

Monday, May 8, 2017

BUY

Initiation

Last price IDR 640
Target Price IDR 1,100
Upside/Downside +71.9%

Stock Statistics

Sector Retail
Bloomberg Ticker ERAA.IJ
No of Shrs (mn) 2,900
Mkt. Cap (IDRbn/USDmn) 1,856/138
Avg. daily T/O (IDRbn/USDmn) 30.4/2.6

Major shareholders

PT Eralink International 59.9%
Estimated free float (%) 39.9%

Net Profit Consensus

	2017F	2018F	2019F
Danareksa	303	339	379
Consensus	346	418	451
Danareksa/Cons	-12%	-19%	-19%

ERAA relative to JCI Index



Source : Bloomberg

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Erajaya Swasembada (ERAA IJ)

Poised for growth

We initiate coverage on ERAA with a BUY call and a TP of IDR 1,100. The expectation of higher quarterly revenues from recent product launches – which would lead to strong earnings growth - should support the share price performance going forward. At the current share price, ERAA is trading at an attractive valuation of just 6.1x 2017 P/E, below the average 3-year PE of 10.6x. **BUY!**

Recent product launches to lead to higher revenues in 2Q17 onward. Indonesia is experiencing rapid growth in mobile data usage, 4G LTE. This, we believe, offers the national leading mobile phone distributor, ERAA, ample room for business expansion going forward. Based on our recent discussions with the management, the recent product launches combined with cash back programs with telco operators have met with a positive response. This should translate into a higher top line in the coming quarters, we believe. We forecast higher revenues growth of 9.5% yoy in 2017F.

Continuing to expand its retail mid-low end concept to sustain margins. The management has continued its focus on the Asus, Lenovo and Xiaomi brands, which generally enjoy better margins, along with the continued expansion of retail stores. This will sustain margins going forward. Meanwhile, ERAA is committed toward boosting productivity and efficiency through its focus on regional decentralization in product distribution in a bid to enhance productivity for direct delivery. This should help to sustain gross and operating margins at 8.7% and 2.4%, respectively.

Financing costs may ease, healthier balance sheet. We expect pretax profits to grow by 11.1% yoy in 2017 due to possibly lower financing costs. Operationally, meanwhile, the management seeks to improve working capital efficiency through better inventory control (AR and AP days). This, in turn, may reduce gearing and give rise to a better cash position. Meanwhile, inventory days are expected to trend down slightly.

Attractive valuation with ample room for grow, BUY with a TP of IDR 1,100. We initiate coverage on ERAA with a BUY recommendation and a TP of IDR 1,100, implying 10.6x PE 2017F at a 3-year historical mean. Stripping out the one-time tax fiscal adjustment in 4Q16, we estimate that the net margin will remain stable at 1.3% in 2017 with EPS growth of 14.9% yoy and ROAE of 8.5%. Risks to our call include continued soft purchasing power.

Key Financials

Year to 31 Dec	2015	2016	2017F	2018F	2019F
Revenue, IDR bn	20,008	20,547	22,502	24,644	26,989
EBITDA, IDR bn	445	549	602	661	725
EBITDA growth, (%)	(13.8)	(1.9)	23.3	9.7	9.8
Net profit, IDR bn	226	264	303	339	379
EPS, IDR	78	91	104	117	131
EPS growth (%)	6.4	16.7	14.9	11.8	11.8
BVPS, (IDR)	1,105.3	1,175.6	1,256.2	1,346.5	1,447.3
DPS, (IDR)	20.0	20.0	23.3	26.8	30.0
PER (x)	8.2	7.0	6.1	5.5	4.9
PBV (x)	0.6	0.5	0.5	0.5	0.4
Dividend yield (%)	3.1	3.1	3.6	4.2	4.7
EV/EBITDA (x)	7.5	3.9	3.1	2.4	1.8

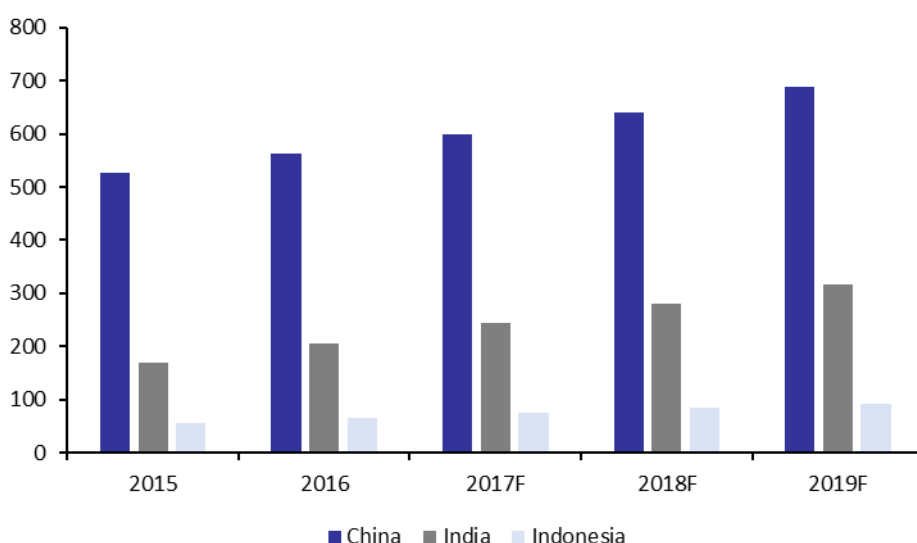
Source : ERAA, Danareksa Estimate

Industry overview: rapid growth in mobile data usage

Indonesia is seeing rapid growth in mobile data usage in the era of fourth-generation long-term evolution, or 4G LTE, with broadband operators rallying to provide improved data services for communications. Cisco Visual Networking Index (VNI) Mobile expects Indonesia to rank the highest globally in terms of data growth usage by 2020.

Indonesia's smartphone market is huge. Based on recent research conducted by International Data Corporation (IDC), Indonesia is the third-largest smartphone market in the Asia Pacific, trailing only China and India in first and second spot, respectively.

Exhibit 1. Smartphone users, in mn



Source: eMarketer

If we compare the number of smartphone users from the IDC data to the national population, then about 25% of Indonesia's population are smartphone users, indicating plenty of room for growth in the future. By comparison, smartphone penetration in China stands at about 41%. In India, the figure is still comparatively low at about 15%.

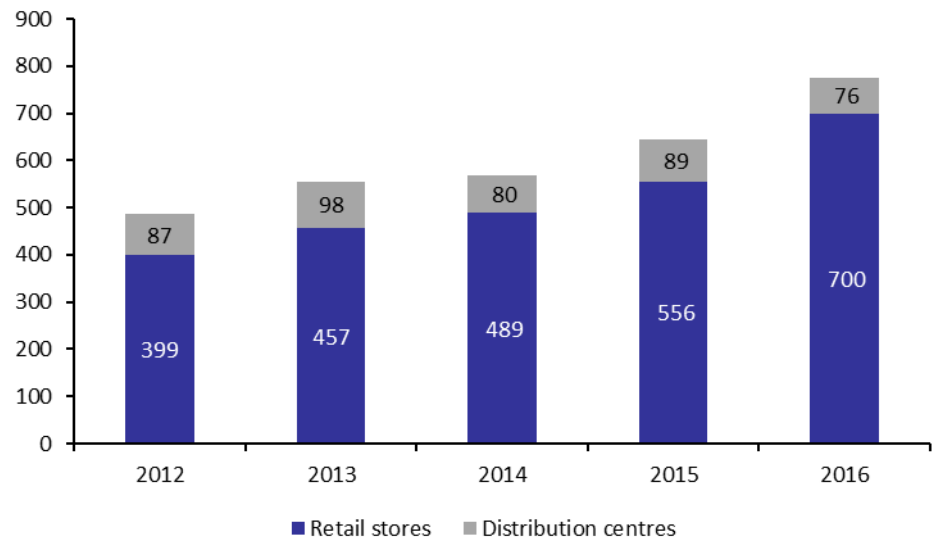
Indonesia is an attractive market for phone makers given that more than 30 million handsets were shipped to the country in 2016 (based on IDC data) and further growth looks assured going forward. All in all, we are optimistic that the upward trajectory of both industry data growth and domestic smartphone consumption will continue.

ERAA is a leading distributor and retailer of mobile phones in Indonesia

Rapid growth in mobile data usage offers ERAA - a leading distributor and retailer of mobile communication products and services in Indonesia - plenty of room to grow in the future. The company's top brand partners are Acer, Alcatel, Apple, Asus, Blackberry, Dell, HTC, Huawei, Lenovo, LG, Motorola, Nokia, Samsung, Sony, Xiaomi, and Venera. At the same time, the company's top mobile operator products are Indosat Ooredoo, Telkomsel, and XL. ERAA is a leading handset retailer and distributor in Indonesia with approximately 40%+ market share, based on the company's recent survey in 2016.

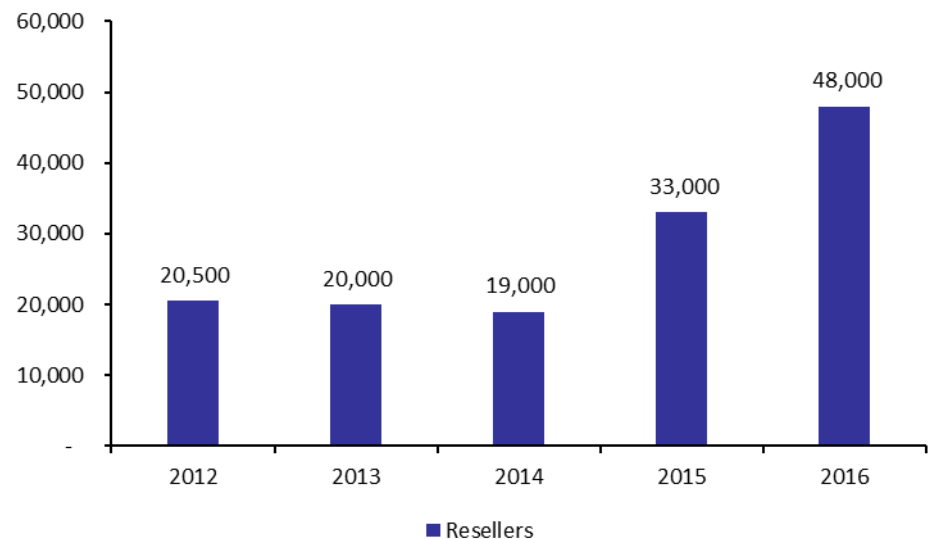
The company currently has a nationwide platform and distribution network with 76 distribution centres, 700 owned retail outlets, +/- 48,000 3rd party outlets and service points and 7,369 employees. Going forward, these numbers are expected to grow along with the expected growth in mobile data usage. ERAA's extensive distribution network is attractive to brand principals and is expected to grow further.

Exhibit 2. Growth in ERAA's distribution centres and retail stores, units



Source: Company

Exhibit 3. Growth in ERAA's resellers, units



Source: Company

ERAA currently has a presence in around 25 locations, encompassing Jakarta, Kalimantan, Sulawesi, Sumatera, Java and Bali. Its modern retail network includes ERAA's iBox, Android Nation, Urban Republic, and Erafone.

Exhibit 4. ERAA's megastore modern retailers, 25 locations

Greater Jakarta	Sumatera
Mall of Indonesia Mall Taman Anggrek Mall Metropolitan Taman Palem Padjajaran Margo City Depok ITC Roxy Mas Mal Kelapa Gading	Plaza Medan Fair Palembang Square Bencoolen Mall Bengkulu Sun Plaza Medan Kartini Lampung
Kalimantan	Java and Bali
Balikpapan Plaza Duta Mal Banjarmasin Ruko Pontianak	Gatot Subroto Solo Galaxy Mall Surabaya Teuku Umar Bali Supermall Karawaci Bintaro X-Change Bandung Electronic Centre Summarecon Mall Bekasi Plaza Jambu 2 Bogor
Sulawesi	
A. Yani Makassar Palu Grand Mall	

Source: Company

Exhibit 5. ERAA's iBox



Source: Company, Danareksa Sekuritas

Exhibit 6. ERAA's Android Nation



Source: Company, Danareksa Sekuritas

Exhibit 7. ERAA's Urban Republic



Source: Company, Danareksa Sekuritas

Exhibit 8. Erafone



Source: Company, Danareksa Sekuritas

New product launches in 2Q17

After Apple agreed to establish a research and development centre in Indonesia, the iPhone 7/7S has been available in Indonesia since March 31, 2017. Meanwhile, its rival - the Samsung S8 - will be available in stores starting May 2017. Other new products which have recently become available in its stores include Samsung Galaxy C9, Oppo F3, Motorola M, and Xiaomi Redmi Note 4 – with most of them released in early April 2017. Looking forward, the management also expects that affordably priced brands such as Asus, Lenovo and Xiaomi will help to ensure stable sales growth.

Exhibit 9. iPhone 7/7S



Source: Company

Exhibit 10. Samsung S8



Source: Company

Exhibit 11. Samsung Galaxy C9



Source: Company, Danareksa Sekuritas

Exhibit 12. Oppo F3



Source: Company, Danareksa Sekuritas

Exhibit 13. Motorola M


Source: Company, Danareksa Sekuritas

Exhibit 14. Xiaomi Redmi Note 4


Source: Company, Danareksa Sekuritas

Continuing to expand its retail mid-low end concept

Growth will be driven by higher expected sales volume as the management pursues its strategy of expanding the mid-low end retail store concept to reach the mass market by opening 40 retail outlets in Indonesia (Branded, Multibrand, JB and iBox) over the next few years. Notably, the company will continue to expand more retail outlets with Indosat, Ooredoo and XL Axiata, which can compete with local and traditional stores. These outlets will also receive subsidies from mobile operators to increase their price competitiveness against traditional stores.

Marketing efforts include cash back promotions with Indosat and an XL bundling program. For example, if a customer buys any smartphone in an ERAA store and signs a new contract with either Indosat or XL in an ERAA store, then the customer will be given a cash back as part of the subsidy provided by the partner operator.

Exhibit 15. XL's promotion cash back

	24 months service		
	Cash back IDR6mn	Cash back IDR4mn	Cash back IDR1.5mn
	Prio XL	Prio L	Prio M
Data	(IDR350,000 / month)	(IDR250,000 / month)	(IDR150,000 / month)
Free	10 GB 200 Minutes 200 Texts	5 GB 100 Minutes 100 Texts	2.5 GB 50 Minutes 50 Texts
	12 months service		
	Cash back IDR2.5mn	Cash back IDR1.5mn	Cash back IDR750k
	Prio XL	Prio L	Prio M
Data	(IDR350,000 / month)	(IDR250,000 / month)	(IDR150,000 / month)
Free	10 GB 200 Minutes 200 Texts	5 GB 100 Minutes 100 Texts	2.5 GB 50 Minutes 50 Texts

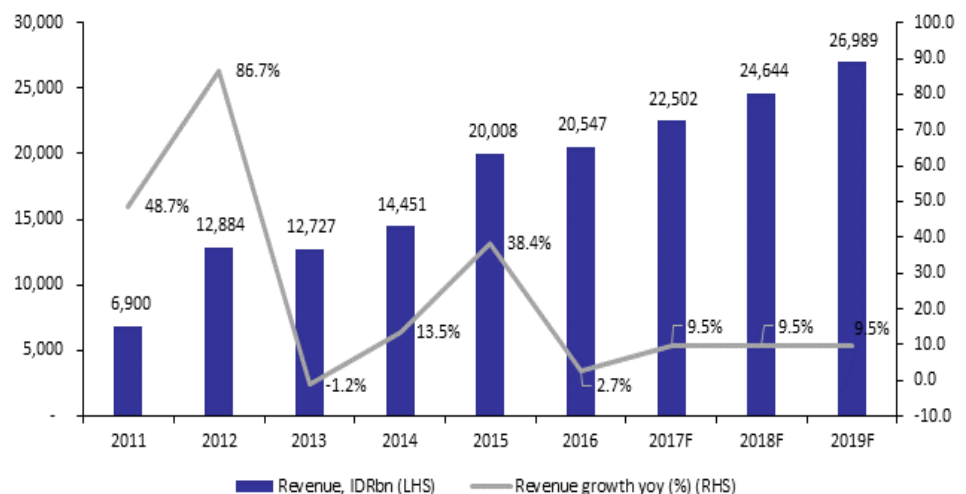
Source: Company, Danareksa Sekuritas

Benefiting from 4G growth and recent product launches

Supported by rapid growth in mobile data usage and the recent product launches in 2Q17, we forecast growth in revenues of 9.5% yoy in 2017F to IDR22.5tn. This is pretty much in line with the management's target (IDR23tn, 10% yoy growth), or much better growth than in the previous year (2016: 2.7% yoy).

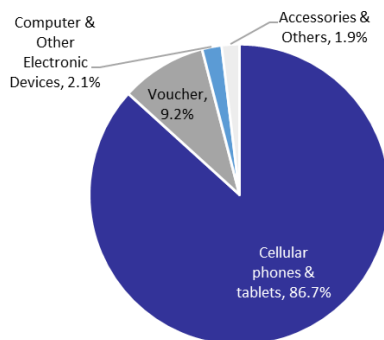
Among the company's business divisions, cellular, phones and tablets will continue to be the main revenues driver in 2017 (accounting for an estimated 86.7% of total revenues). The key growth driver for cellular, phones and tablets is higher sales volume.

Exhibit 16. Revenues yoy growth, %



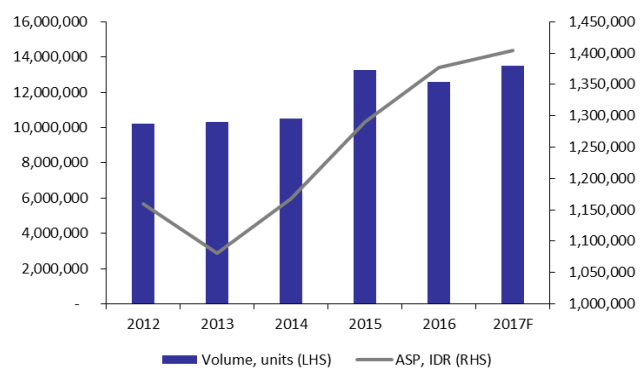
Source: Company, Danareksa Sekuritas

Exhibit 17. Revenues contribution, 2017F



Source: Company, Danareksa Sekuritas

Exhibit 18. Cellular, phones and tablets' volume and ASP



Source: Company, Danareksa Sekuritas

We expect the gross margin to be maintained

We take a conservative view and expect the gross margin to be maintained at around 8.7% - little changed from its level in the previous year. The gross margin will be supported by the company's focus on higher-margin retail sales (as opposed to the distribution margin) and a better merchandising mix. Note that the management is increasingly focused on the Asus, Lenovo and Xiaomi brands, which despite having generally lower ASP, also have better margins. The cellular, phones and tablets business division contributed almost 85% of consolidated gross profits in 2016. We forecast the gross margin for the cellular, phones and tablets business division to stay at around 8.8%.

Exhibit 19. Gross profits contribution, %

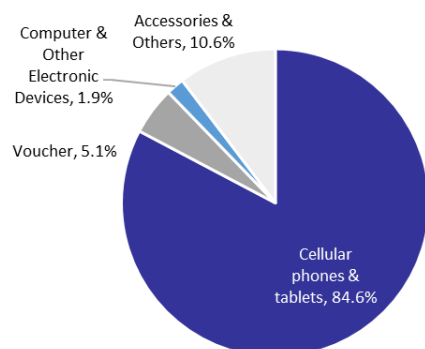
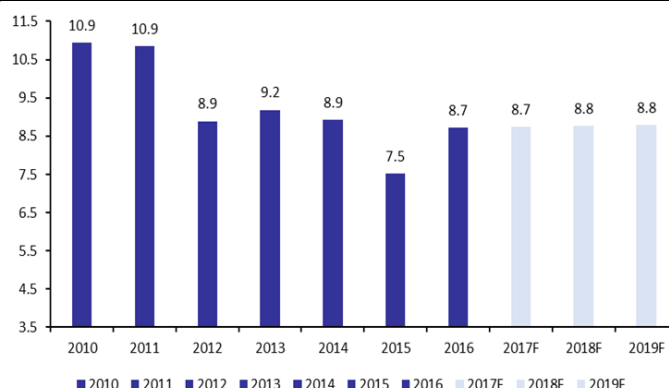
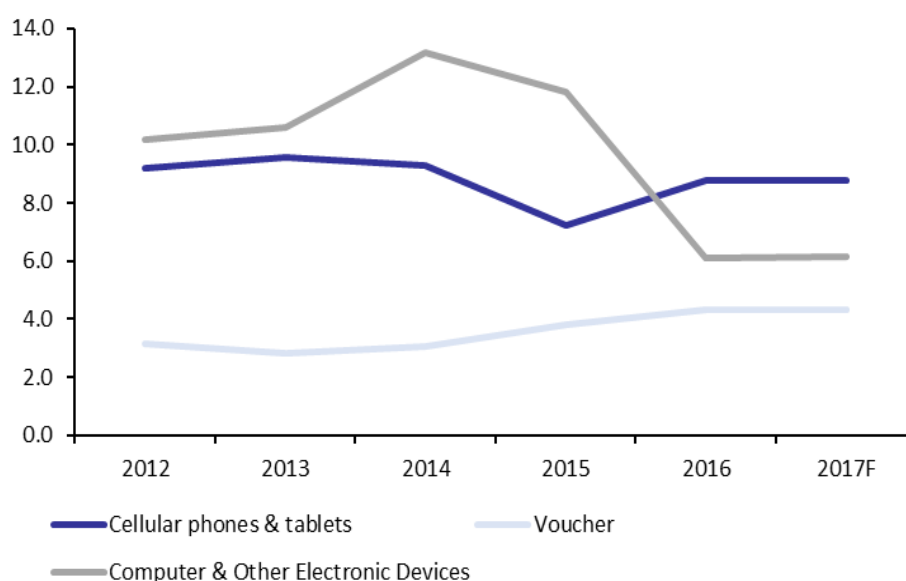


Exhibit 20. Gross margin, %



Source: Company, Danareksa Sekuritas

Exhibit 21. Gross margin by business segment, %

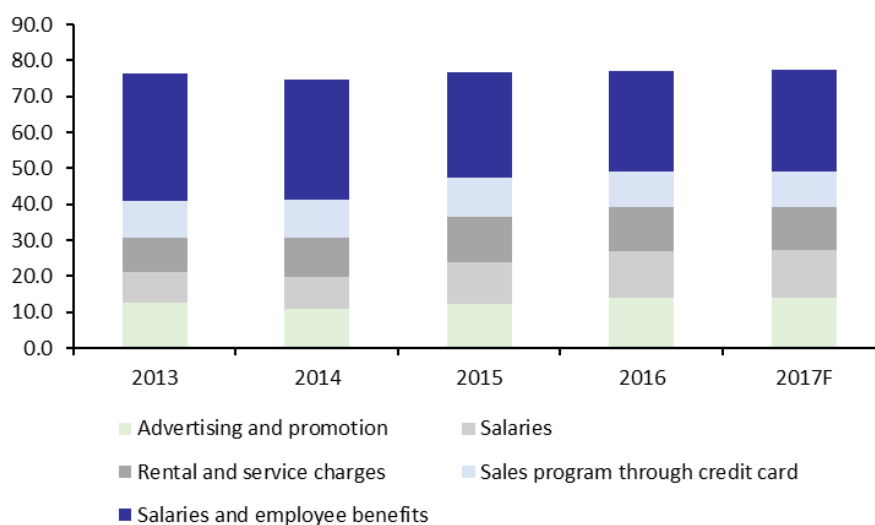


Source: Company, Danareksa Sekuritas

We also expect the operating margin to be maintained

At the operating level, we expect the operating margin to be maintained, noting that the two major operating expenses - salaries and advertising & promotional expenses (which contribute 41.3% and 14.1% of total operating expenses respectively) - will only increase gradually.

Exhibit 22. Opex, IDRbn

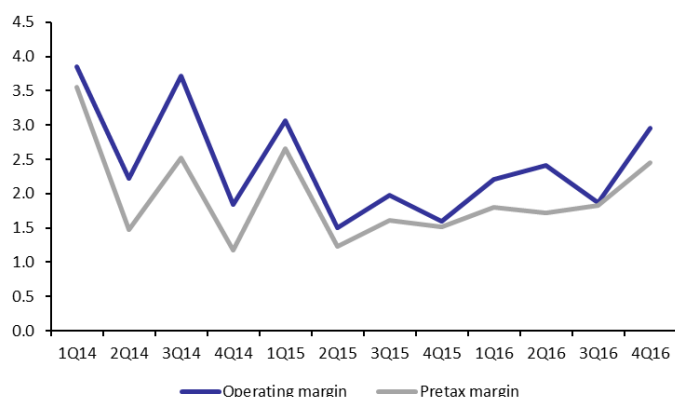


Source: Company, Danareksa Sekuritas

Pretax profits to grow at a brisker pace

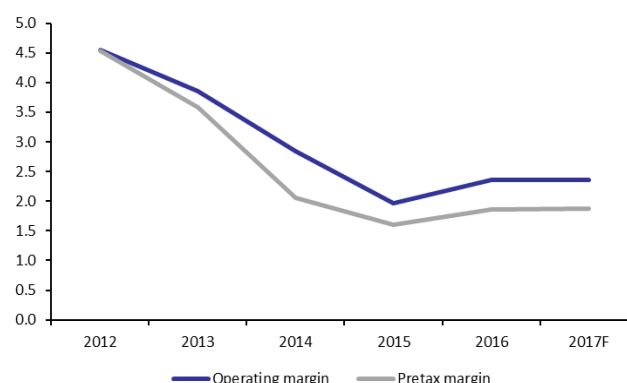
We expect the pretax profits to grow by 11.1% yoy in 2017, supported by strong cash flow that will lower gearing and financing costs. As a result, the pretax margin should remain stable at around 1.9%.

Exhibit 23. Quarterly operating and pretax margin, %



Source: Company, Danareksa Sekuritas

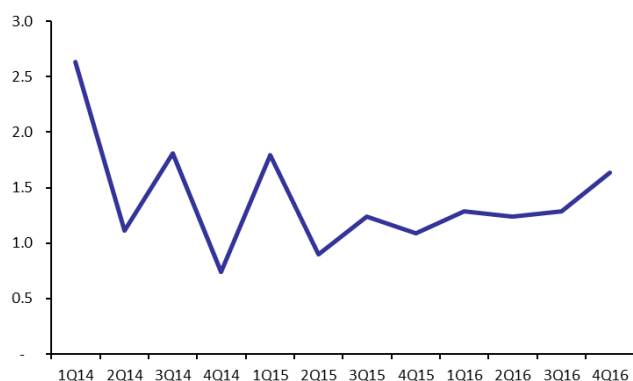
Exhibit 24. Operating and pretax margin, %



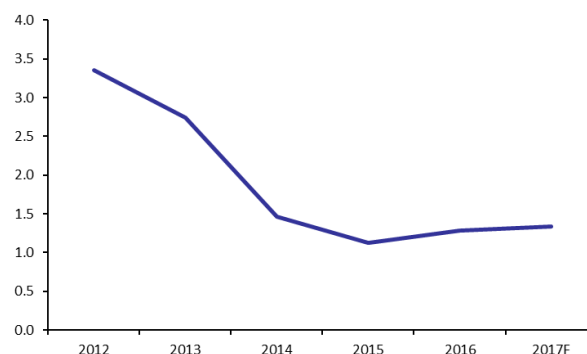
Source: Company, Danareksa Sekuritas

Bottom line set to increase

Stripping out the 4Q16 tax fiscal adjustment which led to higher tax payments in 2016, we expect the tax rate to return to its normal level. As such, we expect the 2017 bottom line to increase by around 14.9% yoy with a slight improvement in the consolidated net margin by 7ppt from 1.28% in 2016 to 1.35% in 2017.

Exhibit 25. Quarterly net margins, %


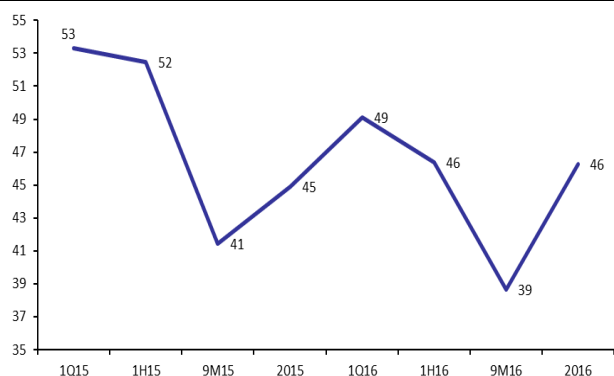
Source: Company, Danareksa Sekuritas

Exhibit 26. Net margins, %


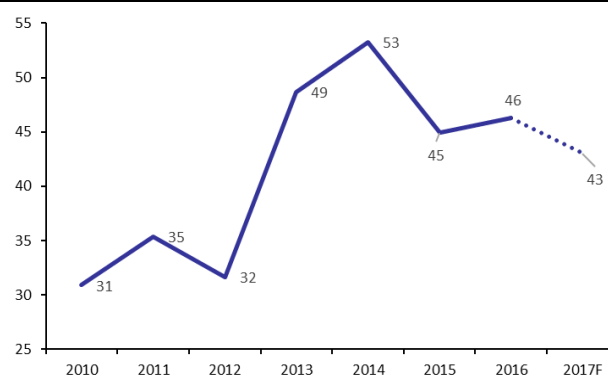
Source: Company, Danareksa Sekuritas

Looking to achieve more efficient working capital management

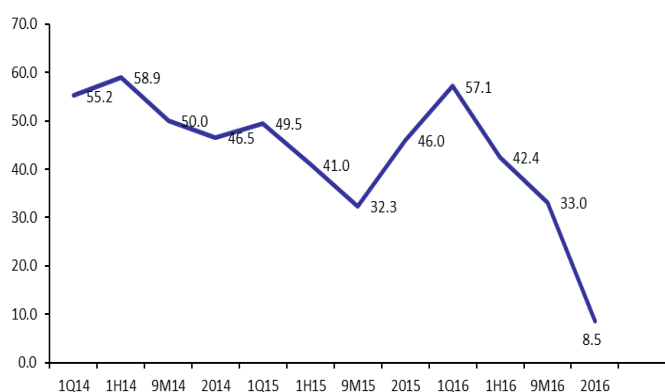
Operationally, the management seeks to improve working capital efficiency. This should lead to a stronger cash position. To this end, the management's strategy is to effectively manage its inventory level, account receivables and account payables. This will be reflected in slightly lower inventory days and lower net gearing going forward. Meanwhile, we expect ROAE and ROAA to improve in the coming years.

Exhibit 27. Quarterly inventory days


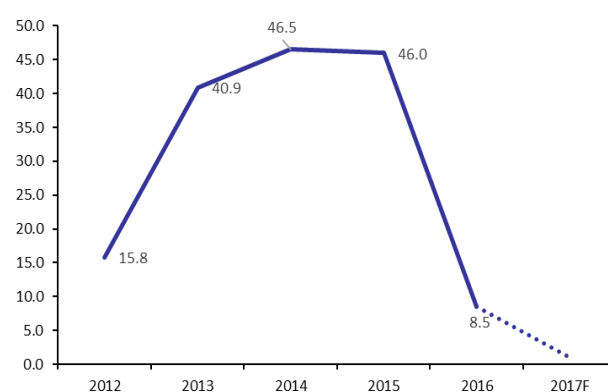
Source: Company, Danareksa Sekuritas

Exhibit 28. Inventory days


Source: Company, Danareksa Sekuritas

Exhibit 29. Quarterly net gearing, %


Source: Company, Danareksa Sekuritas

Exhibit 30. Net gearing ratio, %


Source: Company, Danareksa Sekuritas

ERAA is cheap!

ERAA trades at a very attractive valuation of just 7x PE 2017F, below its 3-year historical mean (2014-2016). We initiate coverage on the stock with a BUY recommendation and a TP of IDR 1,100, implying a 3-year mean of P/E 2017F 10.6x. At its current level, we think the valuation offers a good entry point for investors to BUY the stock, noting its promising growth potential and 8.6% ROAE in 2017, higher than in 2016.

Exhibit 31. ERAA's 3-year historical PE band 2014-2016



Source: Company, Danareksa Sekuritas

Risks

Government policy

One challenge faced by ERAA is the recent government policy which stipulates that smartphones may only be sold in the country if they have a minimum local content of 40% of the total components in the phone. The Ministry of Industry, the Ministry of Communications and Information, and the Ministry of Trade have all agreed that smartphones which have less than 40% local content will not be issued a permit by the Ministry of Trade. This policy will be strictly imposed on all 4G-capable smartphones that are imported into Indonesia.

iPhone 7's predecessor, the iPhone 6, failed to meet the local content requirement and was therefore banned from being sold in Indonesian shopping malls for quite some time. After Apple made a statement saying that it would build a local R&D centre in the coming months, the government finally decided to issue Apple a permit. However, the government will continue to monitor the situation and evaluate the extent of Apple's investment every three months. If the company cannot meet the requirement by July 27, 2017, then the government may revoke its permit.

Purchasing power

The affordability of the company's products is related to consumer purchasing power. If purchasing power weakens, revenues may decline.

Appendix

Exhibit 32. ERAA's valuation vs. TELE's valuation, 2017F

	2017F	
	ERAA	TELE (*)
Price, IDR	640	1,085
Market cap, IDRbn	1,856	7,631
P/E, x	6.1	14.7
P/BV, x	0.5	2.3
Operating cash flow/share	151.4	-5.3
Free cash flow/share	115.7	-0.4
Revenue, IDRbn	22,502	30,491
Growth yoy, %	9.5	11.6
Net profit, IDRbn	303	519
Growth yoy, %	14.9	10.8
Profitability		
Gross margin, %	8.7	5.1
Operating margin, %	2.4	3.0
Pretax margin, %	1.9	2.2
Net margin, %	1.3	1.7
ROAE, %	9	17
ROAA, %	4	15
Inventory days	43	38
Account receivable	35	35
Account payable	59	11
Net gearing	1%	60%

Source: Company, Danareksa *Bloomberg' consensus

Exhibit 33. Income Statement

Year to 31 Dec (IDRbn)	2015	2016	2017F	2018F	2019F
Revenue	20,008	20,547	22,502	24,644	26,989
COGS	(18,502)	(18,755)	(20,536)	(22,485)	(24,619)
Gross profit	1,506	1,792	1,967	2,159	2,370
EBITDA	445	549	602	661	725
Oper. profit	393	484	531	583	640
Interest income	1	4	4	5	5
Interest expense	(155)	(154)	(143)	(137)	(120)
Forex Gain/(Loss)	0	0	0	0	0
Income from assoc. co's	(3)	0	0	0	0
Other Income (Expenses)	85	50	28	18	12
Pre-tax profit	320	384	426	476	532
Income tax	(91)	(122)	(125)	(140)	(157)
Minority interest	(4)	2	2	2	2
Net profit	226	264	303	339	379
Core Net Profit	229	264	303	339	379

Exhibit 34. Balance Sheet

Year to 31 Dec (IDRbn)	2015	2016	2017F	2018F	2019F
Cash & cash equivalent	127	615	774	975	1,229
Receivables	2,387	1,876	2,439	2,287	2,445
Inventory	2,553	2,203	2,636	2,662	2,842
Other Curr. Asset	399	475	316	319	323
Fixed assets - Net	437	457	503	548	591
Other non-curr.asset	1,898	1,799	1,698	1,715	1,732
Total asset	7,800	7,425	8,367	8,506	9,163
ST Debt	1,450	801	721	649	584
Payables	2,873	2,921	3,718	3,675	4,110
Other Curr. Liabilities	76	213	204	196	189
Long Term Debt	136	3	2	2	2
Other LT. Liabilities	60	78	79	80	81
Total Liabilities	4,595	4,015	4,724	4,601	4,966
Shareholder's Funds	3,138	3,349	3,582	3,843	4,135
Minority interests	67	61	61	62	62
Total Equity & Liabilities	7,800	7,425	8,367	8,506	9,163

Exhibit 35. Cash Flow

Year to 31 Dec (IDRbn)	2015	2016	2017F	2018F	2019F
Net income	226	264	303	339	379
Depreciation and Amort.	52	65	72	78	86
Change in Working Capital	319	931	69	72	86
Other Oper. Cash Flow	(20)	(76)	(4)	(5)	(5)
Operating Cash Flow	578	1,184	439	484	545
Capex	(91)	(89)	(104)	(108)	(113)
Others Inv. Cash Flow	(474)	99	(17)	(18)	(18)
Investing Cash Flow	(565)	28	(121)	(127)	(132)
Net change in debt	30	(694)	(91)	(80)	(72)
New Capital	0	0	0	0	0
Dividend payment	(58)	(58)	(68)	(78)	(87)
Other Fin. Cash Flow	(27)	46	0	0	0
Financing Cash Flow	(55)	(706)	(159)	(158)	(159)
Net Change in Cash	(43)	488	160	200	254
Cash - begin of the year	170	127	615	774	975
Cash - end of the year	127	615	774	975	1,229

Exhibit 36. Key Ratios

Year to 31 Dec	2015	2016	2017F	2018F	2019F
Growth (%)					
Sales	38.4	2.7	9.5	9.5	9.5
EBITDA	(1.9)	23.3	9.7	9.8	9.8
Operating profit	(4.2)	23.1	9.7	9.8	9.8
Net profit	6.4	16.7	14.9	11.8	11.7
Profitability (%)					
Gross margin	7.5	8.7	8.7	8.8	8.8
EBITDA margin	2.2	2.7	2.7	2.7	2.7
Operating margin	2.0	2.4	2.4	2.4	2.4
Net margin	1.1	1.3	1.3	1.4	1.4
ROAA	3.2	3.5	3.9	4.1	4.3
ROAE	7.3	8.0	8.6	9.0	9.3
Leverage					
Net Gearing (%)	46.0	8.5	1.0	net cash	net cash
Interest Coverage (x)	2.5	3.1	3.7	4.3	5.4

Source : ERAA, Danareksa Estimate