Wednesday, 21 January 2015

OVERWEIGHT

YE15 Target	**5,900**
JCI Index	**5,166**
Market Cap. (Rp tn)	5,171
US$ (bn)	410
1Y Avg. daily T/O. (Rp bn)	5,912
US$ (mn)	469

JCI Valuation

USD/IDR

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Market outlook

2015 draft revised budget: stronger platform for growth

The draft revised state budget conspicuously epitomizes the government's commitment to encourage growth, allocating greater spending on more productive sectors such as infrastructure. This initiative is mainly funded by savings on subsidies as well as higher tax revenues. The expenditure of ministries sees an increase of 20.4%, mainly channeled through public works and public housing as well as transportation. We believe the revised state budget provides a stronger foundation to propel growth, and that it will receive a positive response from parliament which is expected to approve the budget next month. This will serve as the short-term catalyst for the market. Overweight.

A pro-growth government budget

The draft revised 2015 state budget showcases government initiatives to boost spending - partially funded by the reduction in fuel subsidies. On the income side, the falling oil price was the main culprit behind the considerable reduction in non-tax revenues, although income from tax will improve this year. Overall, when compared to the previous 2015 state budget, we see a 1.4% reduction in government income. On the expenditure side, total spending is 2.2% lower. As such, overall, there is an improvement in the budget deficit to 1.9% from 2.2% previously.

Greater tax income contribution amidst lower crude oil prices

On the revenues side, an increase in tax revenues will be the main source of funding, which posted a 7.6% increase over the previous 2015 budget figure to IDR1,485t, with the tax to GDP ratio improving to 13.6%. Looking further ahead, the government aims to increase this ratio to 14.1% by 2018. Higher tax income is critical, in our view, especially with the considerable decline in crude oil prices - which has major ramifications on the government's non-tax income. The main support for higher tax income will come from: income tax (up 5.6%), VAT (up 9.8%) and excise tax (up 11.8%). In regard to the latter, it will mainly come from excise on tobacco (up 12.9%). By contrast, in the revised budget, the non-tax income saw a 31.5% decline to IDR281t, predominantly due to lower oil and gas revenues of IDR95.6t (down 57%). To strengthen the capital of SOEs, dividends see a 20.5% reduction to IDR35t.

Expenditure is now driven by the spending of ministries, no longer on subsidies

Whilst in past government budgets, the non-ministry expenditures could match or even surpass the expenditures of ministries, the government's decision to reduce fuel subsidies has a major impact on the revised expenditures balance. In the draft revised budget, we can clearly see a greater allocation for the expenditures of ministries, which sees a 20.4% increase to IDR780t from IDR647t previously. By contrast, the non-ministry expenditure is cut by IDR194t or 26% to only IDR551t – predominantly due to the sharp reduction in fuel subsidies to only IDR82t from IDR276t previously. There are eight ministries which received budget allocations of above Rp40tn, and from those ministries, the transportation and public works ministries saw the biggest increases. All in all, this budget further signifies the government's strong intent to improve the current dis-connectivity across Indonesia. The Ministry of Public Works and Public Housing sees a 40.6% higher allocation to IDR119t, whilst the Ministry of Transportation gets a 44.7% higher budget of IDR65t.

Macro assumptions: an ambitious growth target for 2015

In regard to the macro assumptions, there are some revisions, especially given the current weak currency and depressed crude oil price. On the latter, the government is now proposing to use an assumption of USD70/barrel vs the initial assumption of USD105/barrel, whilst on the currency, the assumption is raised to IDR12,200/USD from the initial assumption of IDR11,900/USD. On the currency, whilst there is still the potential for further volatility, our economist believes that the bottom has already been reached. Indeed, we foresee a more favorable situation for the IDR toward the year-end, and we expect the IDR to average IDR11,750/USD in 2015. The economic growth assumption still remains at 5.8%, which we believe is quite challenging to achieve and will arguably require outstanding execution on the part of the government to accelerate growth momentum. The oil lifting assumption, meanwhile, will be cut to 849k barrels/day from the initial assumption of 900k barrels/day.

Indonesia's transformation story remains sound; Overweight maintained

The draft revised budget clearly shows the government's commitment toward the transformation process in Indonesia and we are confident that a more pronounced transformation can be realized in 2015 with the establishment of stronger foundations for structural change in the domestic economy. Nonetheless, in any transformation process, execution is key. In this regard, we have confidence in the new government's capabilities and, most importantly, in its political will to execute.

We continue to believe that SOEs will serve as the agents of growth, especially with a greater commitment from the government to improve the capital base of SOEs by allocating IDR72t in this year's budget, a massive leap from only IDR5.1t. However, a new associated risk for SOEs has transpired, as seen in the government's surprising move recently to call on cement SOEs to lower cement prices by IDR3,000/bag (c. 5-6%) to help ease inflationary pressures. This was beyond our expectation since we had believed that pricing at the micro level would be solely determined by supply/demand dynamics, and that any government intervention would have unnecessary implications.

Arguably, the government's intervention in the cement market through SOEs also appears to have raised concerns beyond the cement sector itself. This has created some uncertainty, given the worry that similar controls could be imposed in other sectors where SOEs are dominant - such as toll roads (JSMR IJ), gas distribution (PGAS IJ), construction, pharmaceuticals (KAEF IJ) and banks. In our view, however, it is too early to conclude that such fears are warranted. Indeed, with the new government taking a proactive approach to luring new investments into Indonesia, the possibility is quite low, we believe. However, given that the market will arguably still factor in such risk in the short -term, this could hinder the market's re-rating process, in our view.

We continue to pitch our 10 top picks in 2015: BMRI, BBRI, TLKM, SMGR, PTPP, WSKT, ACES, ICBP, INCO and BSDE.

Exhibit 1. Macroeconomic assumptions

	2013	2014	2015		
	Realization	APBN-P	APBN	RAPBN-P	Chg, %
GDP growth y-y, %	5.8	5.5	5.8	5.8	-
Inflation y-y, %	8.4	5.3	4.4	5.0	*0.6*
Interest rate SPN 3 months, %	4.4	6.0	6.0	6.2	*0.2*
Exchange rate, Rp/USD	10,460	11,600	11,900	12,200	*2.5*
ICP price, USD/barrel	106	105	105	70	*(33.3)*
Oil lifting, '000 barrel/day	825	818	900	849	*(5.7)*
Gas lifting, '000 barrel/day	1,213	1,224	1,248	1,177	*(5.7)*

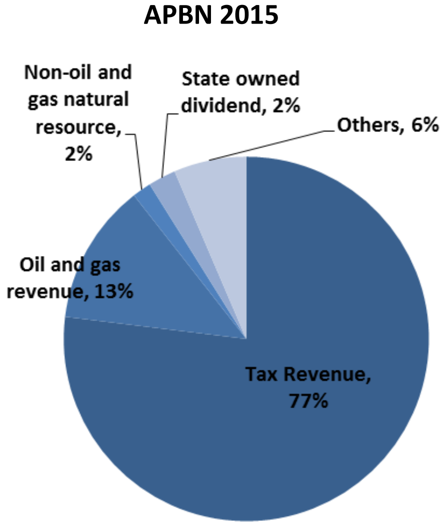
Source: RAPBNP 2015

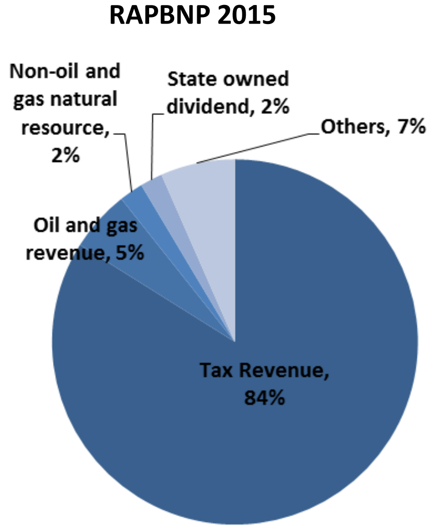
Exhibit 2. Draft state budget revision (RAPBNP) 2015

	2013	2014	2015		
	Realization	APBN-P	APBN	RAPBN-P	Chg, %
A. Government revenue and grant	1,439	1,635	1,794	1,769	*(1.4)*
I. Domestic revenue	1,432	1,633	1,790	1,766	*(1.4)*
1. Tax revenue	1,077	1,246	1,380	1,485	*7.6*
% Tax ratio to GDP	*11.9*	*12.4*	*12.3*	*13.6*	*1.3*
2. Non-tax revenue	355	387	410	281	*(31.5)*
II. Grant	7	2	3	3	*1.6*
B. Government expenditure	1,651	1,877	2,039	1,995	*(2.2)*
I. Central government expenditure	1,137	1,280	1,392	1,331	*(4.4)*
1. Ministries expenditure	583	602	647	780	*20.4*
2. Non-ministries expenditure	554	678	745	551	*(26.0)*
2.1. Subsidy	355	403	415	233	*(43.9)*
2.1.1 Energy subsidy	310	350	345	158	*(54.0)*
a. Fuel subsidy	210	247	276	82	*(70.4)*
b. Electricity subsidy	100	104	69	77	*11.5*
2.1.2 Non Energy subsidy	45	53	70	74	*6.1*
2.2. Interest Payment	113	135	152	155	*2.3*
II. Regional transfer	513	597	647	664	*2.6*
C. Primary balance	(90)	(106)	(94)	(71)	*(24.9)*
D. Surplus / (Deficit)	(212)	(241)	(246)	(226)	*(8.1)*
% Budget deficit to GDP	*(2.3)*	*(2.4)*	*(2.2)*	*(1.9)*	*0.3*
E. Financing	237	241	246	226	*(8.1)*

Source: RAPBNP 2015

Exhibit 3. Composition of government revenues





Source: RAPBNP 2015

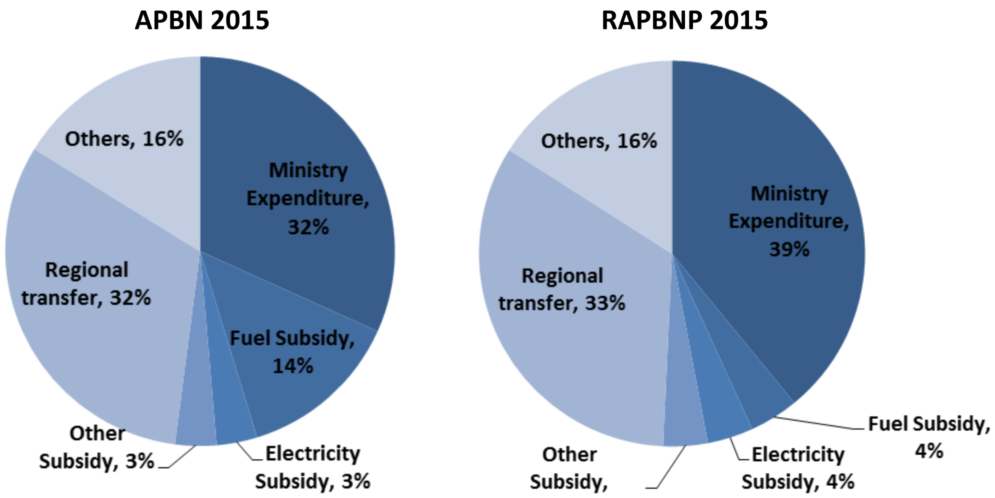
Exhibit 4. Breakdown of government revenues

Income	2014	2015		
	APBNP	APBN	RAPBN-P	% change
Tax Revenue	1,246.1	1,380.0	1,484.6	7.6
1. Domestic tax revenue	1,189.8	1,328.5	1,437.4	8.2
1.1. Income tax	569.9	644.4	680.8	5.6
1.2. VAT	475.6	525.0	576.5	9.8
1.3. Property taxes	21.7	26.7	26.7	0.0
1.4. Excise	117.5	126.7	141.7	11.8
1.5. Tax other	5.2	5.7	11.7	106.2
2. International trade tax revenue	56.3	51.5	47.2	(8.3)
2.1. Import duty	35.7	37.2	35.2	(5.5)
2.2. Export duty	20.6	14.3	12.1	(15.7)
Oil and gas revenue	211.7	224.3	95.6	(57.4)
non-oil and gas natural resource revenue	29.4	30.0	37.4	24.8
State owned dividend	40.0	44.0	35.0	(20.6)
Others	108.2	115.3	116.3	0.9
Total Government Revenue	**1,635.4**	**1,793.6**	**1,769.0**	**(1.4)**

Excise tax breakdown	2014	2015		
	APBNP	APBN	RAPBN-P	% change
Tobacco excise tax	111.4	120.6	136.1	12.9
Ethyl alcohol excise	0.2	0.2	0.2	-
Income beverages containing ethyl alcohol	5.9	6.0	5.5	(9.4)

Source: RAPBNP 2015

Exhibit 5. Composition of government expenditures



Source: RAPBNP 2015

Exhibit 6. Ministries with budgets over Rp40tn (Rp bn)

	2013 Realization	2014 APBN-P	2015 APBN	RAPBN-P	Chg, %
Ministry of Defense	88	83	97	98	*0.7*
Ministry of Public Works and Public Housing	85	79	85	119	*40.6*
Ministry of Education and Culture	72	77	47	53	*13.8*
Ministry of Technology and Higher Education	1	1	42	42	*0.3*
Ministry of Religious Affairs	42	52	56	57	*1.9*
Ministry of Healthcare	35	47	48	51	*7.3*
National Police	43	44	52	53	*3.2*
Ministry of Transportation	32	36	45	65	*44.7*

Source: RAPBNP 2015

Exhibit 7. Capital injections to SOEs (IDR bn)

No.	SOE	2014	2015			
					Difference	
		APBNP	APBN	RAPBNP	Nominal	%
1	PT SMI	-	2,000.0	20,356.6	18,356.6	917.8
2	PT Antam	-	-	7,000.0	7,000.0	-
3	PT Bank Mandiri	-	-	5,600.0	5,600.0	-
4	PT Hutama Karya	-	-	3,600.0	3,600.0	-
5	PT Waskita Karya	-	-	3,500.0	3,500.0	-
6	PTPN III	-	-	3,150.0	3,150.0	-
7	Perum Bulog	-	-	3,000.0	3,000.0	-
8	PT Angkasa Pura II	-	-	3,000.0	3,000.0	-
9	PT Kereta Api Indonesia	-	-	2,750.0	2,750.0	-
10	Perum Perumnas	-	-	2,000.0	2,000.0	-
11	PT Pelindo IV	-	-	2,000.0	2,000.0	-
12	PT Perusahaan Pengelola Aset	-	-	2,000.0	2,000.0	-
13	PT PAL Indonesia	-	1,500.0	1,500.0	-	-
14	PT PII	-	-	1,500.0	1,500.0	-
15	PT Adhi Karya	-	-	1,400.0	1,400.0	-
16	PT SMF	1,000.0	1,000.0	1,000.0	-	-
17	PT Permodalan Nasional Madani	-	-	1,000.0	1,000.0	-
18	PT ASDP	-	-	1,000.0	1,000.0	-
19	PT Krakatau Steel	-	-	956.5	956.5	-
20	PT Dok dan Perkapalan Kodja Bahari	-	-	900.0	900.0	-
21	PT Pindad	-	-	700.0	700.0	-
22	PT Geo Dipa Energi	-	607.3	607.3	-	-
23	PT Pelni	-	-	500.0	500.0	-
24	PT Pertani	-	-	470.0	470.0	-
25	PT Sang Hyang Seri	-	-	400.0	400.0	-
26	PT Dirgantara Indonesia	-	-	400.0	400.0	-
27	PT Djakarta Lloyd	-	-	350.0	350.0	-
28	PT Garam	-	-	300.0	300.0	-
29	Perum Perikanan Indonesia	-	-	300.0	300.0	-
30	PT RNI	-	-	280.0	280.0	-
31	PT Pengembangan Pariwisata Indonesia	-	-	250.0	250.0	-
32	PT BPUI	-	-	250.0	250.0	-
33	PT Perikanan Nusantara	-	-	200.0	200.0	-
34	PT Dok dan Perkapalan Surabaya	-	-	200.0	200.0	-
35	PT Industri Kapal Indonesia	-	-	200.0	200.0	-
36	PTPN IX	-	-	100.0	100.0	-
37	PTPN X	-	-	97.5	97.5	-
38	PTPN XII	-	-	70.0	70.0	-
39	PTPB XI	-	-	65.0	65.0	-
40	PTPN VII	-	-	17.5	17.5	-
	Total	**1,000.0**	**5,107.3**	**72,970.4**	**67,863.1**	**1,328.7**

Source: RAPBNP 2015