR has already signed procurement and construction agreement. Possibilities of delays and difficulties in cash flow, if any, have been discussed with suppliers and contractors. Both contractors and suppliers are willing to take risks that might end up in rescheduling of payments. But for now, the project has received a green light.

Total investment cost of this new plant is estimated to reach US$250mn. Site preparation will start this year, with relatively minimal capex. There would be significant capex expenditure during the erection of the factory and installment of machinery, likely from late FY16 to early FY17. The company has secured US$30mn in foreign currency at an average cost of Rp12,800, to be used to finance part of the foreign denominated capex. As of December 2014, SMBR's cash position was Rp2.1tn while being debt-free. We expect EBITDA of Rp623bn in FY15-16, with maintenance capex of Rp94bn. Thus, the financing shortfall could be about Rp666bn, which could be easily financed by bank loans.

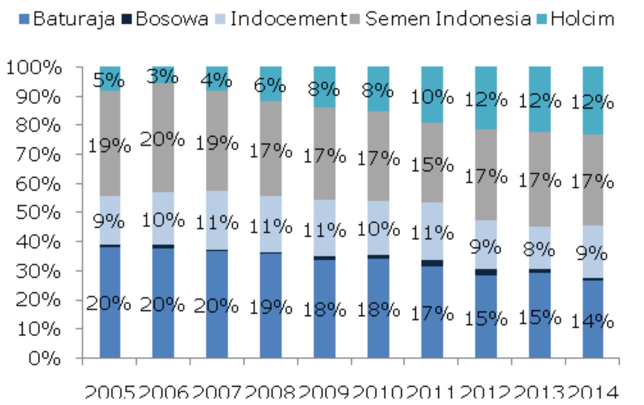
Not anticipating growth: a mistake in the past

SMBR's main market has been the four surrounding provinces of South Sumatera, Lampung, Bengkulu and Jambi. The first two provinces accounted about 98.5% of total SMBR's sales volumes in FY14. These four provinces have been growing at a CAGR of 10.6% in FY05-14, while SMBR's production capacity has been similar at 1.25mn tons in FY01-13. Only in FY13, the company added a new milling line with a capacity of 750k tons. As the market has been growing faster than its capacity, SMBR has lost is market share, from a peak of 22% to 14% in FY14. Holcim Indonesia benefitted the most from this situation, as its market share has grown from a low base of 5% to 12% in FY14. Holcim has entered the market aggressively, allowing for price difference of up to 7.3%. Holcim is willing to sacrifice profitability to win market share. Other significant players in this area are Semen Indonesia and Indocement holding relatively stable market shares of 17% and 9%, respectively.

In FY13, SMBR added new milling capacity of 750k tons. The decision to add this new facility was relatively late to win back lost market share. The upcoming toll road of Trans Sumatera has plenty of potential demand for cement, including the induced demand after the completion of the toll road. SMBR will not miss this opportunity again. Therefore, management has decided to develop a new plant in the current location in Baturaja. In the medium term plan, SMBR is planning to build a green field project in Bengkulu. The expansion plan is to enhance the potential marketing area to untapped markets.

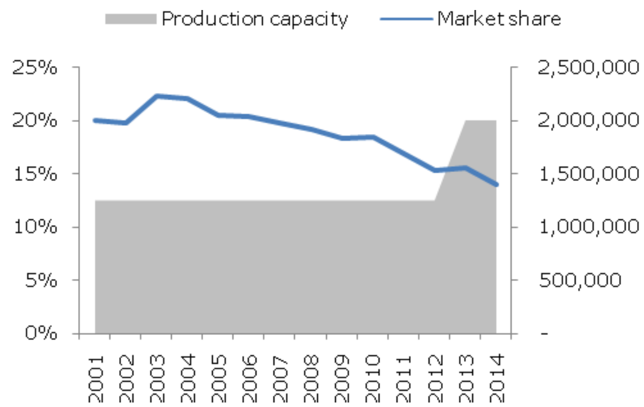
Adding a new capacity of 1.85mn tons will more than double the SMBR's capacity. Therefore, SMBR will need to find new markets with wider reach and better logistics efficiency. Management has indicated that it would enter into a MoU with KeretaApi Indonesia (KAI - SOE railway company) to build and increase the logistic capacity for cement products. KAI is willing to support such project due to better profitability compared with transportation of people. Transportation using railway logistics is not only faster and reliable but also cheaper by 20-25% compared with trucks. This is a win-win solution for both parties, as bulk transportation will be handled by railway, combined with the use of trucks for the last mile transportation.

Fig. 2: Losing market share to competition



Source : ASI, IndoPremier

Fig. 3: Capacity expansion failed to keep up with growing market



Source : ASI, SMBR

New mill to overcome supply shortage, but not successful

In FY13, SMBR completed a new milling facility with a capacity of 750k tons, at a total cement mill capacity of up to 2.0mn tons. However, the clinker production capacity is only 1.2mn tons. Assuming a clinker ratio of 85%, total cement production could reach only a maximum of 1.4mn tons, still below the maximum milling capacity of 2.0mn. In order to fully utilize the new milling capacity, SMBR could import clinker at US$56 per tons from Vietnam, which is about 7.4% higher than its own cement production. Therefore, gross margin from imported clinker would only be about 17-20%.

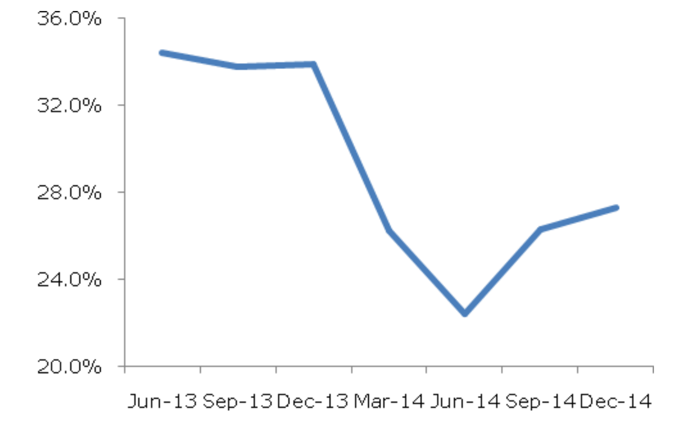
Despite having additional milling capacity since FY13, SMBR has not able to win back its market share. Monthly sales volumes have not been able to surpass 100k tons, similar to the sales volumes before the new milling capacity. Weaker Rupiah reduced the margin of utilizing imported clinker. Hence, we believe that SMBR has decided to rely on its own clinker production. Management has disclosed that SMBR has entered into a clinker purchase agreement with HolcimIndonessa, which seems to have idle capacity, especially with the completion of Tuban 2 plant this year. Having additional capacity from the new plant will be challenging for SMBR in terms of finding new markets to take full advantage of the plant. We have assumed a utilization rate of 30%,45% and 60% for the new plant in FY17-20.

Resetting margins to normal level

In the past two years, the Government has been busy in removing energy subsidy from of its state budget to implement prudent financial practices. The Government has removed subsidy on electricity for industries. SMBR is categorized in I-3 tariff bracket, which has increased by 39% in FY14. Electricity tariff will be set at the beginning of every month, based on 1) oil price 2) general inflation and 3) exchange rate. The electricity tariff as of April 2015 was Rp1,105.5 per kWh (-5.3% from peak in Dec14). The Government has also removed fuel subsidy for manufacturing and industrial uses, resulting in market-priced fuel for logistics both for raw material and finished goods. However, third party distribution companies are still allowed to use subsidized fuel. With unsubsidized energy cost, profit margin of the cement industry has been negatively affected.

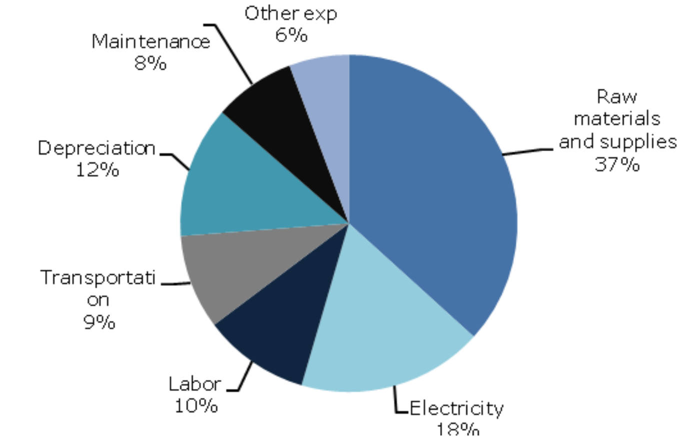
We think that current margin levels should be sustainable, being free of subsidy. In 4Q14, SMBR's EBITDA margin stood at 29%, already reflecting non-subsidized energy cost. In the beginning of the year, the Government urged Semen Indonesia to reduce cement price by 5% due to lower fuel and electricity tariffs. SMBR as a price-taker soon followed by reducing prices by 2-3%. As a result, management indicated that EBITDA margin is down again to 25% in 1Q15. We suspect that peers such as Semen Indonesia and Indocement will be in similar situation. For FY15, we think that pressure due to costs is relatively limited, especially with soft oil and coal prices.

Fig. 4: Normalized margin from subsidy removal



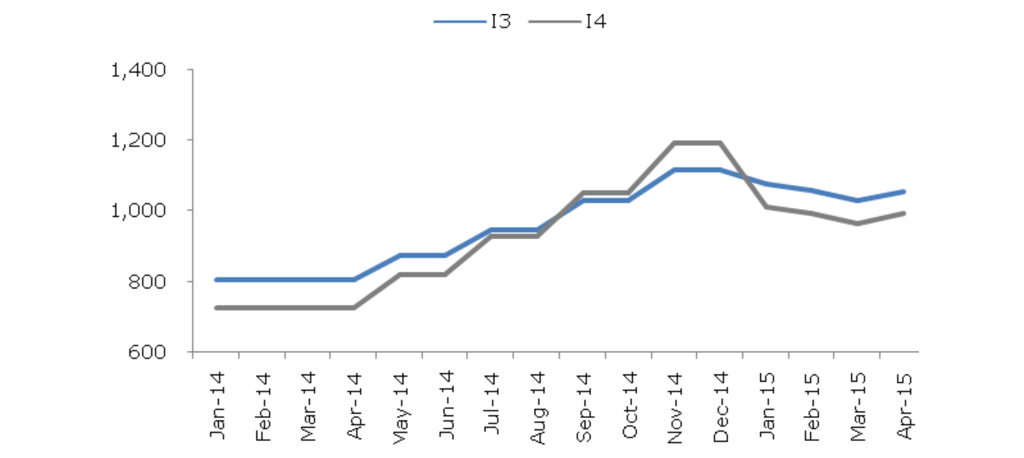
Source : SMBR

Fig. 5: Cost of Goods Sold breakdown



Source : SMBR

Fig. 6: Electricity tariff hikes for I3-I4



Source : PLN

Fig 7 DCF valuation for SMBR (Rpbn)

	2015	2016	2017	2018	2019	2020	2021	2022
EBITDA	306.42	328.13	518.02	603.69	708.71	815.45	913.03	953.67
(-) Tax	(76.60)	(82.03)	(129.50)	(150.92)	(177.18)	(203.86)	(228.26)	(238.42)
(-) Capital expenditures	(1,206)	(1,788)	(68)	(78)	(88)	(98)	(107)	(111)
(-) ΔWC	116.50	(1.19)	(7.64)	(4.22)	(4.71)	(4.96)	(5.08)	(2.72)
Terminal value								
FCFF	**(859)**	**(1,543)**	**313**	**371**	**439**	**509**	**572**	**602**
								6,888
	(859)	(1,543)		371	439	509	572	7,490
Enterprise value	2,252							
Cash	1,257							
Debt	-							
Net debt	1,257							
Equity value	3,509							
Value per share, Rp	357							

Source: IndoPremier

Year To 31 Dec (RpBn)	2013A	2014A	2015F	2016F	2017F
Income Statement					
Net Revenue	1,169	1,215	1,189	1,276	1,834
Cost of Sales	(706)	(842)	(830)	(895)	(1,352)
Gross Profit	462	372	359	381	482
SG&A Expenses	(135)	(136)	(144)	(148)	(171)
Operating Profit	327	236	215	233	311
Net Interest	0	0	0	0	0
Forex Gain (Loss)	0	0	0	0	0
Others-Net	2	7	0	0	0
Pre-Tax Income	329	243	215	233	311
Income Tax	(88)	(66)	(48)	(45)	(53)
Minorities	0	0	0	0	0
Net Income	241	177	167	189	257
Balance Sheet					
Cash & Equivalent	1,903	2,054	1,257	242	99
Receivable	36	81	16	17	25
Inventory	132	187	114	123	185
Other Current Assets	36	14	14	14	14
Total Current Assets	2,107	2,336	1,400	396	323
Fixed Assets - Net	590	558	1,672	3,365	3,225
Goodwill	0	0	0	0	0
Non Current Assets	15	33	33	33	33
Total Assets	2,711	2,926	3,105	3,793	3,581
ST Loans	0	0	0	500	0
Payable	68	91	0	98	148
Other Payables	126	88	79	86	115
Current Portion of LT Loans	0	0	0	0	0
Total Current Liab.	194	180	170	684	263
Long Term Loans	0	0	0	0	0
Other LT Liab.	51	29	31	32	34
Total Liabilities	244	209	201	716	297
Equity	2,018	2,018	2,018	2,018	2,018
Retained Earnings	449	699	886	1,059	1,267
Minority Interest	0	0	0	0	0
Total SHE + Minority Int.	2,467	2,717	2,904	3,077	3,285
Total Liabilities & Equity	2,711	2,926	3,105	3,793	3,581

Source : SMBR,IndoPremier

Year to 31 Dec	2013A	2014A	2015F	2016F	2017F
Cash Flow					
Net Profit	241	177	167	189	257
Depr. & Amortization	67	75	92	95	207
Changes in Working Capital	(28)	(95)	116	(1)	(8)
Others	28	(47)	22	5	16
Cash Flow From Operating	308	110	397	288	473
Capital Expenditure	(134)	(61)	(1,206)	(1,788)	(68)
Others	0	0	0	0	0
Cash Flow From Investing	(134)	(61)	(1,206)	(1,788)	(68)
Loans	(3)	0	0	500	(500)
Equity	1,378	0	0	0	0
Dividends	(60)	(78)	(48)	(44)	(53)
Others	(13)	(14)	1	1	1
Cash Flow From Financing	1,302	(92)	(47)	457	(552)
Changes in Cash	1,476	(43)	(855)	(1,044)	(147)
FinancialRatios					
Gross Margin (%)	39.6	30.7	30.2	29.9	26.3
Operating Margin (%)	28.0	19.4	18.0	18.3	17.0
Pre-Tax Margin (%)	28.2	20.0	18.0	18.3	17.0
Net Margin (%)	20.6	14.6	14.0	14.8	14.0
ROA (%)	12.3	6.3	5.5	5.5	7.0
ROE (%)	14.1	6.8	5.9	6.3	8.1
ROIC (%)	14.1	6.8	5.9	5.4	7.5
Acct. Receivables TO (days)	5.6	17.4	14.9	4.8	4.2
Acct. Receivables - Other TO (days)	0.0	0.0	0.0	0.0	0.0
Inventory TO (days)	5.7	5.3	5.5	7.6	8.8
Payable TO (days)	34.1	34.5	40.1	38.5	33.2
Acct. Payables - Other TO (days)	7.1	5.8	3.0	0.0	0.0
Debt to Equity (%)	0.0	0.0	0.0	16.2	0.0
Interest Coverage Ratio (x)	0.0	0.0	0.0	0.0	0.0
Net Gearing (%)	(77.1)	(75.6)	(43.3)	8.4	(3.0)

Source : SMBR,IndoPremier

INDOPREMIER

Head Office

PT INDO PREMIER SECURITIES

Wisma GKBI 7/F Suite 718

Jl. Jend. Sudirman No.28

Jakarta 10210 - Indonesia

p +62.21.5793.1168

f +62.21.5793.1167

Institutional Equity & Private Client

Benny B. Soebagjo	Head of Equities	benny.soebagjo@ipc.co.id
Angkula Ruriawan	Equity Sales	angkula.ruriawan@ipc.co.id
Alexander Salim	Equity Sales	alexander.salim@ipc.co.id
Edward Azizy	Equity Sales	edazizy@ipc.co.id
Henry Sutanto	Equity Sales	henry.sutanto@ipc.co.id
Isna Alfiathi	Equity Sales	isna.alfiathi@ipc.co.id
Angky Amarylis	Sales Trader	angky.amarylis@ipc.co.id
Thomas Samuil	Sales Trader	thomas.samuil@ipc.co.id

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

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