

26 May 2023

Consumer Non-cyclical | Tobacco

## Gudang Garam (GGRM IJ)

**Buy** (from Neutral)

### Aggressive Hikes To Expand Margins; U/G To BUY

Target Price (Return): IDR31,700 (+17%)  
 Price (Market Cap): IDR27,175 (USD3,509m)  
 ESG score: 3.13 (out of 4)  
 Avg Daily Turnover (IDR/USD) 46,880m/3.13m

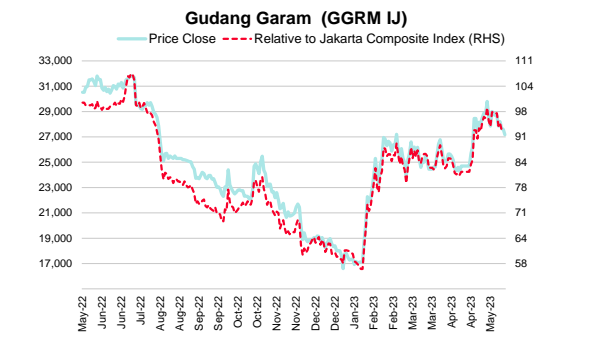
- Upgrade to BUY from Neutral, new TP at IDR 31,700 from IDR36,000, 17% upside and c.3% yield.** Despite consumers' downtrading likely to drag volumes (c.-5% YoY), we expect resilient demand from middle-to-upper income buyers who are less price sensitive. This and price increments should see Gudang Garam's 2023F revenue grow 6.8% YoY. Our TP is based on 12x P/E, on par with the peer average of 12.9x. GGRM is currently trading at 10.3x 2023F P/E, or -1SD from its 5-year P/E. This report marks the transfer of coverage to Indonesia Research.
- 2023F margins expansion on early aggressive price increments.** Based on our ground checks, GGRM's price increment of 1.3-7.1% MoM began in March, mainly affecting Gudang Garam Merah – hand-rolled *kretek* cigarettes (SKTs) – by 16% and the mid-priced Surya Pro Exclusive by 40%. In April-May, GGRM continued raising prices by 2.4-8.9%. YTD, the overall price increments have reached 7.5-45.2% while the 2023 excise tax price rise on machine-rolled *kretek* cigarettes (SKMs) was only 11.8% and 4.8% on SKT. The SKT segment should see wide margins expansion while another round of price rise in SKMs may offset the excise tax increment.
- Expecting gross margin adjustments in 2Q23.** While 1Q23 gross margin surged to 14.7% (1Q22: 11.2%, 4Q22: 11.1%), we expect 2Q23 gross margin to contract due to the 2023 excise tax's full impact. Note: Tobacco companies usually have a 2-month period to sell their stock with the previous year's excise tax. With the drop in volumes but higher ASPs, we estimate GGRM's gross margins to reach 10.9% in 2023 vs 8.9% in 2022.
- Weaker sales volumes from the mid-low income segment.** As consumer downtrading dragged GGRM's sales volumes in 2022 (-9% YoY), we expect this trend to continue, particularly in the mid-low income segment. Note: The price difference of Tier-2 cigarettes is c.IDR600/stick. Despite our expectations of purchasing power improving in 2H23, especially in 4Q23 – given the tapering of inflationary impacts, seasonality, and windfalls from election campaigns, we remain cautious on the risk of weather disruptions that may cause poor harvests, thereby raising staples prices. As such, we estimate 2023 volumes to drop by 5% YoY. With the excise tax in 2024 already fixed by the Finance Ministry to be the same as in 2023, we believe GGRM is able to better plan and strategise price increases. 2024F revenue should be supported by price increases instead of volumes, which should drop by 5-6% YoY. Hence we expect a 4.5% YoY revenue growth.
- ESG framework update.** As there is now greater focus on the E pillar on critical climate change issues, we tweaked our ESG weightage. Henceforth, we assign a 50% weightage to the E pillar, followed by 25% each to the S and G pillars. See our [2 May thematic](#) research for more details. GGRM's ESG score of 3.1, based on our proprietary methodology, is slightly above the country median. As such, we apply a 3% ESG premium to our TP.

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#### Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	51.0	10.0	4.2	26.7	(11.0)
Relative	52.5	11.1	5.8	31.1	(9.0)
52-wk Price low/high (IDR)	16,600 – 31,800				



Source: Bloomberg

Forecasts and Valuation	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Total turnover (IDRb)	124,881	124,683	133,144	139,141	145,412
Recurring net profit (IDRb)	5,609	2,783	4,937	5,381	6,276
Recurring net profit growth (%)	(26.7)	(50.4)	77.4	9.0	16.6
Recurring P/E (x)	9.32	18.79	10.59	9.72	8.33
P/B (x)	0.9	0.9	0.8	0.8	0.8
P/CF (x)	9.71	5.05	7.45	7.49	6.33
Dividend Yield (%)	9.6	8.3	2.7	4.7	5.1
EV/EBITDA (x)	1.80	1.83	1.56	1.46	1.34
Return on average equity (%)	9.5	4.7	8.3	8.5	9.4
Net debt to equity (%)	10.0	9.9	9.8	10.8	10.5

Source: Company data, RHB

#### Overall ESG Score: 3.13 (out of 4)

##### E: EXCELLENT

The company has started the necessary measures and manages Scope 1 emissions from its manufacturing operations, including energy, greenhouse gas, water, and waste.

##### S: GOOD

GGRM values equality, inclusiveness, sound labour relations (including provision of minimum wages), investment in human capital, and communities.

##### G: GOOD

Under the supervision of the board of commissioners, the board of directors are responsible for maintaining corporate governance standards. The work of the independent audit committee continued throughout 2022 – overseen by the board of commissioners.

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## Financial Exhibits

Asia	Financial summary (IDR)	Dec-21	Dec-22	Dec-23F	Dec-24F	Dec-25F
Indonesia	Recurring EPS	2,914.95	1,446.40	2,566.10	2,796.87	3,261.86
Consumer Non-cyclical	DPS	2,600.00	2,250.00	722.35	1,282.21	1,397.59
<b>Gudang Garam</b>	BVPS	30,813.67	30,069.26	31,972.20	33,546.06	35,469.52
GGRM IJ	Return on average equity (%)	9.5	4.7	8.3	8.5	9.4
Buy						
	<b>Valuation metrics</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
<b>Valuation basis</b>	Recurring P/E (x)	9.32	18.79	10.59	9.72	8.33
P/E	P/B (x)	0.9	0.9	0.8	0.8	0.8
	FCF Yield (%)	1.2	9.6	2.0	2.7	4.7
<b>Key drivers</b>	Dividend Yield (%)	9.6	8.3	2.7	4.7	5.1
i. Rising interest income;	EV/EBITDA (x)	1.80	1.83	1.56	1.46	1.34
ii. New products launched;	EV/EBIT (x)	8.19	15.39	8.64	8.07	6.96
iii. Stronger-than-expected consumer purchasing power.						
	<b>Income statement (IDRb)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
<b>Key risks</b>	Total turnover	124,881	124,683	133,144	139,141	145,412
i. Tight competition;	Gross profit	14,273	11,096	14,578	15,524	17,078
ii. Cut in fuel subsidies;	EBITDA	32,359	31,708	37,466	40,637	44,514
iii. Weak consumer purchasing power.	Depreciation and amortisation	(25,246)	(27,938)	(30,711)	(33,286)	(35,978)
	Operating profit	7,113	3,771	6,756	7,350	8,535
<b>Company Profile</b>	Net interest	162	(111)	(270)	(281)	(293)
Gudang Garam manufactures and distributes cigarettes, and operates activities related to the cigarette industry through its subsidiaries. The company also operates in paper-related businesses.	Pre-tax profit	7,287	3,647	6,473	7,055	8,229
	Taxation	(1,682)	(867)	(1,539)	(1,677)	(1,956)
	Reported net profit	5,605	2,780	4,934	5,378	6,273
	Recurring net profit	5,609	2,783	4,937	5,381	6,276
	<b>Cash flow (IDRb)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Change in working capital	(3,287)	4,728	(1,246)	(1,168)	(977)
	Cash flow from operations	5,385	10,358	7,023	6,983	8,258
	Capex	(4,762)	(5,338)	(5,992)	(5,566)	(5,816)
	Cash flow from investing activities	(4,586)	(5,157)	(6,019)	(5,627)	(5,862)
	Dividends paid	(5,003)	(4,329)	(1,390)	(2,467)	(2,689)
	Cash flow from financing activities	(1,404)	(4,964)	(882)	(1,844)	(2,128)
	Cash at beginning of period	4,774	4,170	4,407	4,529	4,037
	Net change in cash	(605)	237	122	(488)	268
	Ending balance cash	4,170	4,407	4,529	4,041	4,305
	<b>Balance sheet (IDRb)</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Total cash and equivalents	4,170	4,407	4,529	4,037	4,310
	Tangible fixed assets	29,780	32,426	35,645	38,635	41,759
	Total assets	89,964	88,563	94,249	99,091	104,683
	Short-term debt	9,980	10,071	10,522	10,971	11,392
	Total long-term debt	123	65	65	65	65
	Total liabilities	30,676	30,707	32,732	34,545	36,436
	Total equity	59,288	57,856	61,517	64,546	68,247
	Total liabilities & equity	89,964	88,563	94,249	99,091	104,683
	<b>Key metrics</b>	<b>Dec-21</b>	<b>Dec-22</b>	<b>Dec-23F</b>	<b>Dec-24F</b>	<b>Dec-25F</b>
	Revenue growth (%)	9.1	(0.2)	6.8	4.5	4.5
	Recurrent EPS growth (%)	(26.7)	(50.4)	77.4	9.0	16.6
	Gross margin (%)	11.4	8.9	10.9	11.2	11.7
	Operating EBITDA margin (%)	25.9	25.4	28.1	29.2	30.6
	Net profit margin (%)	4.5	2.2	3.7	3.9	4.3
	Dividend payout ratio (%)	89.2	155.7	28.2	45.9	42.9
	Capex/sales (%)	3.8	4.3	4.5	4.0	4.0
	Interest cover (x)	94.9	14.4	25.1	26.1	29.1

Source: Company data, RHB

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Figure 1: Tobacco retail price March-May in IDR

Brand	Mar 2023	MoM %	Apr 2023	MoM %	May 2023	MoM %	Price/stick
<b>Bentoel</b>							
Dunhill	35,500	4.4%	35,800	0.8%	35,800	0.0%	1,790
Lucky Strike	30,900	4.0%	30,900	0.0%	30,900	0.0%	1,545
<b>WIIM</b>							
Diplomat EVO	21,500	0.9%	22,500	4.7%	22,600	0.4%	1,413
<b>HMSF</b>							
A mild 16s	32,000	4.9%	32,000	0.0%	32,000	0.0%	2,000
Djisamsoe 12s	19,700	0.3%	19,700	0.0%	19,600	-0.5%	1,633
Djisamsoe Magnum Filter Mild 16s	30,600	0.3%	30,600	0.0%	30,600	0.0%	1,913
Marlboro Red 20s	40,300	0.5%	40,300	0.0%	41,300	2.5%	2,065
Marlboro Filter Black 20s	35,900	-0.3%	36,700	2.2%	36,700	0.0%	1,835
Sampoerna Kretek 12s	15,700	15.2%	15,800	0.6%	15,800	0.0%	1,317
A Ultra Mild 16s	30,500	-7.3%	30,500	0.0%	30,500	0.0%	1,906
<b>GGRM</b>							
Gudang Garam Signature Mild	31,500	3.3%	33,200	5.4%	33,200	0.0%	2,075
Gudang Garam Signature	22,800	-0.3%	24,000	5.3%	24,600	2.5%	2,050
Gudang Garam Merah	15,800	16.0%	15,900	0.6%	15,900	0.0%	1,325
Gudang Garam International	24,500	7.1%	25,100	2.4%	25,700	2.4%	2,142
Surya Pro	30,500	0.0%	31,700	3.9%	32,900	3.8%	2,056
Surya Pro Mild	30,500	0.0%	31,700	3.9%	32,900	3.8%	2,056
Surya Pro Exclusive	42,700	40.0%	43,200	1.2%	44,300	2.5%	2,769
GG Mild	30,900	1.3%	32,000	3.6%	32,600	1.9%	2,038
GG Shiver	30,500	0.0%	33,200	8.9%	33,200	0.0%	2,075
GG Move	23,000	0.5%	24,000	4.3%	24,600	2.5%	2,050
<b>Djarum</b>							
LA Bold 12	21,700	0.0%	21,800	0.5%	21,800	0.0%	1,817
Djarum Super 12	24,500	0.0%	24,900	1.6%	24,900	0.0%	2,075
LA Bold 20	32,700	0.0%	32,700	0.0%	32,900	0.6%	1,645
Djarum Super Mild 20	36,500	0.0%	36,800	0.8%	36,800	0.0%	1,840

Source: Company data, RHB

Figure 2: Sales volume – GGRM vs industry

(bn sticks)	2016	2017	2018	2019	2020	2021	2022
<b>Industry</b>							
Machine-rolled kretek cigarettes (SKM)	253	251	251	273	225	231	215
Growth %	-6.9%	-6.9%	-6.9%	-6.9%	-6.9%	-6.9%	-6.9%
Hand-rolled kretek cigarettes (SKT)	72	67	65	68	81	90	105
Growth %	21.1%	21.1%	21.1%	21.1%	21.1%	21.1%	21.1%
Machine rolled white cigarettes (SPM)	17	17	14	15	11	11	10
Growth %	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%	7.0%
<b>Total</b>	<b>342</b>	<b>335</b>	<b>330</b>	<b>356</b>	<b>317</b>	<b>332</b>	<b>330</b>
<b>Growth %</b>	<b>6.2%</b>	<b>-2.0%</b>	<b>-1.5%</b>	<b>7.9%</b>	<b>-11.0%</b>	<b>4.7%</b>	<b>-0.6%</b>
<b>GGRM</b>							
SKM	68.6	70.0	77.0	87.4	80.7	82.1	73.9
Growth %	-2.2%	2.1%	9.9%	13.6%	-7.7%	1.8%	-10.0%
SKT	8.5	8.6	8.2	8.5	9.1	9.0	8.6
Growth %	-0.4%	1.9%	-4.7%	3.5%	6.6%	-1.0%	-3.8%
<b>Total</b>	<b>77.1</b>	<b>78.7</b>	<b>85.2</b>	<b>95.9</b>	<b>89.7</b>	<b>91.1</b>	<b>82.5</b>
<b>Growth %</b>	<b>-2.0%</b>	<b>2.0%</b>	<b>8.3%</b>	<b>12.6%</b>	<b>-6.5%</b>	<b>1.5%</b>	<b>-9.4%</b>

Source: Company data, RHB

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Figure 3: 1Q23 results summary

IDRbn	1Q22	4Q22	1Q23	QoQ (%)	YoY (%)	FY23F RHB	FY23F Cons
<b>Revenue</b>	<b>29,291</b>	<b>30,763</b>	<b>29,731</b>	<b>(3.4)</b>	<b>1.5</b>	<b>22.3%</b>	<b>22.8%</b>
COGS	26,018	27,357	25,375	(7.2)	(2.5)		
<b>Gross profit</b>	<b>3,273</b>	<b>3,406</b>	<b>4,356</b>	<b>27.9</b>	<b>33.1</b>	<b>29.9%</b>	<b>25.5%</b>
Operating expenses	1,903	1,589	1,833	15.4	(3.7)		
<b>Operating profit</b>	<b>1,370</b>	<b>1,817</b>	<b>2,523</b>	<b>38.8</b>	<b>84.2</b>	<b>37.3%</b>	<b>36.0%</b>
Net interest income/ (expense)	(94)	(57)	(156)	171.9	66.6		
Forex gain (loss)	5	(37)	1	(101.7)	(87.2)		
Other income/ (expense)	93	(20)	132	(752.4)	41.5		
<b>Pre-tax profit</b>	<b>1,374</b>	<b>1,703</b>	<b>2,499</b>	<b>46.8</b>	<b>81.9</b>		
Taxation	(297)	(421)	(536)	27.4	80.3		
Minority interest	(0)	(0)	(0)				
<b>Net profit</b>	<b>1,077</b>	<b>1,282</b>	<b>1,963</b>	<b>53.1</b>	<b>82.3</b>	<b>39.8%</b>	<b>36.3%</b>
<b>Margin</b>							
Gross margin (%)	11.2	11.1	14.7				
Operating margin (%)	4.7	5.9	8.5				
Net margin (%)	3.7	4.2	6.6				

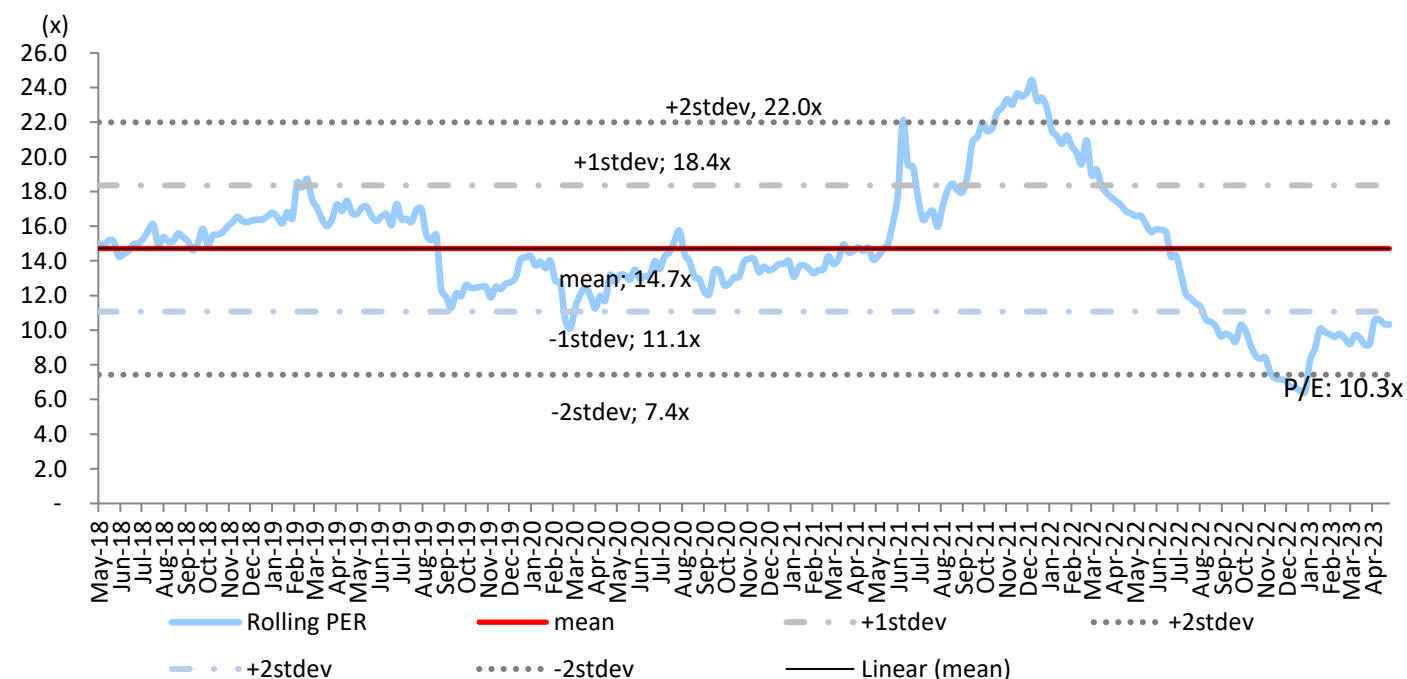
Source: Company data, RHB

Figure 4: Peer comparison

Company	Ticker	Market cap (USDm)	P/E (x)	
			2023F	2024F
Hanjaya Mandala Sampoerna	HMSP IJ	7,746	14.1	13.2
Gudang Garam	GGRM IJ	3,499	10.2	9.8
<b>Global weighted average</b>		<b>11,245</b>	<b>12.9</b>	<b>12.2</b>

Source: Bloomberg, RHB

Figure 5: GGRM's 5-year P/E band



Source: Company data, RHB

### Recommendation Chart

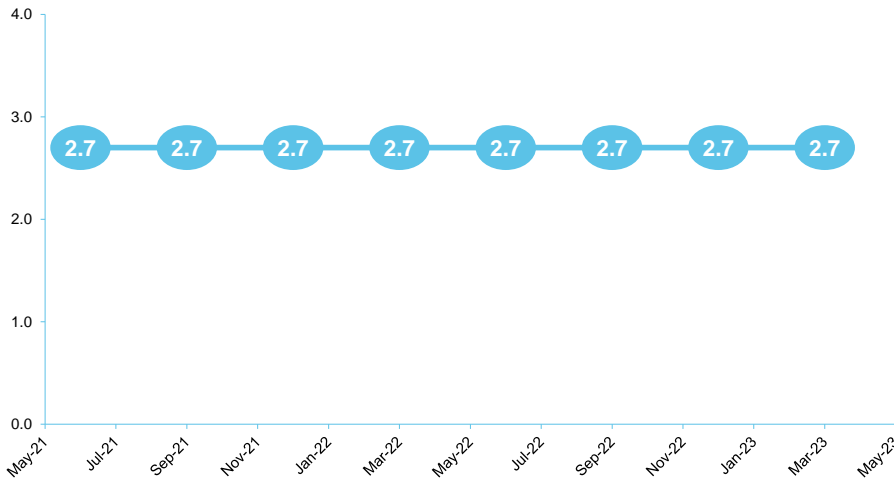


Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2021-04-01	Neutral	36,000	36,325
2020-12-11	Neutral	40,000	41,350
2020-04-29	Buy	60,000	45,000
2020-03-31	Buy	60,000	41,100
2019-11-05	Buy	66,000	53,925
2019-10-31	Buy	66,000	56,100
2019-09-20	Neutral	57,700	54,600
2019-09-16	Sell	57,700	54,600
2019-08-28	Buy	100,000	74,525
2019-08-01	Buy	100,000	74,625
2019-05-02	Buy	100,000	81,650
2019-04-01	Buy	115,000	82,800
2019-03-06	Buy	115,000	92,000
2018-11-01	Buy	99,000	72,300
2018-04-30	Buy	91,100	69,325

Source: RHB, Bloomberg

### ESG Rating History



Source: RHB

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<b>Buy:</b>	Share price may exceed 10% over the next 12 months
<b>Trading Buy:</b>	Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain
<b>Neutral:</b>	Share price may fall within the range of +/- 10% over the next 12 months
<b>Take Profit:</b>	Target price has been attained. Look to accumulate at lower levels
<b>Sell:</b>	Share price may fall by more than 10% over the next 12 months
<b>Not Rated:</b>	Stock is not within regular research coverage

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