

11 December 2020

Consumer Non-cyclical | Tobacco

Indonesia Tobacco

2021 Outlook: Continued Headwinds; Stay U/W

- **Stay UNDERWEIGHT on the sector, with both stocks downgraded to NEUTRAL from BUY.** The Finance Minister has announced a 12.5% excise tariff increment for 2021, targeted at machine-rolled segments, with higher increments for the Tier-1 bracket. There was no excise bracket simplification, and as expected, 2021 excise regulations continue to favour hand-rolled clove cigarettes (SKT) and smaller players. 1H21's expected soft consumption recovery should depress margins further, while market share may continue to be cannibalised by non-Tier-1 players, as consumers downtrade. We downgraded the stocks to reflect the tax hike.
- **HMSP to see better margins on higher SKT contribution.** With SKT contributing c.23% of Hanjaya Mandala Sampoerna's revenue (vs Gudang Garam's c.7%), its margins should be relatively better. This is as the Government has decided to keep the SKT excise flat in 2021. This is to support the labour-intensive sector (c.158k workers) and tobacco farmers (c.2.6m people), as SKT uses more tobacco leaves, and is sourced domestically. Hence, one of HMSP's key focuses, moving forward, is to develop its SKT segment, which provides much better margins and potentially higher market share, as it will eventually be more affordable than machine-made cigarettes (SKM). Note that SKT's excise is at half of SKM's, at IDR425/stick.
- **Government's agenda to reduce cigarette prevalence is at the expense of larger players.** In the press release, Finance Minister Sri Mulyani noted Indonesia's high cigarette prevalence rate of 32.3-32.4%, including minors (18 years and below). The government has taken numerous measures to support the industry, as it is a labour-intensive sector, while also looking to lower cigarette consumption (reduce sales volumes). This has resulted in the government lending support for SKT players, while oppressing SKM – especially Tier-1 companies – as it seeks to help SMEs. This is given the Government's move to continue raising taxes on SKM tier-1 cigarettes – much higher than rates imposed on lower tiers. The Tier-1 SKM excise tax gap to Tier-2A in 2021, has been increased 22% YoY, with Tier-2A (IDR535/stick) now at a 38% discount to that of Tier-1 (IDR865). This is positive for leading Tier-2 manufacturers like Wismilak Inti Makmur (WIIM IJ, NOT RATED).
- **Controlling illicit cigarettes.** Aggressive excise tax hikes have led to an increase in the illicit cigarette market, c.380m sticks in 2020 from 330m in 2017. This has led to an opportunity loss of IDR339bn in state revenue. Part of the excise revenue budget is to eradicate illegal players, and develop an industrial area for tobacco products or KIHT in several areas including Malang, Yogyakarta, and Sidoarjo. A centralized KIHT should centralise the tobacco industry, and ease the Government's monitoring of the illegal market. Other measures include excise revenue sharing to support the welfare of tobacco farmers and cigarettes workers. To support the industry, the Government encourages export sales, with manufacturers able to enjoy a longer excise payable extension period of 90 days from 60 days previously.
- **We downgrade earnings for both stocks** due to the 2021 excise tax hike, which leads to lower sales volume targets and lower margin assumptions. We tone down GGRM by 13%-18% and HMSP by 10%-23% for 2020F-2022F. On margins, we have lowered expectations, as the remaining <11% ASP hike to comply with the retail price floor or HJE, will not be enough to pass on the excise cost increase. We expect 2021 industry sales volumes to be similar to the 2017 decline seen post a 15% excise tax hike.

Underweight (Maintained)

Stocks Covered 2
Rating (Buy/Neutral/Sell): 0/2/0
Last 12m Earnings Revision Trend: Negative

Top Pick

H.M Sampoerna (HMSP IJ) – NEUTRAL

Target Price

IDR1,550

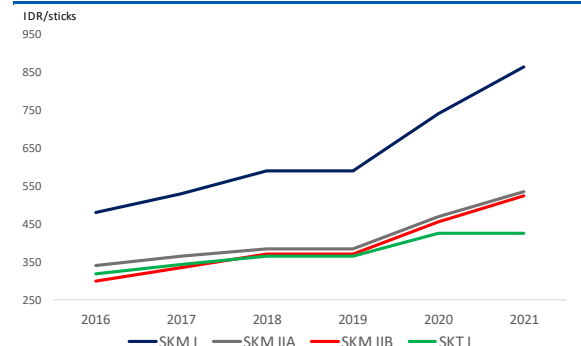
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5-Year historical excise tax on SKM and SKT



Source: Ministry of Finance, RHB

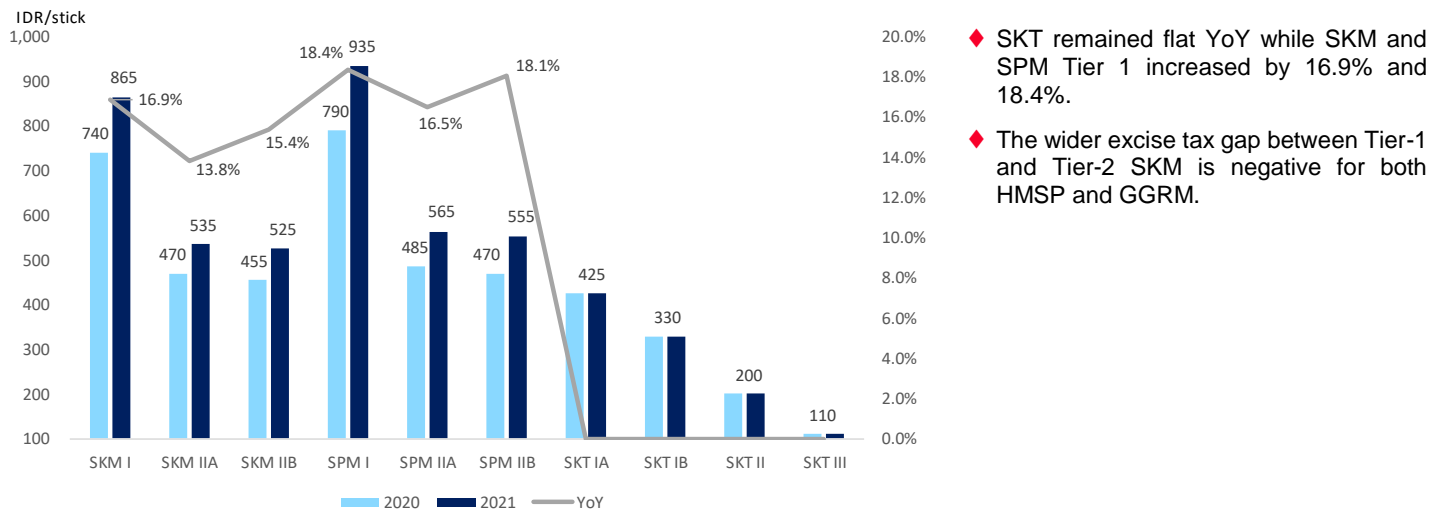
Company Name	Rating	Target Price(IDR)	% Upside (Downside)	P/E (x) Dec-20F	P/B (x) Dec-20F	Yield (%) Dec-20F
Gudang Garam	NEUTRAL	IDR40,000	(9.7)	10.7	1.4	-
Hanjaya Mandala Sampoerna	NEUTRAL	IDR1,550	(7.2)	20.1	6.2	7.2

Source: Company data, RHB

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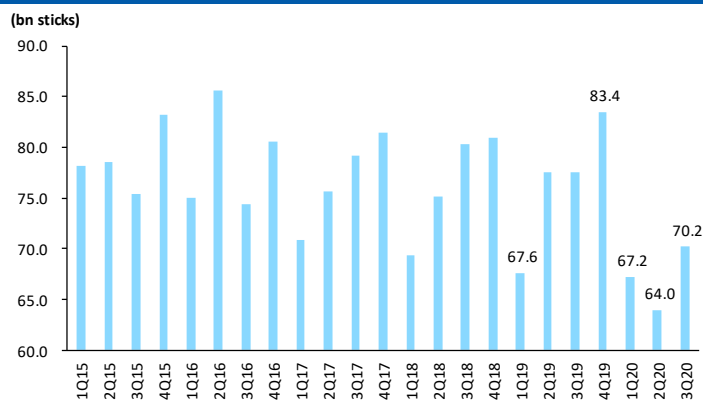
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Figure 1: Excise tax in 2020 vs 2021



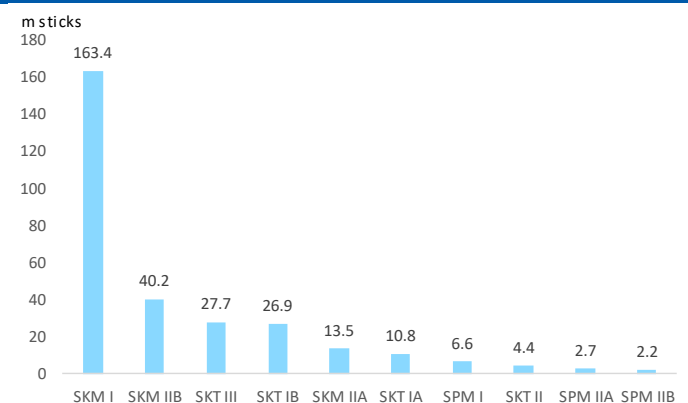
Source: Ministry of Finance, RHB

Figure 2: 9M20 cigarette sales volumes



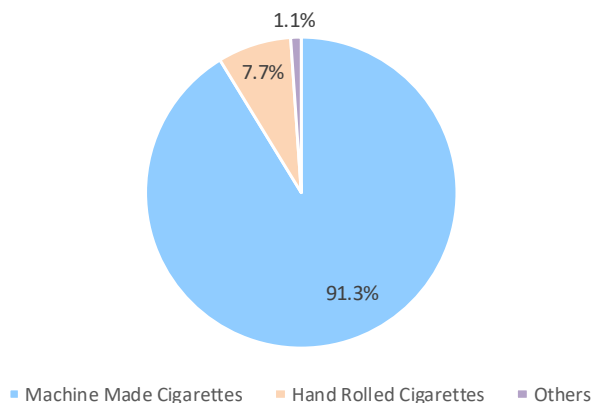
Source: Company data, RHB

Figure 3: Ministry of Finance's projection on cigarette production volumes for 2020



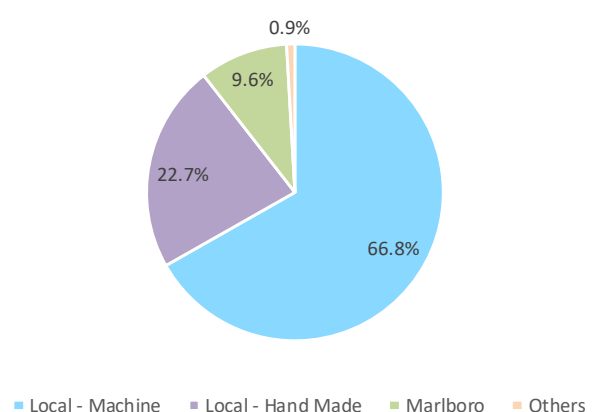
Source: Ministry of Finance, RHB

Figure 4: GGRM's 9M20 revenue breakdown



Source: Company data, RHB

Figure 5: HMSP's 9M20 revenue breakdown



Source: Company data, RHB

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Figure 6: Ground checks on cigarette retail prices

Brand	Packaging	Sticks/pack	May-20 Price(IDR)	Jun-20 Price(IDR)	Jul-20 Price(IDR)	Aug-20 Price(IDR)	Sep-20 Price(IDR)	Oct-20 Price(IDR)	Nov-20 Price(IDR)	% MoM	YTD %chg	Price per stick	Disc to HJE	Pass from HJE
Djarum	Djarum MLD	20	27,000	27,500	27,500	27,500	27,500	27,600	27,600	0.0%	18%	1,380	23.2%	Fail
	Djarum MLD Black Series	16	23,800	23,800	23,800	23,800	23,800	23,800	23,800	0.0%	7%	1,488	14.3%	Pass
	LA Light 16	16	23,200	23,800	23,800	23,800	23,800	23,800	23,500	-1.3%	6%	1,469	15.7%	Fail
	LA Light Ice Menthol	16	23,200	23,800	23,800	23,800	23,800	23,800	23,500	-1.3%	6%	1,469	15.7%	Fail
	Djarum LA Bold	12	17,000	17,000	17,000	17,000	17,000	17,500	18,500	5.7%	23%	1,542	10.3%	Pass
	Djarum LA Bold	20	26,400	26,400	26,600	26,600	26,600	26,700	26,500	-0.7%	10%	1,325	28.3%	Fail
	Djarum Black 16	16	23,000	23,000	23,800	23,800	23,800	23,800	23,800	0.0%	7%	1,488	14.3%	Pass
	Djarum Super	12	18,800	18,800	18,800	18,800	18,800	18,900	18,600	-1.6%	-1%	1,550	9.7%	Pass
	Djarum Super	16	23,500	23,800	23,800	25,000	25,000	26,000	25,800	-0.8%	11%	1,613	5.4%	Pass
	Djarum Super Wave	12				16,000	16,000	16,000	16,000	0.0%		1,333	27.5%	Fail
											9.7%			
Sampoerna	A Mild 12	12	18,100	18,100	18,100	18,100	18,100	18,200	19,700	8.2%	14%	1,642	3.6%	Pass
	A Mild 16	16	24,500	24,500	24,500	25,000	25,000	25,000	25,000	0.0%	4%	1,563	8.8%	Pass
	U Mild	16	22,700	22,900	22,900	23,400	23,400	23,400	23,500	0.4%	9%	1,469	15.7%	Fail
	Philip Morris Bold (Ubold)	12	15,000	15,200	15,200	15,200	15,200	15,200	15,200	0.0%	13%	1,267	34.2%	Fail
	Marlboro Red	20	31,400	31,400	31,400	31,400	31,400	31,400	32,000	1.9%	4%	1,600	11.9%	Pass
	Marlboro Ice Burst	20	31,400	31,400	31,400	31,400	31,400	31,400	33,000	5.1%	7%	1,650	8.5%	Pass
	Sampoerna Kretek	12	13,100	13,100	13,100	13,100	13,100	13,100	13,500	3.1%	4%	1,125	29.8%	Fail
	Dji Sam Soe (kretek)	12	18,200	18,200	18,200	18,200	18,200	18,300	18,300	0.0%	1%	1,525	-4.3%	Pass
	Magnum Mild	16	20,000	20,300	20,800	21,300	21,300	21,300	20,900	-1.9%	15%	1,306	30.1%	Fail
	A volution red	20	31,000	31,200	31,200	31,200	31,200	31,400	31,500	0.3%	8%	1,575	7.9%	Pass
	Dji Sam Soe Magnum Filter	12	18,800	18,800	18,800	18,800	18,800	18,800	20,000	6.4%	6%	1,667	2.0%	Pass
	Marlboro Filter Black	20	30,000	31,300	31,300	31,300	31,300	31,500	31,500	0.0%	15%	1,575	7.9%	Pass
											8.3%			
Gudang Garam	GG MILD	16	21,000	21,000	21,000	21,500	21,500	21,500	22,500	4.7%	18%	1,406	20.9%	Fail
	Gudang garam Internasional	12	21,000	21,000	21,000	21,000	21,000	21,000	21,000	0.0%	9%	1,750	-2.9%	Pass
	Surya 12	12	17,500	17,500	18,000	19,500	19,500	19,500	19,500	0.0%	11%	1,625	4.6%	Pass
	Surya 16	16	24,900	24,900	24,900	25,500	25,500	25,500	25,500	0.0%	5%	1,594	6.7%	Pass
	GG Signature Mild	16	19,900	19,900	19,900	20,000	20,000	20,000	21,000	5.0%	14%	1,313	29.5%	Fail
	GG Signature Mild	12						15,000	15,000	0.0%		1,250	36.0%	Fail
	GG Surya Pro Mild	16	19,900	19,900	19,900	20,100	20,100	21,500	21,500	0.0%	17%	1,344	26.5%	Fail
	GG Surya Profesional	16	19,900	19,900	19,900	20,500	20,500	21,500	21,500	0.0%	16%	1,344	26.5%	Fail
	GG Kretek Merah	12	14,500	14,500	14,500	14,500	14,500	14,500	14,500	0.0%	4%	1,208	20.8%	Fail
											11.7%			
Japan Tobacco	Camel Activate Purple Mint	20	25,500	25,500	25,500	25,500	25,500	25,500	25,000	-2.0%	25%	1,250	20.0%	Fail
	Camel White	20	25,500	25,500	25,500	25,500	25,500	25,500	25,000	-2.0%	25%	1,250	20.0%	Fail
	Clas Yellow	20	25,500	25,500	25,500	26,000	26,000	26,000	25,500	-1.9%	28%	1,275	17.6%	Fail
	Kretek Purple	12				15,000	15,000	15,000	15,000	0.0%		1,250	2.0%	Pass
											25.8%			

Source: RHB

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Hanjaya Mandala Sampoerna (HMSP IJ)

High 2021 Excise Tax Hike; D/G To NEUTRAL

Neutral (from Buy)

Target Price (Return): IDR1,550 (-7.2%)
Price: IDR1,670
Market Cap: USD13,767m
Avg Daily Turnover (IDR/USD) 154,558m/10.1m

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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(20.5)	11.0	9.9	(4.6)	(19.3)
Relative	(14.7)	2.4	(11.4)	(25.2)	(15.3)
52-wk Price low/high (IDR)				1,155 – 2,320	

Hanjaya Mandala Sampoerna (HMSP IJ)



Source: Bloomberg

- **D/G NEUTRAL from Buy with new IDR1,550 TP from IDR1,850, 7% downside.** We cut FY20F-22F earnings by 10-23% on a higher actual 2021 excise tariff – this translates to lower FY21F GPMs (-54bps YoY) and volumes. A continued widening excise tax gap (+22% YoY to IDR330/stick gap) between tier-1 and -2 markets may further promote down-trading (2020F: tier-2 market expands c.25% YoY). Machine-rolled clove cigarettes (SKMs) account for c.77% of total sales, with excise duties contributing c.82% to COGS. Valuation at 19x FY21F P/E is expensive.
- **A 16.9% excise tax hike in 2021 SKM to IDR865/stick** translates to a IDR125/stick increment. This is much higher than the next tier (2A), which just experienced a IDR65/stick rise in excise tariffs to IDR535/stick (+13.8% YoY). Note: Tier-1 experienced a 25.4% YoY rise in 2020 excise tariffs. Tier-2A's 2021 excise offers a 38% discount to tier-1, with the discount gap widening by 22% vs 2020 levels, which itself widened 30% YoY from 2019's numbers. Consequently, Hanjaya Mandala Sampoerna may continue to lose market share to non-tier-1 firms like Wismilak Inti Makmur (WIIM IJ, NR). On a brighter note, hand-rolled cigarette (SKT) excise was set YoY flat by the Government.
- **Margins are supported by the SKT segment**, which contributes c.23% to sales. HMSP's SKT segment contributions are much larger than Gudang Garam's (GGRM IJ, NEUTRAL, TP: IDR40,000) 7%. As a result, a flat 21F SKT excise tax could partially support HMSP's FY21F consolidated margins – a 50bps YoY expansion from FY20 estimates.
- **SKM's lower margins outlook amidst a weak 1H21 purchasing power environment.** Given that private consumption spending could experience a benign recovery in 1H21 – as continued high COVID-19 cases remain a concern until a vaccine can be mass distributed – we believe HMSP may not be able to fully pass on 2021's excise tax hikes for its SKM products unlike previously. Note: 3Q20 GPM was still down 5ppts YoY, indicating that HMSP had not even fully passed on 2020's excise tax hike by end September. 2021's SKM tax hike would require a c.14% increase in ASPs to fully pass on the excise.
- **10-23% earnings downgrade due to the unfavourable excise tax hike** – mainly considering 2021's higher excise tax, and lower market share/sales volume targets and margin assumptions. We estimate 2021 sales volumes declining 3% in line with the industry – similar with 2017's dip post a 15% excise tax hike. On margins, we tone down expectations, as the remaining <11% ASP hike – to comply with the retail price floor or HJE – will not be enough to pass on 2021's excise cost increase, in our view.
- **Upside risks:** i) A faster-than-expected economic recovery should enable HMSP to pass on the excise tax, and ii) less consumers down-trade to more affordable alternatives. Downside risk: A stock de-rating, given the unfavourable outlook of the Government's long-term view on the industry, which currently trades at a 15-20% premium to regional peers.

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (IDRb)	106,742	106,055	89,123	95,116	105,069
Recurring net profit (IDRb)	13,459	13,694	9,680	10,172	11,495
Recurring net profit growth (%)	6.2	1.7	(29.3)	5.1	13.0
Recurring P/E (x)	14.43	14.19	20.07	19.10	16.90
P/B (x)	5.5	5.4	6.2	6.1	5.9
P/CF (x)	9.35	10.78	15.43	17.74	16.79
Dividend Yield (%)	6.4	7.0	7.2	5.0	5.2
EV/EBITDA (x)	10.02	9.50	14.04	13.35	11.79
Return on average equity (%)	39.0	38.6	29.0	32.4	35.6
Net debt to equity (%)	net cash	net cash	net cash	net cash	net cash

Source: Company data, RHB

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Financial Exhibits

Asia	Financial summary (IDR)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Indonesia	Recurring EPS	115.71	117.73	83.22	87.45	98.82
Consumer Non-cyclical	DPS	107.30	117.20	119.80	83.22	87.45
Hanjaya Mandala Sampoerna	BVPS	303.98	306.74	267.57	271.80	283.18
HMSP IJ	Return on average equity (%)	39.0	38.6	29.0	32.4	35.6
Neutral						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Valuation basis	Recurring P/E (x)	14.43	14.19	20.07	19.10	16.90
We derive our 12-month TP of IDR1,550 with DCF calculations, assuming WACC of 11.3%.	P/B (x)	5.5	5.4	6.2	6.1	5.9
	FCF Yield (%)	10.0	8.8	6.3	5.4	5.7
Key drivers	Dividend Yield (%)	6.4	7.0	7.2	5.0	5.2
i. Higher interest income;	EV/EBITDA (x)	10.02	9.50	14.04	13.35	11.79
ii. New products launched;	EV/EBIT (x)	10.58	10.27	15.27	14.37	12.59
iii. Stronger-than-expected consumer purchasing power.						
	Income statement (IDRb)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Key risks	Total turnover	106,742	106,055	89,123	95,116	105,069
Upside risks:	Gross profit	25,491	26,123	19,713	20,529	22,753
i. Faster-than-expected economic recovery;	EBITDA	17,835	18,452	12,645	13,240	14,919
ii. Less consumers down-trading.	Depreciation and amortisation	(953)	(1,374)	(1,014)	(944)	(950)
	Operating profit	16,882	17,077	11,630	12,296	13,970
Downside risks:	Net interest	973	1,145	941	914	959
i. Continuing decline in market share;	Pre-tax profit	17,961	18,259	12,571	13,211	14,929
ii. Tight competition;	Taxation	(4,423)	(4,538)	(2,891)	(3,038)	(3,434)
iii. Cut in fuel subsidies;	Reported net profit	13,538	13,722	9,680	10,172	11,495
iv. Weak consumer purchasing power.;	Recurring net profit	13,459	13,694	9,680	10,172	11,495
v. Stock de-rating.						
Company Profile	Cash flow (IDRb)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
HMSP manufactures hand-rolled and machine-rolled clove-blended cigarettes. The company distributes its products both domestically and internationally.	Change in working capital	6,675	3,372	1,898	(167)	(878)
	Cash flow from operations	20,779	18,015	12,593	10,949	11,567
	Capex	(1,397)	(948)	(450)	(487)	(587)
	Cash flow from investing activities	(376)	(1,356)	(159)	(591)	(758)
	Cash flow from financing activities	(12,388)	(13,355)	(14,635)	(9,539)	(9,938)
	Cash at beginning of period	7,502	15,516	18,821	16,620	17,440
	Net change in cash	8,014	3,305	(2,201)	820	870
	Ending balance cash	15,516	18,821	16,620	17,440	18,310
	Balance sheet (IDRb)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	15,516	18,821	16,620	17,440	18,310
	Tangible fixed assets	7,288	7,298	6,734	6,278	5,915
	Total investments	70	82	82	82	82
	Total assets	46,602	50,903	44,272	45,730	48,518
	Total liabilities	11,244	15,223	13,149	14,115	15,579
	Total equity	35,358	35,680	31,123	31,615	32,938
	Total liabilities & equity	46,602	50,903	44,272	45,730	48,518
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	7.7	(0.6)	(16.0)	6.7	10.5
	Recurrent EPS growth (%)	6.2	1.7	(29.3)	5.1	13.0
	Gross margin (%)	23.9	24.6	22.1	21.6	21.7
	Operating EBITDA margin (%)	16.7	17.4	14.2	13.9	14.2
	Net profit margin (%)	12.7	12.9	10.9	10.7	10.9
	Dividend payout ratio (%)	92.2	99.4	144.0	95.2	88.5
	Capex/sales (%)	1.3	0.9	0.5	0.5	0.6
	Interest cover (x)	554	319			

Source: Company data, RHB

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Figure 1: RHB vs Street estimates

IDRbn	RHB			Consensus			RHB/consensus (%)		
	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F
Net revenue	89,123	95,116	105,069	96,418	101,484	108,576	92.4	93.7	96.8
Gross profit	19,713	20,529	22,753	20,535	22,220	24,153	96.0	92.4	94.2
EBITDA	12,645	13,240	14,919	13,185	14,459	15,706	95.9	91.6	95.0
EBIT	11,630	12,296	13,970	12,058	13,081	13,908	96.5	94.0	100.4
NPAT	9,680	10,172	11,495	10,184	11,134	12,113	95.0	91.4	94.9

Source: Bloomberg, RHB

Figure 2: Changes on earnings estimate

	New			Old			New/old (%)		
	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F
Income statement (IDRbn)									
Total turnover	89,123	95,116	105,069	94,603	100,281	114,082	(5.8)	(5.2)	(7.9)
Gross profit	19,713	20,529	22,753	21,017	23,280	26,493	(6.2)	(11.8)	(14.1)
EBITDA	12,645	13,240	14,919	13,865	16,253	19,073	(8.8)	(18.5)	(21.8)
Net profit	9,680	10,172	11,495	10,729	12,617	14,859	(9.8)	(19.4)	(22.6)
Key Metrics									
EPS (IDR)	83.2	87.5	98.8	92.2	108.5	127.7	(9.8)	(19.4)	(22.6)
BVPS (IDR)	267.6	271.8	283.2	276.5	291.3	308.8	(3.2)	(6.7)	(8.3)
EPS growth (%)	(29.5)	5.1	13.0	(21.8)	17.6	17.8			
Gross margin (%)	22.1	21.6	21.7	22.2	23.2	23.2			
EBITDA margin (%)	14.2	13.9	14.2	14.7	16.2	16.7			
Net profit margin (%)	10.9	10.7	10.9	11.3	12.6	13.0			
Return on average equity (%)	31.1	32.2	34.9	33.4	37.2	41.4			

Source: RHB

Figure 3: 10 Year DCF

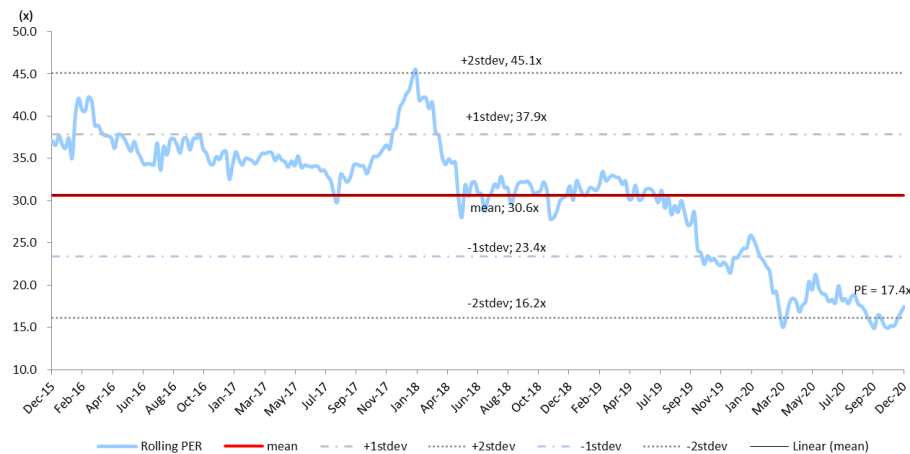
IDRbn	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F
EBIT	12,296	13,970	15,978	17,342	18,813	20,319	21,933	23,665	25,522	27,515	29,655
EBIT (1-t)	9,468	10,757	12,303	13,353	14,486	15,646	16,889	18,222	19,652	21,187	22,834
Depreciation & amortisation	944	950	977	995	1,013	1,027	1,038	1,047	1,054	1,058	1,057
Change in working capital	(167)	(878)	(711)	(692)	(745)	(768)	(824)	(884)	(896)	(958)	(1,024)
Capex	(487)	(587)	(989)	(900)	(960)	(969)	(974)	(1,006)	(1,069)	(1,075)	(1,080)
Net free cash flow to firm	9,758	10,241	11,580	12,756	13,794	14,937	16,130	17,379	18,741	20,212	21,787
Terminal value											193,449
PV	9,758	9,204	9,354	9,261	9,001	8,760	8,502	8,233	7,980	7,735	74,033
Terminal growth	0.0%										
WACC	11.3%										
Total discounted firm value	161,823										
Less: Net debt	(17,440)										
Less: Minority interest	-										
Equity value	179,262										
Number of shares (bn)	116										
Equity value per share (IDR)	1,541										

Source: RHB

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Consumer Non-cyclical | Tobacco

Figure 4: HMSP's 5-Year P/E band



♦ HMSP is currently trading at -2SD below its 5-year mean

Source: Bloomberg, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-11-19	Buy	1,850	1,560
2020-07-22	Neutral	1,950	1,780
2020-03-31	Buy	2,200	1,425
2019-10-28	Buy	2,500	2,180
2019-09-16	Neutral	2,800	2,290
2019-07-29	Buy	3,500	2,820
2019-04-23	Sell	2,900	3,460
2019-03-22	Neutral	3,700	3,800

Source: RHB, Bloomberg

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Gudang Garam (GGRM IJ)

Neutral (from Buy)

Steep 21F Excise Tax Hike; D/G NEUTRAL

- **D/G NEUTRAL from BUY, new IDR40,000 TP from IDR60,000, 10% downside.** We reduce Gudang Garam's FY20F-22F earnings by 13-18% on higher 2021 excise tariffs, which lowers FY21F GPM by 70bps YoY. The further widening of the excise tax gap (+22% YoY to IDR330 gap/stick) between Tiers 1 and 2, may further promote downtrading (2020: Tier-2 market expanded c.25% YoY). Machine-rolled clove cigarettes (SKM) accounted for almost 93% of total sales, and excise taxes contributed c.82% to COGS. Nevertheless, at 10x 21F P/E, the stock is still attractive.
- **16.9% excise tax hike in 2021F for SKM, to IDR865/stick.** This translates to a IDR125/stick increment – much higher than that of Tier-2A which saw a IDR65/stick increment to IDR535/stick or 13.8% YoY. Note that Tier-1 saw a 25.4% YoY increase in excise tariff in 2020. Tier-2A's 2021 tariff offers a 38% discount to Tier-1, with the discount gap 22% wider than 2020's level – which had widened 30% YoY from 2019. As a result, GGRM may continue to lose market share to non-Tier 1 companies like Wismilak Inti Makmur (WIIM IJ, NOT RATED). On a brighter note, the tariff for hand-rolled cigarettes (SKT) will be flat YoY. However, SKT only accounts for c.7% of GGRM's total revenue, as nearly 93% of sales are from SKM.
- **Continued margin contraction amidst weak purchasing power environment.** Given that private consumption spending could see a benign 1H21 recovery, as still-high COVID-19 cases remain a concern ahead of a mass distribution of vaccines, we think GGRM may not be able to fully pass-on the 2021F tax hike again. This would result in further margin decline (70bps lower GPM vs 2020F). Note that its 3Q20 GPM was down 5.4ppts YoY, as GGRM could not fully pass-on 2020's excise tax hike. The FY21F SKM tax hike would require ±14% ASP increment to fully pass on the tax.
- **12.8-18.4% earnings downgrade on unfavourable excise tax hike,** lower market share/sales volume and margin assumptions. We estimate 2021F sales volume to decline 4% YoY, against the industry's 3% (similar to 2017's decline post 15% excise tax hike). On margins, we have toned down our expectations, as the remaining <11% ASP hike to comply with the retail price floor (HJE) will not be enough to pass on the 2021F excise cost increase. The steep 33% decline in target price is due to lower volume growth assumptions over the forecasted period, and a lower margin outlook.
- **Potentially strong 4Q20, but only for ST catalyst.** In early October, GGRM increased its valued products' ASPs by 4-7% (ie Surya Pro and Surya Pro Mild) in order to start complying with the Government's HJE. The company should continue to increase ASPs during the last weeks of the quarter to start catching up on passing on the tax hike. Hence, we should see margin expansions during the quarter, while volume is also supported by distributors stocking up ahead of the excise tax hike.
- **Upside risk** is a faster-than-expected economic recovery for GGRM to pass on the excise tax. Downside to our call would be negative sentiment on potential future non-core business expansions (ie infrastructure).

Target Price (Return): IDR40,000 (-9.7%)
 Price: IDR44,275
 Market Cap: USD6,037m
 Avg Daily Turnover (IDR/USD) 90,204m/5.99m

Analysts

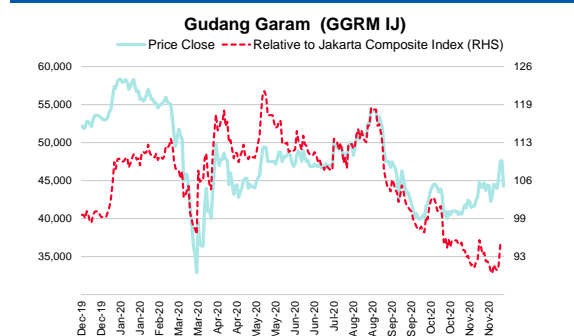
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Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(16.5)	4.4	4.2	(6.4)	(16.9)
Relative	(10.9)	(4.4)	(17.3)	(27.2)	(13.0)
52-wk Price low/high (IDR)	32,900 – 58,325				



Source: Bloomberg

Forecasts and Valuation	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Total turnover (IDRb)	95,708	110,524	106,210	115,774	126,280
Recurring net profit (IDRb)	7,770	10,653	7,717	8,354	9,867
Recurring net profit growth (%)	1.5	37.1	(27.6)	8.3	18.1
Recurring P/E (x)	10.96	8.00	11.04	10.20	8.63
P/B (x)	1.9	1.7	1.4	1.3	1.2
P/CF (x)	7.86	7.55	6.28	10.62	8.71
Dividend Yield (%)	5.9	5.9	na	3.7	5.0
EV/EBITDA (x)	7.56	5.79	6.72	6.24	5.36
Return on average equity (%)	17.8	22.7	14.5	13.9	15.0
Net debt to equity (%)	33.9	27.2	8.3	7.0	5.5

Source: Company data, RHB

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Consumer Non-cyclical | Tobacco

Financial Exhibits

Asia	Financial summary (IDR)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
Indonesia	Recurring EPS	4,038.51	5,536.62	4,010.49	4,341.87	5,128.17
Consumer Non-cyclical	DPS	2,600.00	2,600.00	-	1,651.55	2,230.12
Gudang Garam	BVPS	23,456.95	26,470.05	30,598.91	33,407.61	36,424.04
GGRM IJ	Return on average equity (%)	17.8	22.7	14.5	13.9	15.0
Neutral						
	Valuation metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Recurring P/E (x)	10.96	8.00	11.04	10.20	8.63
	P/B (x)	1.9	1.7	1.4	1.3	1.2
	FCF Yield (%)	8.6	7.5	10.5	4.1	5.7
	Dividend Yield (%)	5.9	5.9	-	3.7	5.0
	EV/EBITDA (x)	7.56	5.79	6.72	6.24	5.36
	EV/EBIT (x)	9.06	6.70	8.38	7.81	6.62
	Income statement (IDRb)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total turnover	95,708	110,524	106,210	115,774	126,280
	Gross profit	18,644	22,783	18,186	19,037	21,339
	EBITDA	13,282	17,112	13,412	14,370	16,612
	Depreciation and amortisation	(2,189)	(2,322)	(2,656)	(2,896)	(3,158)
	Operating profit	11,093	14,790	10,756	11,475	13,454
	Net interest	(678)	(585)	(480)	(350)	(315)
	Pre-tax profit	10,479	14,488	10,579	11,428	13,442
	Taxation	(2,686)	(3,607)	(2,634)	(2,845)	(3,347)
	Reported net profit	7,792	10,881	7,944	8,582	10,095
	Recurring net profit	7,770	10,653	7,717	8,354	9,867
	Cash flow (IDRb)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Change in working capital	855	(1,918)	2,969	(3,455)	(3,470)
	Cash flow from operations	10,836	11,285	13,569	8,022	9,783
	Capex	(3,539)	(4,937)	(4,597)	(4,510)	(4,954)
	Cash flow from investing activities	(3,006)	(4,846)	(4,551)	(4,613)	(5,067)
	Cash flow from financing activities	(8,125)	(4,901)	(7,502)	(2,980)	(6,074)
	Cash at beginning of period	2,329	2,034	3,572	5,088	5,517
	Net change in cash	(295)	1,538	1,516	429	(1,358)
	Ending balance cash	2,034	3,572	5,088	5,517	4,159
	Balance sheet (IDRb)	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Total cash and equivalents	2,034	3,572	5,088	5,517	4,159
	Tangible fixed assets	22,759	25,374	27,315	28,929	30,724
	Total assets	69,097	78,647	79,072	85,674	90,500
	Short-term debt	17,322	17,236	10,000	10,000	8,000
	Total long-term debt	0	177	0	0	0
	Total liabilities	23,964	27,717	20,197	21,394	20,417
	Total equity	45,133	50,931	58,875	64,279	70,083
	Total liabilities & equity	69,097	78,647	79,072	85,674	90,500
	Key metrics	Dec-18	Dec-19	Dec-20F	Dec-21F	Dec-22F
	Revenue growth (%)	14.9	15.5	(3.9)	9.0	9.1
	Recurrent EPS growth (%)	1.5	37.1	(27.6)	8.3	18.1
	Gross margin (%)	19.5	20.6	17.1	16.4	16.9
	Operating EBITDA margin (%)	13.9	15.5	12.6	12.4	13.2
	Net profit margin (%)	8.1	9.8	7.5	7.4	8.0
	Dividend payout ratio (%)	64.2	46.0	0.0	37.0	42.5
	Capex/sales (%)	3.7	4.5	4.3	3.9	3.9
	Interest cover (x)	16.4	25.3	22.4	32.8	42.7

Source: Company data, RHB

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Figure 1: RHB vs Street estimates

IDRbn	RHB			Consensus			RHB/Cons (%)		
	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F
Net revenue	106,210	115,774	126,280	112,288	121,444	132,029	94.6	95.3	95.6
Gross profit	18,186	19,037	21,339	19,101	20,979	23,237	95.2	90.7	91.8
EBITDA	13,412	14,370	16,612	14,154	15,349	16,755	94.8	93.6	99.1
EBIT	10,756	11,475	13,454	11,394	12,410	13,496	94.4	92.5	99.7
Pre-tax profit	10,579	11,428	13,442	10,979	12,033	13,502	96.4	95.0	99.6
NPAT	7,944	8,582	10,095	8,491	9,366	10,410	93.6	91.6	97.0
BVPS	30,599	33,408	36,424	30,027	32,648	35,158	101.9	102.3	103.6
ROE (%)	13.5	13.4	14.4	15.4	15.9	16.7	87.8	83.7	86.3

Source: Bloomberg, RHB

Figure 2: Changes in earnings estimates

	New			Old			New/Old (%)		
	2020F	2021F	2022F	2020F	2021F	2022F	2020F	2021F	2022F
Income Statement (IDRb)									
Total turnover	106,210	115,774	126,280	108,100	115,325	124,699	(1.7)	0.4	1.3
Gross profit	18,186	19,037	21,339	20,076	21,414	23,062	(9.4)	(11.1)	(7.5)
EBITDA	13,412	14,370	16,612	15,947	17,269	18,790	(15.9)	(16.8)	(11.6)
Net profit	7,944	8,582	10,095	9,608	10,513	11,564	(17.3)	(18.4)	(12.7)
Key Metrics									
EPS (IDR)	4,129	4,460	5,247	4,994	5,464	6,010	(17.3)	(18.4)	(12.7)
DPS (IDR)	-	1,652	2,230	3,631	3,206	3,508	(100.0)	(48.5)	(36.4)
BVPS (IDR)	30,599	33,408	36,424	27,833	30,091	32,593	9.9	11.0	11.8
Revenue growth (%)	(3.9)	9.0	9.1	(2.2)	6.7	8.1			
EPS growth (%)	(27.0)	8.0	17.6	(11.7)	9.4	10.0			
Gross margin (%)	17.1	16.4	16.9	18.6	18.6	18.5			
EBITDA margin (%)	12.6	12.4	13.2	14.8	15.0	15.1			
Net profit margin (%)	7.5	7.4	8.0	8.9	9.1	9.3			
Dividend payout ratio (%)	-	40.0	50.0	64.2	64.2	64.2			
ROE (%)	13.5	13.4	14.4	17.9	18.2	18.4			

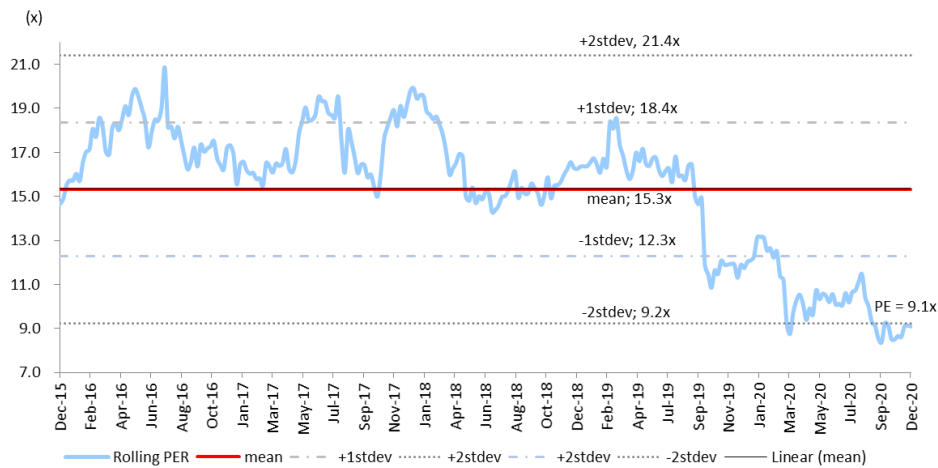
Source: RHB

Figure 3: 10-Year DCF valuation

IDRbn	2021F	2022F	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F
EBIT	11,475	13,454	14,507	15,594	16,711	17,853	19,014	20,187	21,363	22,531	23,679
EBIT (1-t)	8,618	10,104	10,895	11,712	12,551	13,408	14,280	15,161	16,044	16,921	17,783
Depreciation & amortisation	2,896	3,158	3,417	3,657	3,914	4,171	4,414	4,668	4,935	5,215	5,507
Changes in working capital	(3,709)	(3,749)	(4,062)	(4,425)	(4,820)	(5,252)	(6,649)	(6,314)	(6,882)	(7,502)	(8,179)
Capex	(4,510)	(4,954)	(4,871)	(4,534)	(4,848)	(4,837)	(4,576)	(4,801)	(5,033)	(5,270)	(5,512)
Net free cash flow to firm	3,294	4,559	5,379	6,411	6,797	7,491	7,469	8,714	9,065	9,364	9,599
Terminal value											93,129
PV	3,294	4,133	4,421	4,776	4,591	4,587	4,146	4,385	4,135	3,873	38,516
Terminal growth	0.0%										
WACC	10.3%										
Total discounted firm value	80,857										
Less: net debt	4,483										
Less: minority interest	0										
Equity value	76,375										
Number of shares (bn)	1.9										
Equity value per share (IDR)	39,694										

Source: RHB

Figure 4: GGRM's 5-year P/E band



♦ GGRM is currently trading at -2SD below its 5-year mean.

Source: Bloomberg, RHB

Recommendation Chart



Source: RHB, Bloomberg

Date	Recommendation	Target Price	Price
2020-03-31	Buy	60,000	41,100
2019-10-31	Buy	66,000	56,100
2019-09-20	Neutral	57,700	54,600
2019-09-16	Sell	57,700	54,600
2019-05-02	Buy	100,000	81,650
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

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