RETAIL/COMPANY UPDATE

Ace Hardware Indonesia

Continued inventory problems

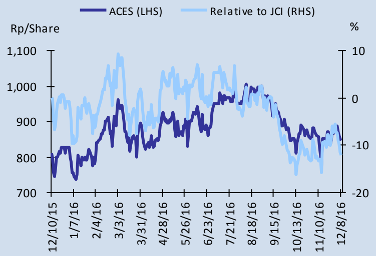
SELL

Target Price, Rp	750
Upside (Downside)	(11.2%)
ACES IJ/ACES..JK	
Last Price, Rp	845
No. of shares, mn	17,150
Market Cap, Rpbn	**14,492**
(US$ mn)	1,074
3M T/O, US$mn	0.3

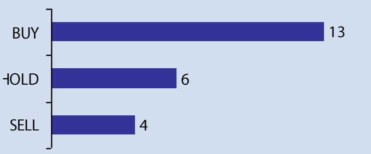
Last Recommendation

6 Oct 2016	SELL	Rp 750
31 Oct 2016	SELL	Rp 750

ACES relative to JCI Index



Market Recommendation



Danareksa vs Consensus

	Our	Cons	% Diff
Target Price, IDR	750	974	-23%
EPS 2017F, IDR	35	40	-13%
PE 2017F, x	24.1	21.2	13%

Given that the company's inventory problems are likely to continue due to soft demand for property, we remain downbeat on ACES and maintain our SELL recommendation. Other concerns are the weak SSSG, which will remain low in 4Q16 and 2017, as well as expected operating margins compression. We foresee negative EPS growth in 2017 assuming there are no one-time gains from asset sales as was the case in 9M16.

Continued inventory problems

In our recent visit to the company, we learnt that ACES' inventory problems are likely to continue in 4Q16-2017F given the soft demand for property, which, in turn, will limit demand for the company's lifestyle merchandising, as discretionary products. Worth noting is that ACES' merchandising team will need to procure products for the upcoming spring season before the early Chinese New Year holiday (which falls on 28 January 2017), as up to 50% of ACES' merchandising is imported from China. As such, we believe that the company's inventory problems may persist following tepid performance in 9M16.

Expect a smaller store format in the future

Looking at the company's latest store openings, we notice that the average additional gross retail space as of November 2016 was down by around 18.1% compared to the end of 2015, indicating the opening of smaller retail format stores this year. This trend will persist in 2017, we believe. Although 11 new stores have been opened this year (2015: 8), exceeding our estimate and the management's guidance of 10 new stores, in terms of gross store space the number is actually slightly lower than expected. Overall, we still foresee revenues growth of 3.0%-4.6% yoy in 2016-17F.

Possible operating margins compression and anaemic SSSG

Assuming gross margins of around 47.5% in 2016-17F (9M16: 47.5%), we foresee the possibility of further operating margins compression in the future, mainly from rising rental costs and higher salary expenses in opex. As for SSSG, it will remain tepid at around 1%, or much lower than the historical average. Hence, at the bottom line, we foresee negative growth in 2017 assuming there are no one-time gains from asset sales as was the case in 9M16.

Valuation

ACES has a strong net cash position and will book ROAE of around 22.0% this year, as per our forecast. The stock is currently trading at 24.1x P/E 2017F or +1 STD based on its 3 years historical average. We maintain our SELL recommendation with a TP of Rp750, implying 21.4x P/E 2017F. Risks to our call include higher-than-expected sales performance next year and a stronger property market.

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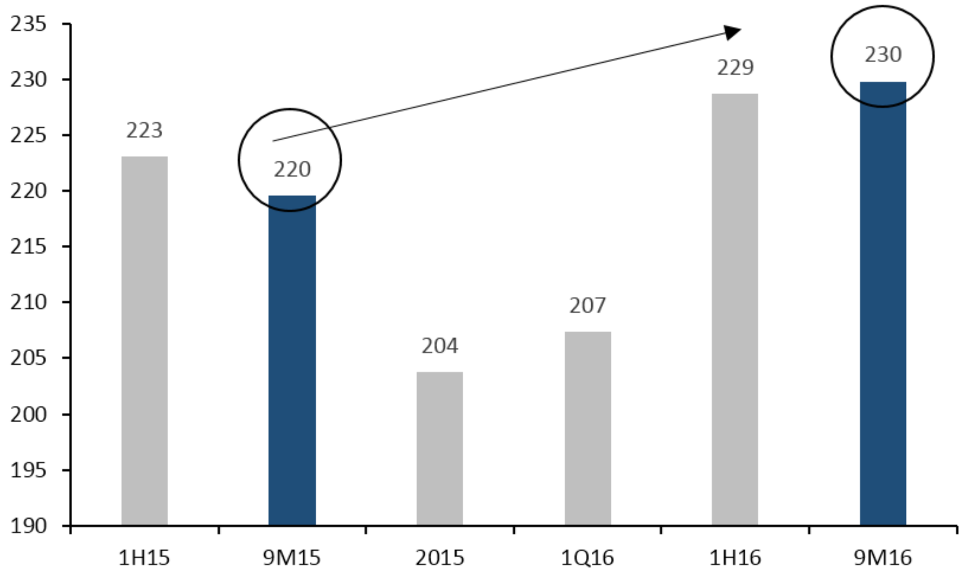
	2014	2015	2016F	2017F	2018F
Revenue, Rp bn	4,541	4,743	4,885	5,109	5,333
EBITDA, Rp bn	663	688	670	666	668
Net profit, Rp bn	562	588	648	597	601
EPS,Rp	33	35	38	35	35
EPS growth (%)	10.7	5.0	10.2	(7.9)	0.7
P/E Ratio (x)	25.7	24.5	22.2	24.1	23.9
EV/EBITDA (x)	21.2	20.1	20.2	20.5	20.1
ROAE (%)	24.1	22.4	22.0	18.4	16.9
Net gearing (%)	net cash	net cash	net cash	net cash	net cash

Why should we sell ACES? Inventory problems.

Inventory problems expected to persist in 4Q16 and 2017

In our recent visit to the company, we learnt that ACES' inventory problems are likely to continue in 4Q16-2017F given the soft demand for property, which, in turn, will limit demand for the company's lifestyle merchandising, as discretionary products. Worth noting is that ACES' merchandising team will need to procure products for the upcoming spring season before the early Chinese New Year holiday (which falls on 28 January 2017), as up to 50% of ACES' merchandising is imported from China. As such, we believe that the company's inventory problems may persist following tepid performance in 9M16.

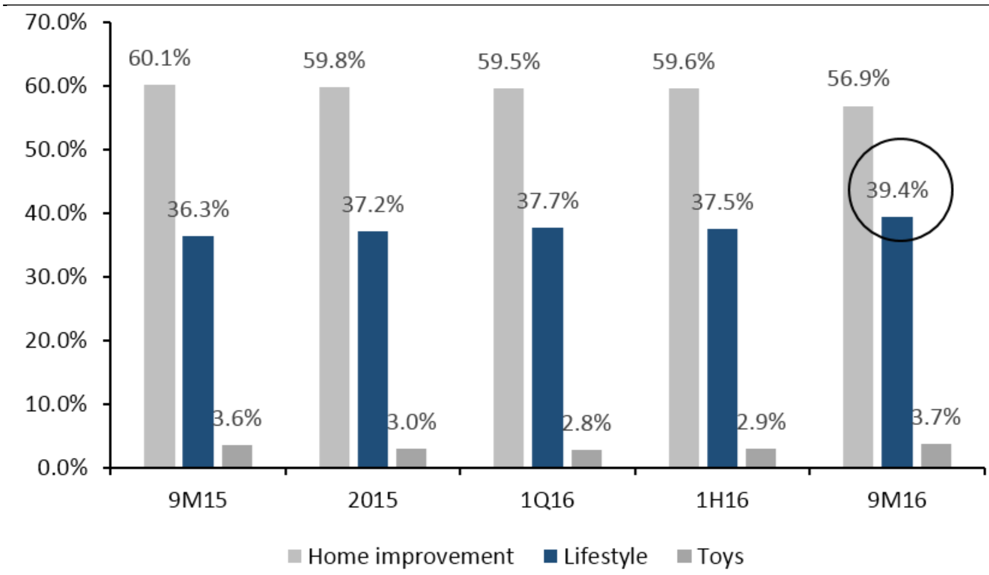
Exhibit 1. Inventory days, 1H15-9M16



Source: Company, Danareksa Sekuritas

ACES' lifestyle products include automotive accessories, furniture, houseware, sporting goods, pet supplies and horeca (hotel, restaurant and cafe) supplies. The home improvement products include household hardware, home appliances, cleaning supplies, gardening tools, plumbing supplies and fixtures, as well as lighting and building materials. In 2017, ACES will need to extend the period of its promotional activities to spur demand, we believe. In terms of the merchandising, the major concerns are on the company's lifestyle business segment, whose sales mix has increased from 36.3% in 9M15 to 39.4% in 9M16.

Exhibit 2. Merchandising mix, 9M15-9M16

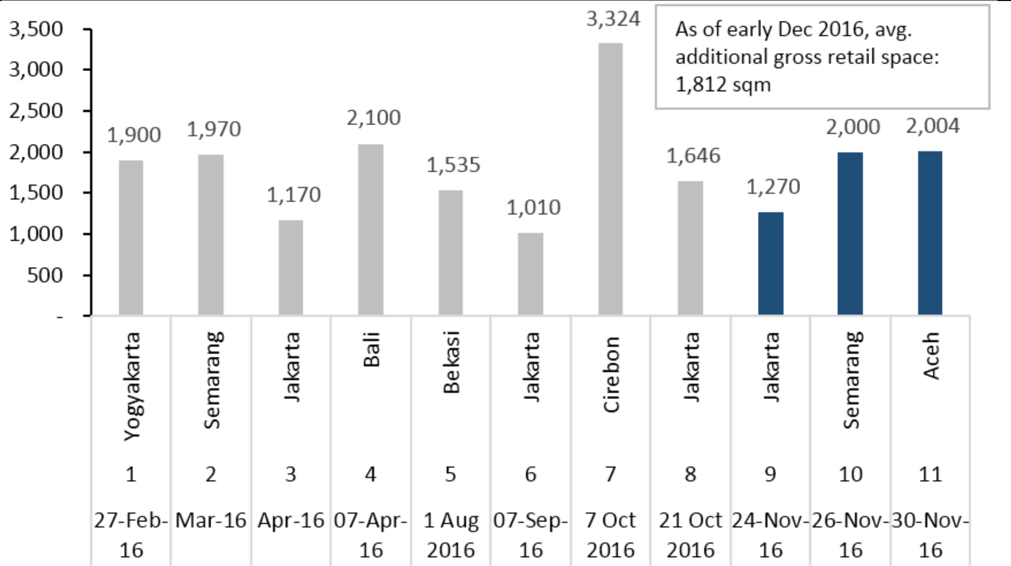


Source: Company, Danareksa Sekuritas

What is interesting? The average additional gross retail space has dropped by 18.1%

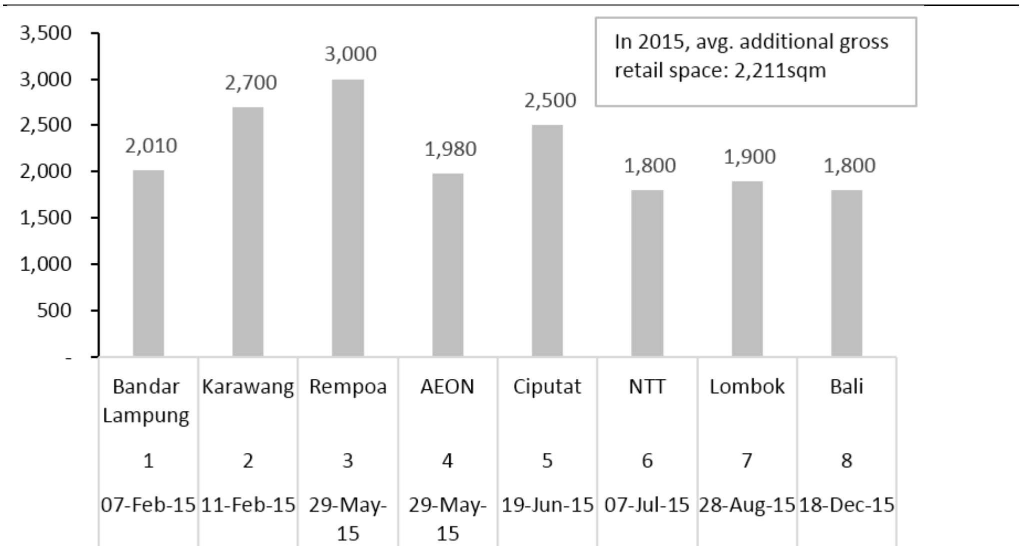
Looking at the company's latest store openings, we notice that the average additional gross retail space as of November 2016 was down by around 18.1% compared to the end of 2015, indicating the opening of smaller retail format stores this year. This trend will persist in 2017, we believe. The management cites this as a positive development, as expansion will be more rapid in the future in terms of the number of new store openings. Nonetheless, we need to slightly reduce our overall gross retail space assumption for this year by approximately 1.2%.

Exhibit 3. List of new store openings, November 2016



Source: Company, Danareksa Sekuritas

Exhibit 4. List of new store openings, 2015

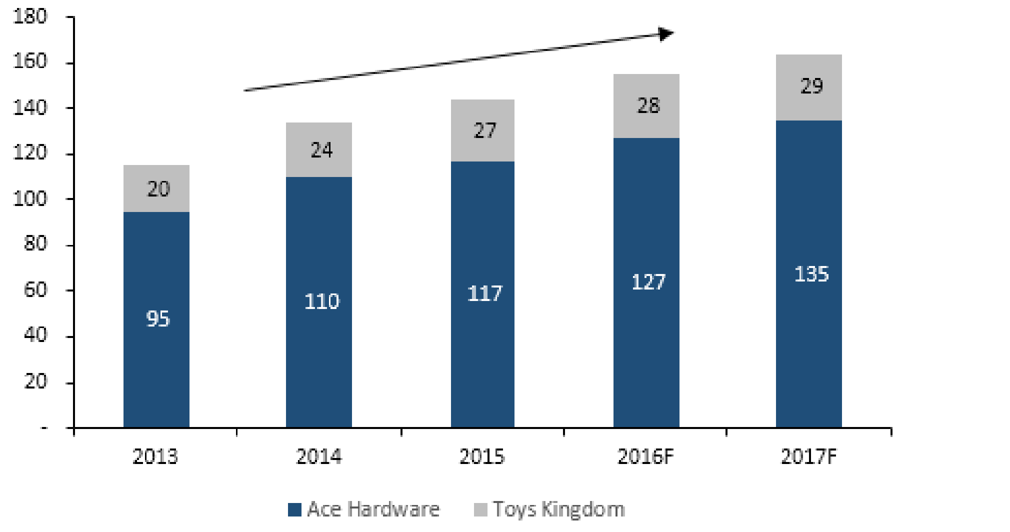


Source: Company, Danareksa Sekuritas

What is the impact? Slightly lower-than-expected gross retail space this year

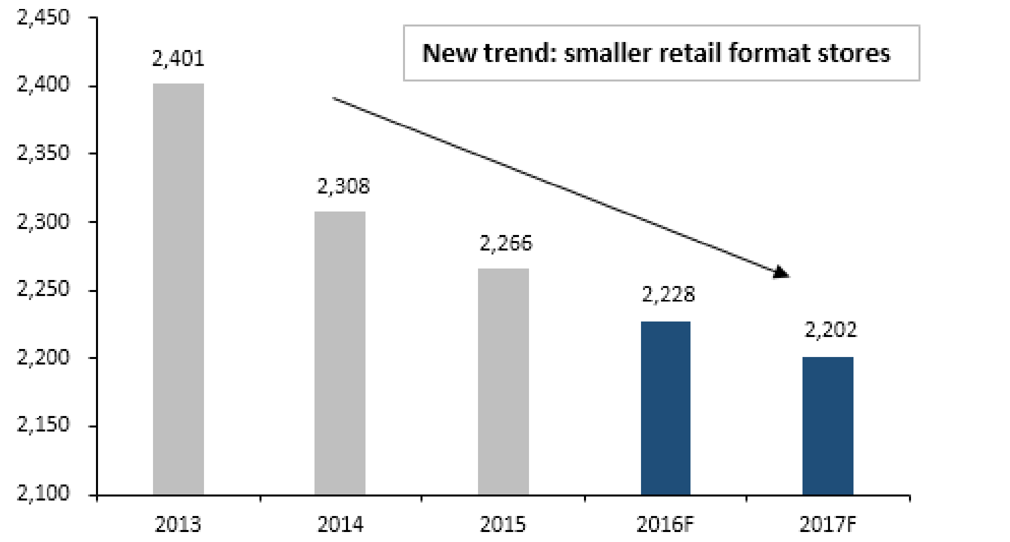
Although 11 new stores have been opened this year (2015: 8), exceeding our estimate and the management's guidance of 10 new stores, in terms of gross store space the number is actually slightly lower than expected. Hence, we trim our revenues estimate for this year by 1.1%. Based on our new assumptions (exhibit 5), we forecast the average total gross retail space to fall by 1.7% yoy this year. For 2017, we expect the trend of smaller format stores to continue with the average total gross retail space to drop 1.2% yoy, in our view.

Exhibit 5. Estimate for the number of stores, 2016-17F



Source: Company, Danareksa Sekuritas

Exhibit 6. Total average gross retail space, 2016-17F



Source: Company, Danareksa Sekuritas

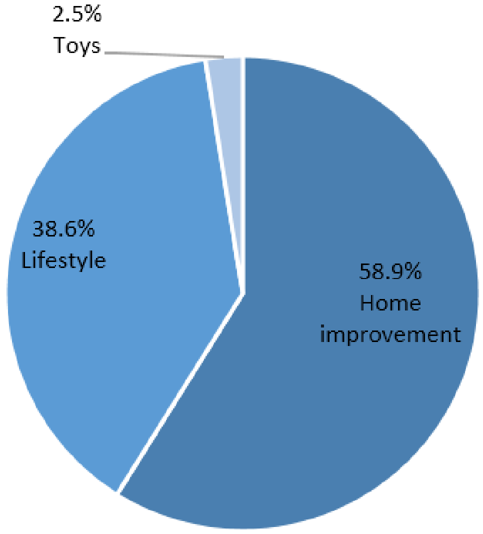
Exhibit 7. Forecast Changes

	Previous			Current			Changes		
	2016F	2017F	2018F	2016F	2017F	2018F	2016F	2017F	2018F
Revenue	4,940	5,109	5,333	4,885	5,109	5,333	-1.1%	0.0%	0.0%
Gross profit	2,350	2,428	2,535	2,322	2,428	2,535	-1.1%	0.0%	0.0%
Operating profit	677	666	668	670	666	668	-1.1%	0.0%	0.0%
Pretax profit	815	741	746	806	741	746	-1.1%	0.0%	0.0%
Net profit	656	597	601	648	597	601	-1.1%	0.0%	0.0%
Gross margin	47.6%	47.5%	47.5%	47.5%	47.5%	47.5%			
Operating margin	13.7%	13.0%	12.5%	13.7%	13.0%	12.5%			
Pretax margin	16.5%	14.5%	14.0%	16.5%	14.5%	14.0%			
Net margin	13.3%	11.7%	11.3%	13.3%	11.7%	11.3%			

Source: Danareksa Sekuritas

What is the overall outlook? Aiming for 3.0% and 4.6% yoy top line growth in 2016-17F
The slow recovery in the property sector remains the main challenge facing ACES in 2016-17F since the company's major revenues contributors are the home improvements segment (58.9%) and the lifestyle segment (38.6%). Sales in both these segments are affected by the pace of expansion in the commercial and housing property sectors.

Exhibit 8. Business segmentation, 9M16

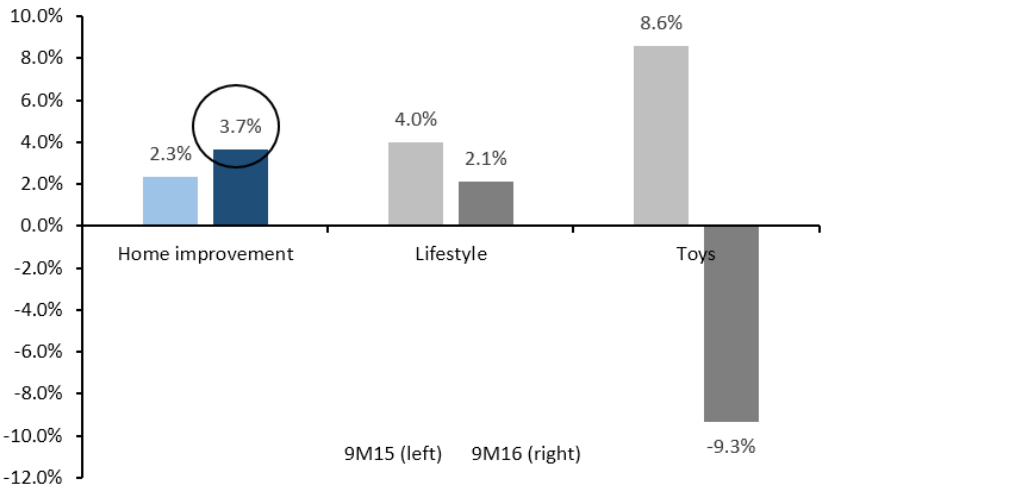


Source: Company, Danareksa Sekuritas

Business segmentation growth

Based on our current forecast, we estimate that revenues in the home improvements segment will grow by 3.5%-4.5% yoy in 2016-17F, an improvement over 9M16's performance. In the lifestyle segment, revenues are expected to grow by around 2.5-3.5% yoy in 2016-17F.

Exhibit 9. Business segmentation growth yoy, 9M15-9M16

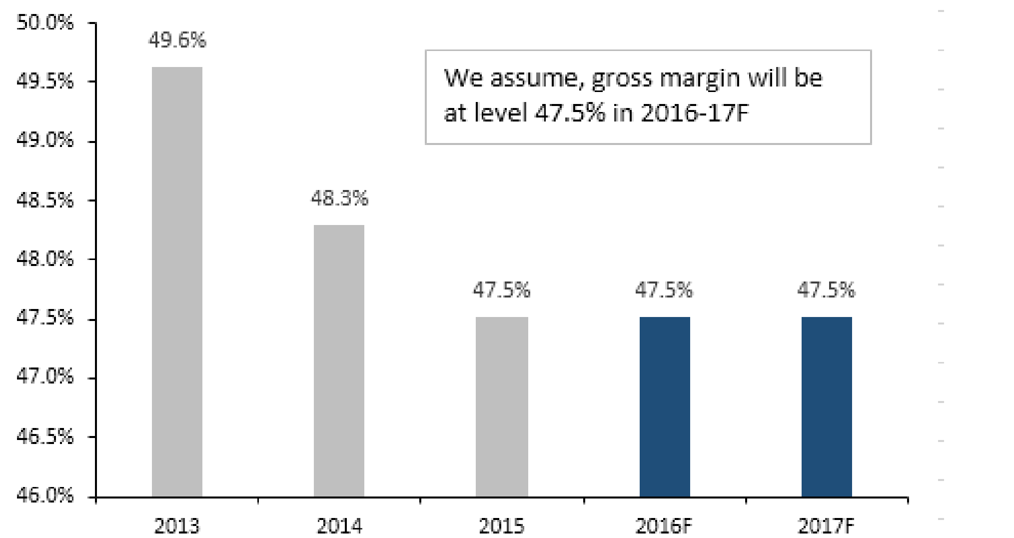


Source: Company, Danareksa Sekuritas

What is the outlook for gross margins?

We assume gross margins will remain steady at around 47.5% in 2016-17F (9M16: 47.5%) as per the management's target.

Exhibit 10. Gross margins assumption, 2016-17F

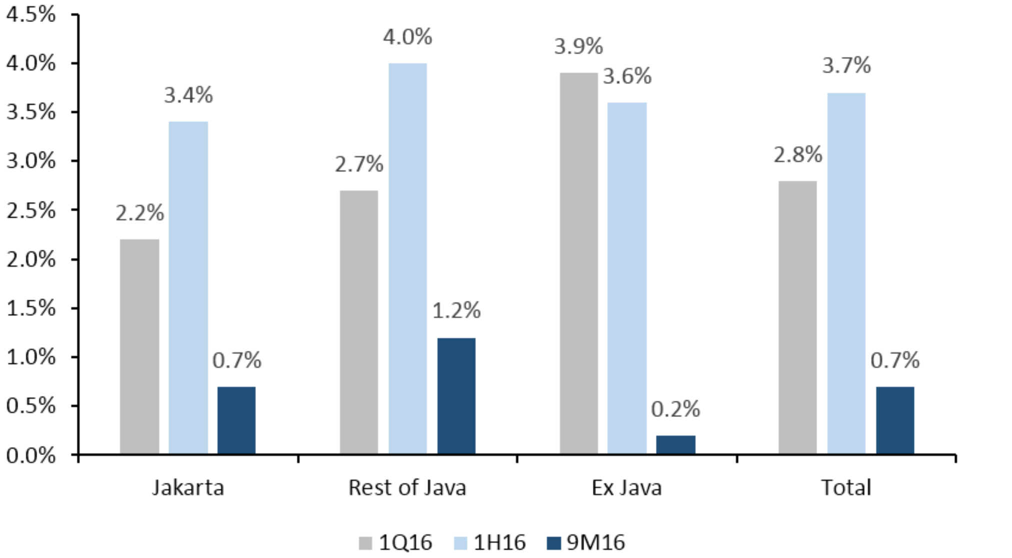


Source: Company, Danareksa Sekuritas

What is the outlook for SSSG?

In terms of SSSG, we estimate SSSG of around 1% at the end of 2016.

Exhibit 11. SSSG, 1Q16-9M16

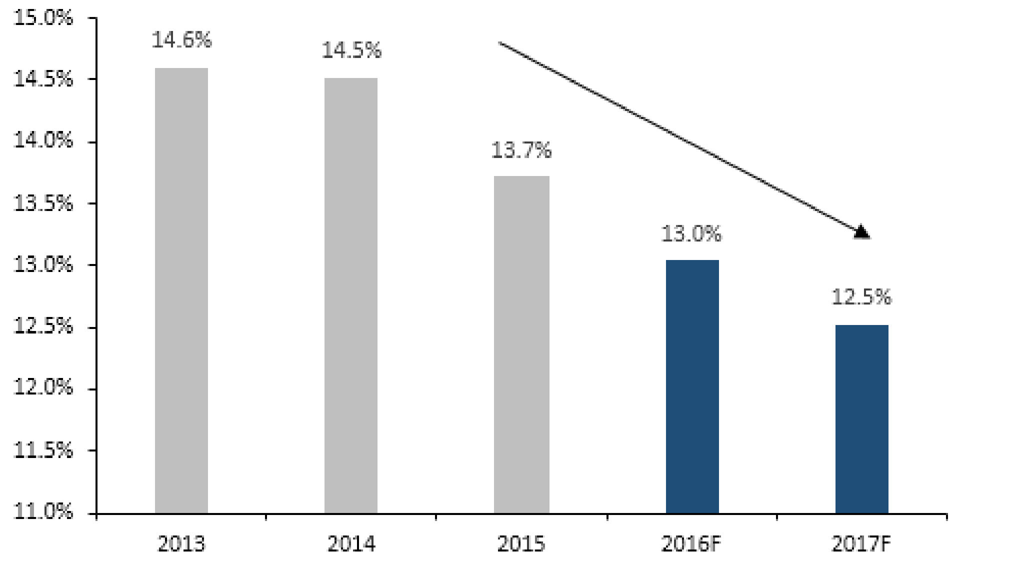


Source: Company, Danareksa Sekuritas

What is the outlook for operating margins?

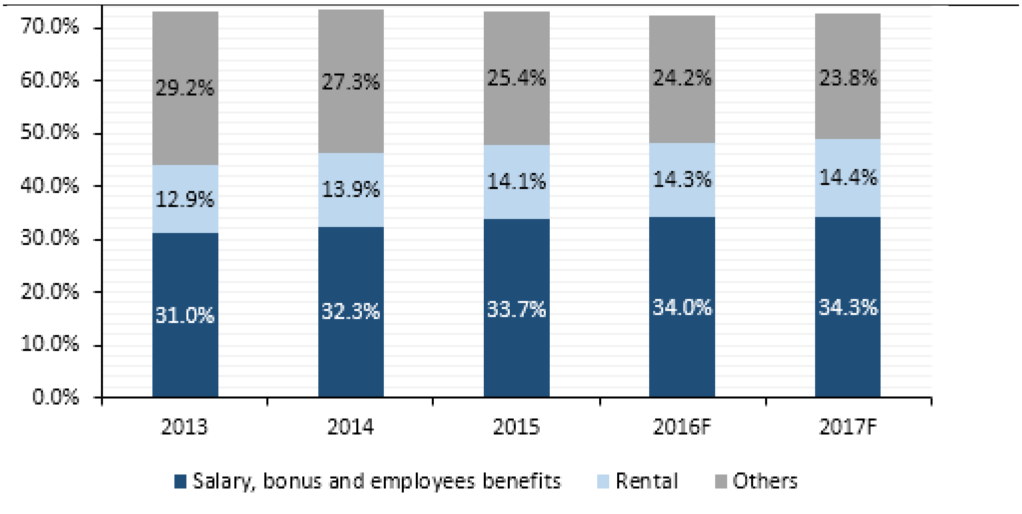
We expect operating margins compression in 2016-17F from 13.7% to 13.0%-12.5%.

Exhibit 12. Operating margins assumptions, 2016-17F



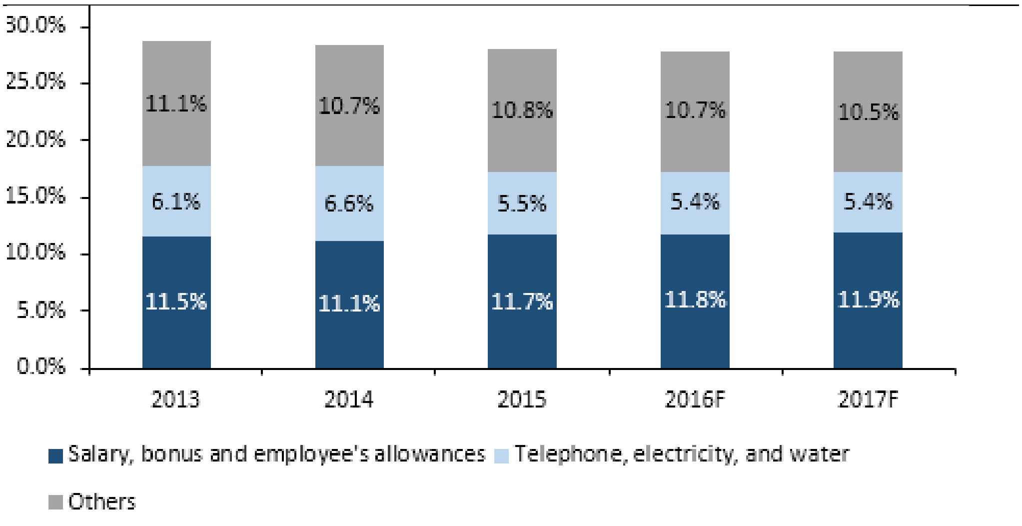
Source: Company, Danareksa Sekuritas

Exhibit 13. Breakdown of selling expenses, 2016-17F



Source: Company, Danareksa Sekuritas

Exhibit 14. Breakdown of SG&A, 2016-17F



Source: Company, Danareksa Sekuritas

Exhibit 15. Profit and Loss, Rp bn

	2014	2015	2016F	2017F	2018F
Revenue	4,541	4,743	4,885	5,109	5,333
COGS	(2,348)	(2,489)	(2,564)	(2,681)	(2,799)
Gross profit	2,194	2,254	2,322	2,428	2,535
Operating expenses	(1,531)	(1,565)	(1,652)	(1,762)	(1,867)
Operating profit	663	688	670	666	668
Other income / expenses	66	82	153	92	97
Net interest	(36)	(32)	(17)	(18)	(19)
Pre-tax profit	693	738	806	741	746
Taxes	(136)	(152)	(166)	(152)	(153)
Minority Interest	5	2	8	8	8
Net profit	562	588	648	597	601

Source: Company, Danareksa sekuritas

Exhibit 16. Balance Sheet, Rp bn

	2014	2015	2016F	2017F	2018F
Cash	391	622	888	766	1,028
Receivables	20	16	21	18	23
Inventories	1,296	1,522	1,408	1,674	1,543
Others	464	307	307	307	307
Total current assets	2,171	2,467	2,624	2,765	2,901
Property & plant - net	463	457	627	796	964
Other assets	324	343	343	344	344
Total non current assets	787	800	970	1,139	1,307
Total assets	2,958	3,268	3,594	3,904	4,207
Account payable	107	127	129	139	141
Short term debt	19	22	23	24	25
Others	300	262	262	262	262
Total current liabilities	427	412	415	426	428
Long term debt	7	1	1	1	1
Other long term	195	226	226	226	226
Total non current liabilities	202	226	226	226	226
Total liabilities	629	639	641	652	655
Total equity	2,329	2,629	2,953	3,252	3,552

Source: Company, Danareksa sekuritas

Exhibit 17. Cash Flow, Rp bn

	2014	2015	2016F	2017F	2018F
Net profit	562	588	656	598	618
Depreciation	79	82	85	89	92
Changes in working capital	(457)	(350)	83	(208)	82
Others	61	126	(0)	(0)	(0)
Cash flow from operating	245	446	824	479	792
Fixed assets	95	71	166	(3)	(3)
Investment other assets	(38)	(19)	(0)	(0)	(0)
Cash flow from investing	57	51	166	(4)	(4)
Additional (reduction) in loan	76	21	1	1	1
New shares issuance	(7)	(23)	(0)	(0)	(0)
Dividend payment	(142)	(266)	(328)	(299)	(309)
Others	-	-	-	-	-
Cash flow from financing	(73)	(267)	(327)	(298)	(308)
Changes in cash	230	230	663	177	480
Beginning in cash	162	391	622	1,285	1,462
Ending in cash	391	622	1,285	1,462	1,943

Source: Company, Danareksa sekuritas

Exhibit 18. Key Ratios

	2014	2015	2016F	2017F	2018F
Growth (% YoY)					
Revenue	16.6	4.4	3.0	4.6	4.4
Gross profit	13.4	2.7	3.0	4.6	4.4
Operating profit	17.4	3.8	-2.7	-0.5	0.2
Net profit	10.5	4.6	10.2	-7.9	0.7
Profitability (%)					
Gross margin	48.3	47.5	47.5	47.5	47.5
Operating margin	14.6	14.5	13.7	13.0	12.5
Net margin	12.4	12.4	13.3	11.7	11.3
ROAA	19.0	18.0	18.0	15.3	14.3
ROAE	24.1	22.4	22.0	18.4	16.9
Leverage					
Net gearing (%)	net cash	net cash	net cash	net cash	net cash

Source: Company, Danareksa sekuritas

Exhibit 19. Forward 3 historical average P/E

Source: Company, Danareksa sekuritas

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