

Nippon Indosari (ROTI IJ)

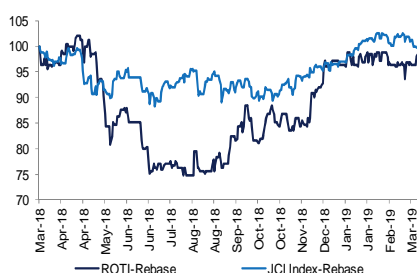
15 March 2019

Results Note

SELL (from HOLD)

Stock Data	
Target price (Rp)	Rp910
Prior TP (Rp)	Rp1,010
Shareprice (Rp)	Rp1,200
Upside/downside (%)	(24.1)
Sharesoutstanding (m)	6,152
Marketcap. (US\$ m)	470
Free float (%)	41.5
Avg. 6m dailyT/O (US\$ m)	0.1

Price Performance			
	3M	6M	12M
Absolute (%)	-8.8	6.3	-10.3
Relative to JCI (%)	-12.7	-3.8	-11.9
52w high/low (Rp)	1,270 - 930		



Major Shareholders	
PT Indoritel Makmur International	25.8%
Bonlight Investment, Ltd	20.7%
Demeter Indo Investment Pte. Ltd	15.2%

Estimate Change: Vs. Consensus		
	2019F	2020F
Latest EPS (Rp)	22	30
Vs. Prior EPS (%)	(52.8)	(50.5)
Vs. Consensus (%)	(30.9)	(20.3)

Source: Bloomberg

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Transition-led earnings disruption

- Earnings outperformance (+19% yoy) furnished by lower return rate.
- Lower return rate prompts a decelerated gross sales growth.
- Recent market enlargement lacks of strategic viability.
- Downgrade to SELL due to low profitability prospect.

Above-consensus FY18 earnings was due to lower return rate. Nippon Sariroti (ROTI) reported FY18 net profit of Rp173bn (+19% yoy) which was both above our (104%) and market estimate (109%). This earnings outperformance hinges on lower return rate of 17.6% in FY18 (vs. FY17: 18.2%) and lower minority interests' loss attributable to ROTI of Rp46bn (+3x yoy) due to an increased stake in Prima Top Boga to 51%. Though, adj. operating profit (incl. scrap sales) came lower at Rp195bn (-23% yoy). Gross sales grew relatively slower to Rp3.3tn (+10% yoy vs. 5-yr CAGR of 14%) and net sales was at Rp2.7tn (+11% yoy) as driven by lower return rate. Production costs increased moderately to Rp1.2tn (+8% yoy) while operating costs hiked to Rp1.2tn (+23% yoy) due to spiking logistical cost (+18% yoy) as operating salary (+19% yoy) and A&P (+36% yoy) surged. Thus, we witnessed divergence in profitability margins with GPM/OPM/NPM gauged at 53.9%/7%/6.2% in FY18 (vs. FY17: 52.5%/10.2%/5.8%). On quarterly basis, 4Q18 net profit was ay Rp70bn (+11% qoq, +43% yoy) driven by lower 4Q18 sales return of 13.6% (vs. 4Q17: 17.3%).

New systematic pattern unveils on return rate and sales growth. We see idiosyncrasy between sales growth and return rate pattern vis-à-vis its historical pattern (fig. 1). In the last four quarters, gross sales growth tends to move in parallel with return rate unlike the past pattern that demonstrated no correlation between these variables which is particularly bad for ROTI as lower return rate entails with slowed sales growth. This might be reasoned by several points. First, competition from packaged private bread labels live on as partly attributable to ROTI's premium price (avg. 16%) to its competitors. Second, our view concurs with Euromonitor where we see unpackaged baked goods saw strong growth in tourist regions such as Jakarta, Surabaya and Bali. In turn, we forecast moderate gross sales growth (3-yr CAGR FY18-21F of 12%) and lower sales return of 15% in FY19F/20F (vs. FY18: 17.6%) to account for systematic pattern change in pertaining variables spurred by competition.

Strategy viability on new business plans are on absence. We are critical on ROTI's initiative to enlarge market coverage (to small bakery segment and offshore market). First, small bakery market is a well-saturated market with fierce competition landscape as this market is resided by many players and lack of customer brand loyalty. Second, the demand from small bakery market is highly elastic (i.e. price sensitive). Third, the expansion to Philippines market soared operating expenses with its profitability remains blurred in foreseeable sight. Thus, we assume higher opex-to-sales of 48.9%/48.5% in FY19F/20F to account for ROTI's new product dropping policy that hikes transportation cost (FY19F/20F: 8% vs. 5-yr avg.: 7% of sales) and A&P spending (FY19F/20F: 7.5%/8% vs. 5-yr avg. 5.5%) due to market expansion.

Downgrade to SELL due to degraded earnings quality. In the lights of a persisted competition, we believe ROTI has transitioned to new regime where we can expect low-double digit growth on sales and profitability margin. Given this prospect and current demanding valuation, we downgrade our recommendation to SELL with lower TP of Rp910 (from Rp1,010). Our new TP implies P/E FY19F of 31.3x, in-line with small-cap FMCG valuation (avg. 31x).

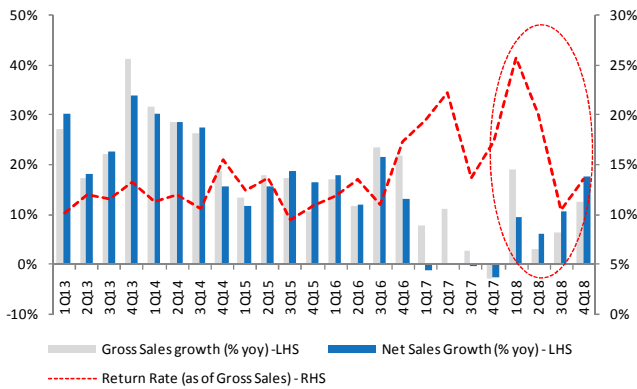
Year To 31 Dec	2017A	2018A	2019F	2020F	2021F
Revenue (RpBn)	2,491	2,767	3,177	3,501	3,892
EBITDA (RpBn)	328	277	241	295	389
EBITDA Growth (%)	(34.6)	(15.5)	(13.0)	22.4	31.8
Net Profit (RpBn)	146	173	180	229	299
EPS (Rp)	28	28	29	37	49
EPS Growth (%)	(50.1)	1.5	4.0	27.7	30.3
Net Gearing (%)	(27.6)	(25.8)	(28.5)	(21.0)	(17.2)
PER (x)	43.4	42.8	55.0	40.2	29.2
PBV (x)	2.0	2.3	2.2	2.2	2.0
Dividend Yield (%)	0.0	0.0	0.0	0.0	0.0
EV/EBITDA (x)	21.4	24.5	27.3	22.2	17.1

Source: ROTI, IndoPremier

Share Price Closing as of : 14 March 2019

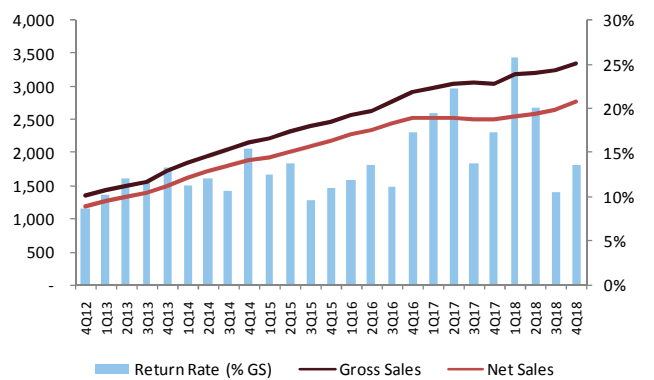
ROTI IJ Results Note

Fig. 1: New pattern unveils on return rate and sales growth



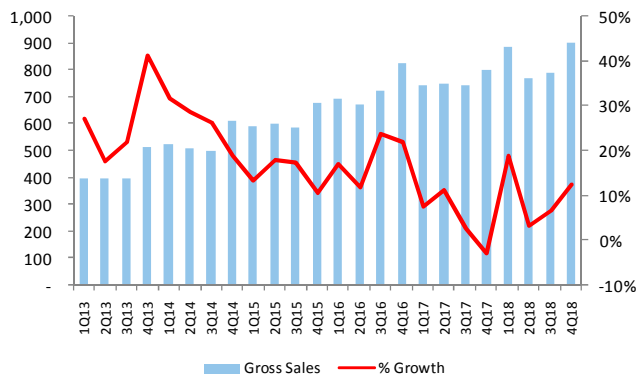
Source: ROTI, IndoPremier

Fig. 2: Gross sales, net sales, and return rate (4-q rolling)



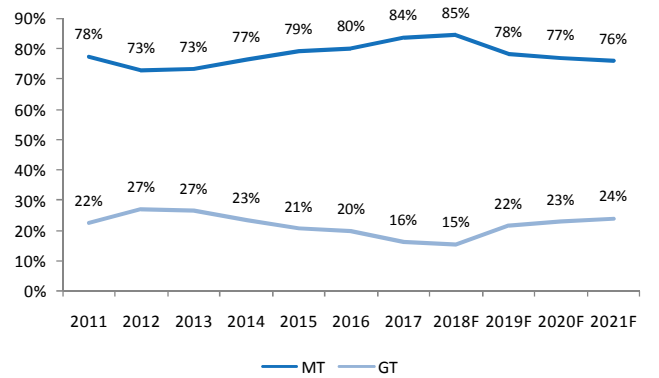
Source: ROTI, IndoPremier

Fig. 3: Quarterly gross sales growth



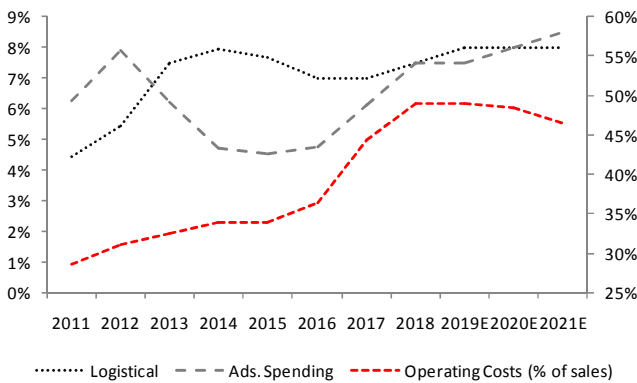
Source: ROTI, IndoPremier

Fig. 4: Expect higher GT contribution as it enters new market



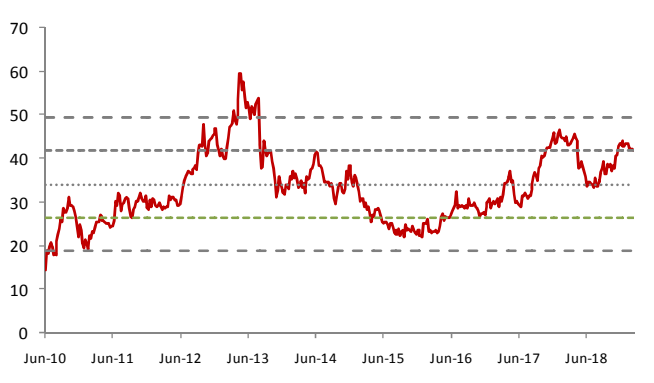
Source: ROTI, IndoPremier

Fig. 5: New strategy spurs higher operating costs



Source: ROTI, IndoPremier

Fig. 6: Valuation is currently pretty demanding



Source: ROTI, IndoPremier

ROTI IJ Results Note

Year To 31 Dec (RpBn)	2017A	2018A	2019F	2020F	2021F
Income Statement					
Net Revenue	2,491	2,767	3,177	3,501	3,892
Cost of Sales	(1,183)	(1,274)	(1,534)	(1,680)	(1,889)
Gross Profit	1,308	1,492	1,643	1,821	2,004
SG&A Expenses	(1,107)	(1,354)	(1,554)	(1,698)	(1,811)
Operating Profit	201	138	89	123	193
Net Interest	(57)	2	40	68	80
Forex Gain (Loss)	0	0	0	0	0
Others-Net	42	46	50	55	65
Pre-Tax Income	186	187	179	245	338
Income Tax	(51)	(60)	(45)	(61)	(84)
Minorities	11	46	46	46	46
Net Income	146	173	180	229	299
Balance Sheet					
Cash & Equivalent	1,895	1,295	1,354	656	569
Receivable	324	413	423	466	518
Inventory	50	65	69	84	94
Other Current Assets	51	104	9	10	11
Total Current Assets	2,320	1,876	1,855	1,216	1,193
Fixed Assets - Net	1,994	2,222	2,607	2,967	3,303
Goodwill	62	61	67	72	77
Non Current Assets	183	234	0	0	0
Total Assets	4,559	4,394	4,529	4,255	4,572
ST Loans	119	41	0	0	0
Payable	149	190	0	223	251
Other Payables	260	294	333	365	411
Current Portion of LT Loans	499	0	500	0	0
Total Current Liab.	1,027	525	1,037	589	662
Long Term Loans	498	499	0	0	0
Other LT Liab.	214	453	498	548	602
Total Liabilities	1,739	1,477	1,535	1,136	1,264
Equity	1,582	1,505	1,505	1,505	1,505
Retained Earnings	1,193	1,337	1,459	1,629	1,864
Minority Interest	46	75	30	(16)	(62)
Total SHE + Minority Int.	2,821	2,918	2,994	3,119	3,308
Total Liabilities & Equity	4,560	4,395	4,529	4,255	4,572

Source: ROTI, IndoPremier

ROTI IJ Results Note

Year to 31 Dec	2017A	2018A	2019F	2020F	2021F
Cash Flow					
Net Income (Excl.Extraordinary&Min.Int)	135	127	134	184	253
Depr. & Amortization	114	130	147	173	196
Changes in Working Capital	15	(141)	58	(28)	(20)
Others	(2)	30	65	55	(14)
Cash Flow From Operating	262	146	403	383	416
Capital Expenditure	(384)	(408)	(304)	(537)	(537)
Others	35	85	80	80	80
Cash Flow From Investing	(349)	(323)	(224)	(457)	(457)
Loans	120	(576)	(40)	(500)	0
Equity	1,308	(77)	0	0	0
Dividends	0	0	0	0	0
Others	(35)	185	(40)	(8)	9
Cash Flow From Financing	1,393	(467)	(81)	(508)	9
Changes in Cash	1,306	(645)	99	(583)	(32)
Financial Ratios					
Gross Margin (%)	52.5	53.9	51.7	52.0	51.5
Operating Margin (%)	8.1	5.0	2.8	3.5	5.0
Pre-Tax Margin (%)	7.5	6.8	5.6	7.0	8.7
Net Margin (%)	5.8	6.2	5.7	6.6	7.7
ROA (%)	3.9	3.9	4.0	5.2	6.8
ROE (%)	6.8	6.0	6.1	7.5	9.3
ROIC (%)	5.2	7.1	7.1	9.4	11.6
Acct. Receivables TO (days)	44.3	48.6	48.0	46.4	46.2
Acct. Receivables - Other TO (days)	0.0	0.0	0.0	0.0	0.0
Inventory TO (days)	23.5	22.1	22.8	21.9	21.2
Payable TO (days)	49.6	48.6	46.9	46.5	45.9
Acct. Payables - Other TO (days)	0.0	0.0	0.0	0.0	0.0
Debt to Equity (%)	39.6	18.5	16.7	0.0	0.0
Interest Coverage Ratio (x)	0.5	0.6	0.4	0.1	0.0
Net Gearing (%)	(27.6)	(25.8)	(28.5)	(21.0)	(17.2)

Source: ROTI, 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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