

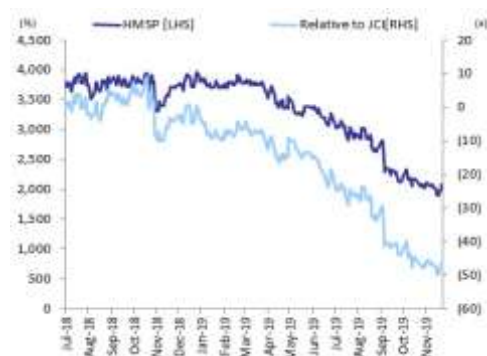
Friday, 13 December 2019

NEUTRAL
Upgrade

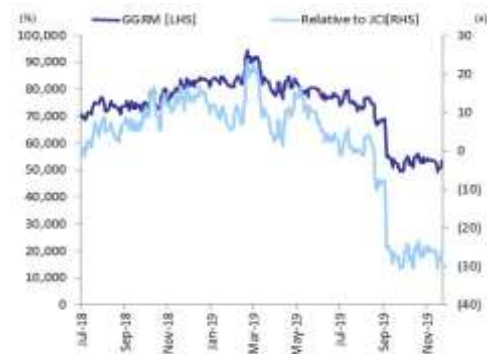
Cigarette

Navigating strong headwinds

HMSP relative to JCI Index



GGRM relative to JCI Index



Source : Bloomberg

Despite the headwinds facing the industry, we believe that the major cigarette producers can weather the storm supported by their strong brands and ample working capital. Sales volume will decline in 2020 but significant retail price (HJE) hikes should translate into decent earnings growth. Upgrade to Neutral.

2020's excise tax/stick is up by an average of 22.8%. Based on the new Ministry of Finance Regulation (PMK No. 152/PM 0.10/2019) on cigarette excise tax, the government raised tariffs in the tier 1 category by 25.4% yoy for SKM, 26.4% yoy for SPM and 16.4% yoy for SKT. The government also increased minimum retail selling prices (HJE) for SKM by 52% yoy, while for SPM and SKT, the HJE was increased by 58% and 16% yoy, respectively.

Aggressive price hikes will translate into solid FY19 earnings growth. By the end of March 2020, the retail selling prices of cigarettes must meet the 2020 minimum retail selling prices (HJE). As such, cigarette players are gradually increasing their retail selling prices to comply with the regulation. We note that the price increases for value-for-money products such as Marlboro Filter Black and GG Mild Shiver etc. have been more aggressive as these products currently trade at deeper discounts to the 2020 HJE vis-à-vis premium products. As such, margins should be positively impacted, especially in 4Q19 and 1Q20. Hence, we expect GGRM to continue reporting strong FY19F earnings growth of 29.5% yoy, while HMSP should book 5.7% yoy earnings growth on soft sales volume.

Overhangs remain. New government regulations gives rise to several questions: (1) is the 2019 excise tax increase of 23% yoy a one-off or will such a move be repeated in the future to curb cigarette consumption?, (2) what will be the impact of higher excise tax and steep rises in HJE on sales volume?, and (3) will PP 109/2012 be revised to further limit sales of cigarette products with stricter regulation on brand/packaging as well as advertising. In our view, the uncertainty regarding these issues will create headwinds for share prices going forward.

Strong brands and ample working capital to support the big players. In our view, high excise tax with steep increases in HJE will hurt the smaller cigarette players the most, while the big five players (HMSP, GGRM, Djarum, BAT and Nojorono) may benefit from slight price differences between cigarette products. Big cigarette players have strong brands and ample working capital to support their businesses. Hence, while we expect the industry's sales volume to decline by 12% yoy in 2020, we expect better performance from both HMSP and GGRM with sales volume declines of -10.3% and -9.3% yoy, respectively.

Upgrade to Neutral. Based on our assumptions, with the steep price increases in 2020, we estimate both HMSP and GGM to maintain margins despite expected sales volume declines. This should translate into decent FY20F earnings growth of 9.4% yoy for GGRM and 7.5% yoy for HMSP. The share prices of HMSP & GGRM have tanked 40% and 33% yoy. Despite the headwinds facing the industry, we upgrade our recommendation on GGRM to BUY and HMSP to HOLD.



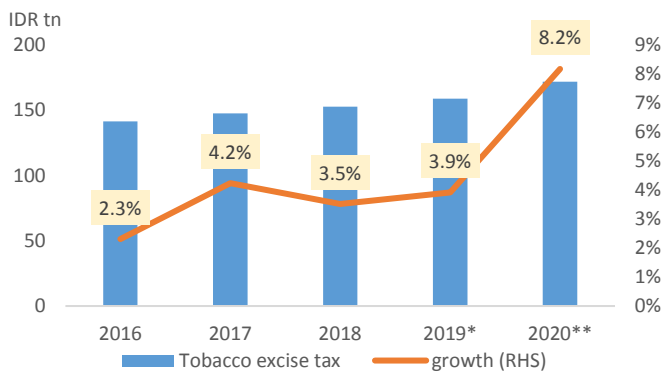
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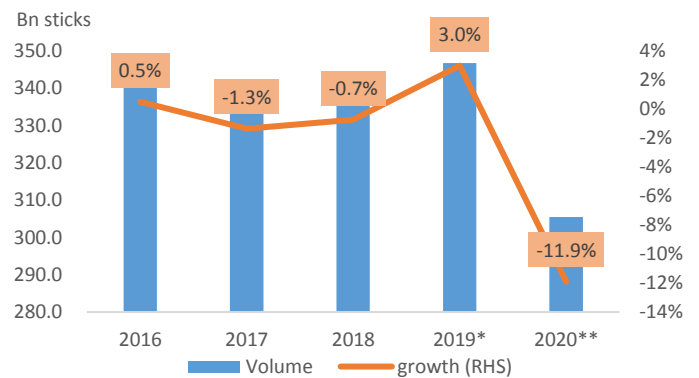
Company	Ticker	Rec	Target Price (Rp)	Market Cap. (RpBn)	P/E (x)		P/BV (x)		ROE (%) 2020F
					2019F	2020F	2019F	2020F	
HM Sampoerna	HMSP IJ	HOLD	2,100	238,452	16.8	15.6	6.6	6.4	41.9
Gudang Garam	GGRM IJ	BUY	60,850	99,764	10.1	9.2	2.0	1.9	21.0

Exhibit 1. Tobacco excise tax and growth



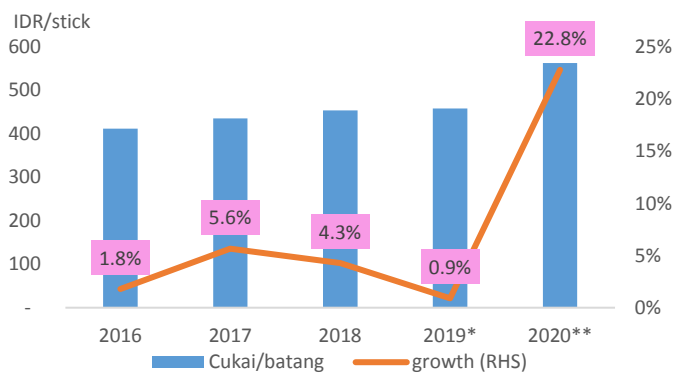
Source: Ministry of Finance * State Budget **2020 government budget

Exhibit 2. Industry volume and growth



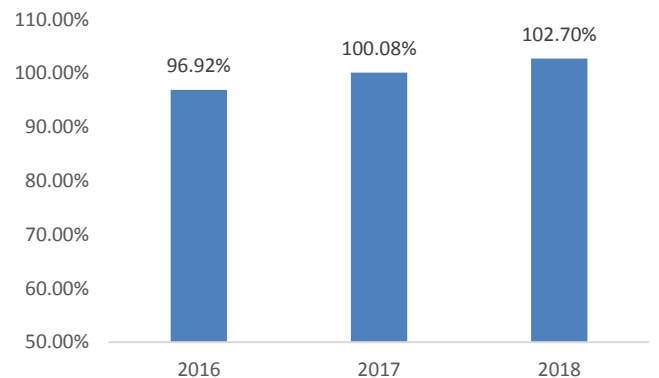
Source: Ministry of Finance * State Budget **2020 government budget

Exhibit 3. Excise tax/stick and growth



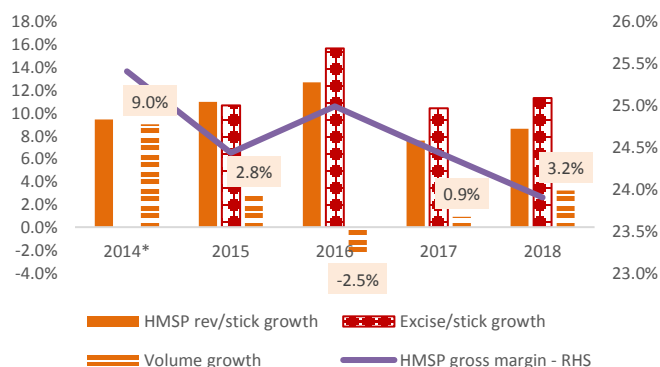
Source: Ministry of Finance
* State Budget **2020 government budget

Exhibit 4. Achievement of Excise tax revenues to the budget



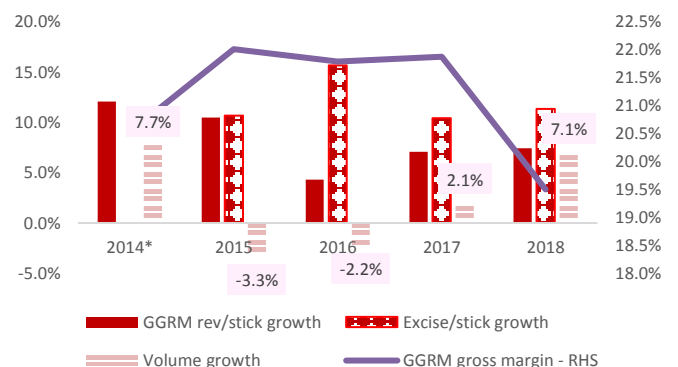
Source: Ministry of Finance

Exhibit 5. Impact of excise on HMSP's gross margin and volume



Source: Company

Exhibit 6. Impact of excise on GGRM's gross margin and volume



Source: Company

Cigarettes: Revision to PP 109/2012 would further limit sales of cigarettes

The government is in discussions on whether to revise government regulation (PP) 109/2012 regarding guidance which addresses addictive substances in tobacco products, as proposed by the Ministry of Health. It is reported that the proposed revisions are:

- Larger coverage of health warning images to 90% of total packaging (from 40% previously),
- Ban on the cigarette industry from undertaking promotional activities to push sales in various media
- Ban on per stick cigarette sales

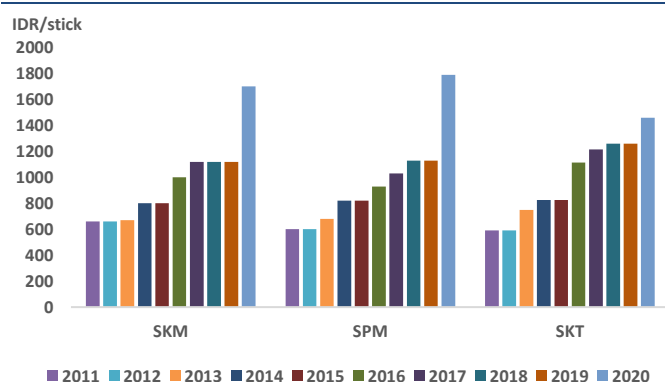
The government claims that the implementation of existing PP 109/2012 in the past few years reduced smoker prevalence for children above 10 years old. However, for young people less than 18 years old, smoker prevalence increased to 9.1% in 2018 from 7.2% in 2013. Several industry players stated their objections to the proposed revisions to the current regulation.

Exhibit 7. Excise tax and Minimum retail prices for 2020

Type	Criteria	Minimum retail price (Rp)	Excise (Rp)	Excise - yoy growth	Production limit
		(per stick)	(per stick)		
SKM	I	Minimum Rp1,700	740	25.4%	Above 3bn sticks Maximum 3bn sticks
	II	Above Rp1,275 From Rp1,020 to Rp1,275	470 455		
SPM	I	Minimum Rp1,790	790	26.4%	Above 3bn sticks Maximum 3bn sticks
	II	Above Rp1,485 From Rp1,015 to Rp1,485	485 470		
SKT or SPT	I	Above Rp1,460 From Rp1,015 to Rp1,460	425 330	16.4%	Above 2bn sticks Above 500mn to max 2bn sticks Max 500mn sticks
	II	Minimum Rp535	200		
	III	Minimum Rp450	110		
SKTF or SPTF		Minimum Rp1,700	740	25.4%	No production limit

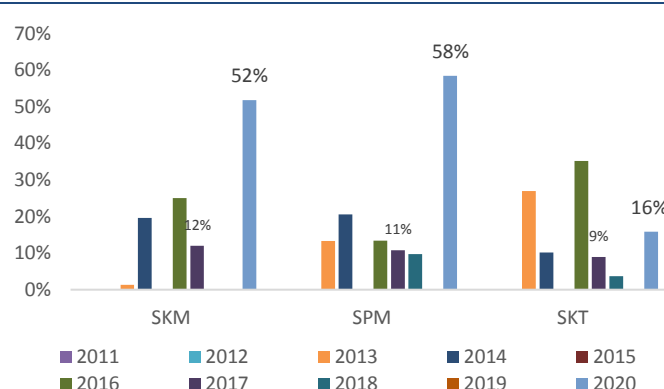
Source: Ministry of Finance

Exhibit 8. HJE from 2011-2020



Source: Company

Exhibit 9. The growth of HJE, 2012-2020



Source: Company

Friday, 13 December 2019

HOLD

Upgrade

Last price (IDR)	2,100
Target Price (IDR)	2,100
Upside/Downside	0.0%
Previous Target Price (IDR)	2,100

Stock Statistics

Sector	CIGARETTE
Bloomberg Ticker	HMSP IJ
No of Shrs (mn)	116,318
Mkt. Cap (IDRbn/USDmn)	244,268/17,435
Avg. daily T/O (IDRbn/USDmn)	119.3/8.5

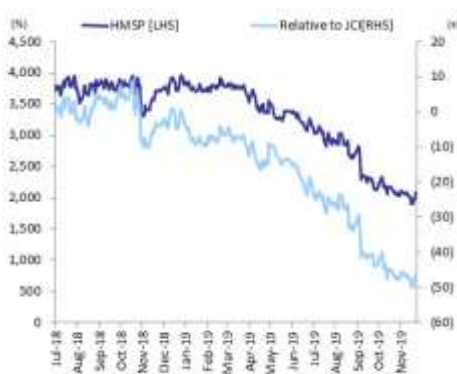
Major shareholders (%)

PHILIP MORRIS INDONESIA	92.5
VONTOBEL HOLDING AG	0.4
Estimated free float	7.5

EPS Consensus (IDR)

	2019F	2020F	2021F
Danareksa	123.0	132.2	136.3
Consensus	124.8	117.0	127.7
Danareksa/Cons	(1.4)	13.0	6.8

HMSP relative to JCI Index



Source : Bloomberg



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HM Sampoerna (HMSP IJ)

Higher retail prices to support earnings

We estimate that HMSP will book decent earnings growth in 2020, supported by steep adjustments in retail prices (HJE) despite high excise tax growth. However, as purchasing power is expected to remain soft, we expect consumer preferences for high-tar products to continue. The share price has tanked 40% yoy. Upgrade to HOLD.

Aggressive pricing translates into FY19F earnings growth of 5.7% yoy. Given 23% average excise tax increases in 2020, higher volume is expected in 4Q19 due to the impact of forestalling. For FY19, we assume volume growth of -2.4% yoy (9M19: -3.2% yoy). It is worth noting that cigarette players are required to comply with the government's 2020 minimum retail selling prices (HJE) regulation by the end of March 2020 at the latest. Based on our survey conducted on 20 Nov 2019, HMSP's products currently trade at 11– 67% discounts to the 2020 HJE. As such, aggressive price adjustments are expected in the subsequent months. The improved 4Q19 volume & aggressive pricing should help HMSP to book a FY19 top line of IDR110.5tn (+3.5% yoy) with higher margins across the board, resulting in solid FY19F earnings of IDR14.3tn (+5.7% yoy) with 13% net margin.

Higher HJE to support the 2020 earnings. Going into 2020, the combination of higher excise tax and steep HJE adjustments will undoubtedly hit sales volume. We estimate 10.3% yoy lower volume for FY20F – yet better than the expected performance for the industry (-12% yoy), as the company has strong brands. For 2020, we estimate blended revenues/stick growth of 18.9% yoy, given that price adjustments were partially done in 2019. Higher revenues/stick growth will offset the impact of lower volumes and sustain the FY20F top line growth of 6.7% yoy. With the expectation of maintained margins, we estimate FY20F earnings growth of 7.5% yoy.

Upgrade to HOLD. Based on our sensitivity analysis, if the FY20F volume declines by 15% yoy, HMSP will still manage to book flattish earnings growth – ceteris paribus. HMSP would book negative FY20F earnings growth if its FY20 volume growth declines 20% yoy. However, we estimate decent earnings growth for HMSP in 2020 although the persisting headwinds in the industry may weigh on the share price. With purchasing power expected to remain soft, consumers are likely to prefer high-tar products. Upgrade to HOLD with an unchanged TP of IDR2,100 – based on -2SD average PE of 15.8x.

Key Financials

Year to 31 Dec	2017A	2018A	2019F	2020F	2021F
Revenue (IDRbn)	99,091	106,742	110,522	117,907	120,516
EBITDA (IDRbn)	16,976	17,835	19,095	20,608	21,435
EBITDA Growth (%)	1.4	5.1	7.1	7.9	4.0
Net profit (IDRbn)	12,671	13,538	14,304	15,379	15,858
EPS (IDR)	108.9	116.4	123.0	132.2	136.3
EPS growth (%)	(0.7)	6.8	5.7	7.5	3.1
BVPS (IDR)	293.3	304.0	309.8	320.9	327.0
DPS (IDR)	107.7	107.3	117.2	121.1	130.2
PER (x)	18.9	17.7	16.8	15.6	15.1
PBV (x)	7.0	6.8	6.6	6.4	6.3
Dividend yield (%)	5.2	5.2	5.7	5.9	6.3
EV/EBITDA (x)	13.7	12.6	11.7	10.8	10.4

Source : HMSP, Danareksa Estimates

Exhibit 1. Revenues and Growth



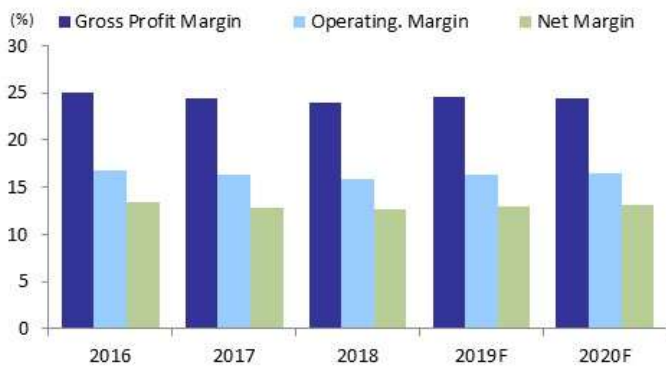
Source: Company, Danareksa Sekuritas estimates

Exhibit 2. Net Profits and Growth



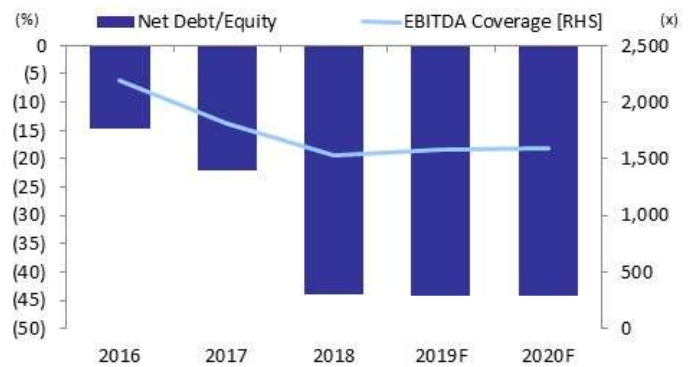
Source: Company, Danareksa Sekuritas estimates

Exhibit 3. Margins



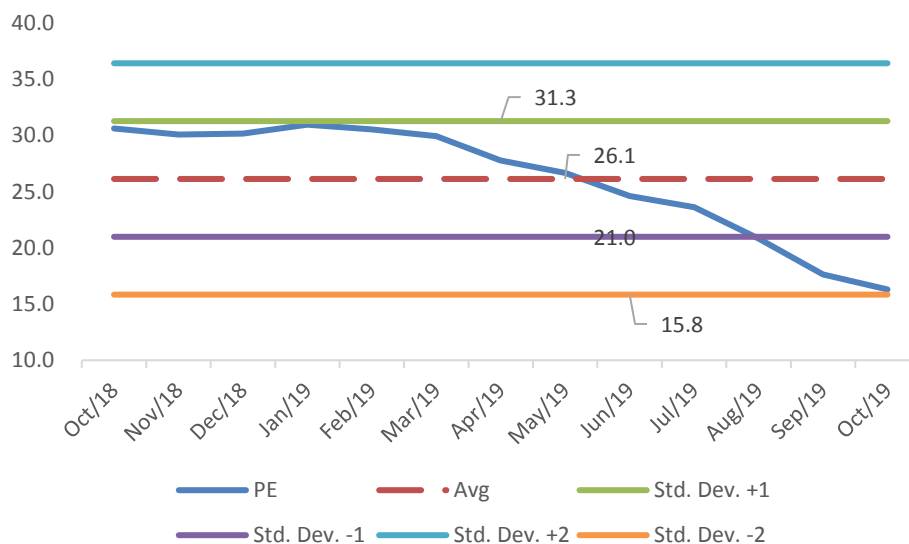
Source: Company, Danareksa Sekuritas estimates

Exhibit 4. Gearing Level



Source: Company, Danareksa Sekuritas estimates

Exhibit 5. PE Band

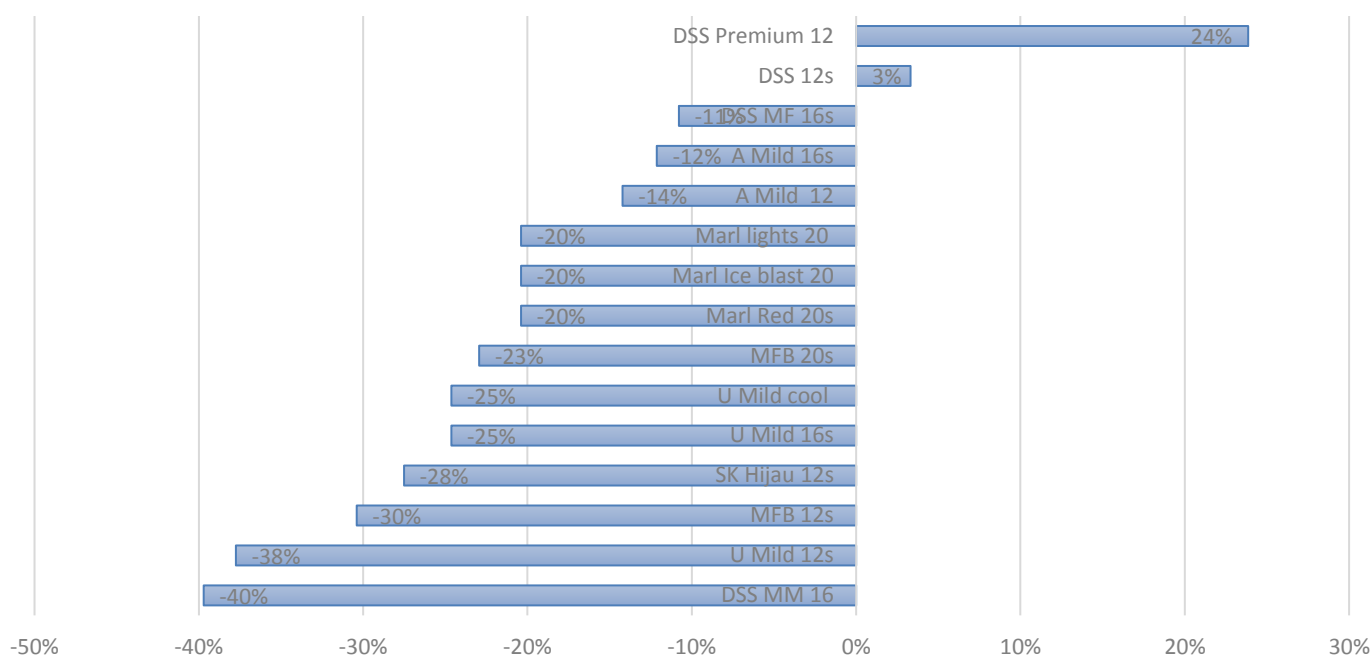


Source: Company, Danareksa Sekuritas estimates

Pricing adjustments began in November 2019

In November 2019, the retail selling prices of HMSP's products were increased by around 4-6% mom as the company seeks to meet the 2020 HJE by the end of March 2020. The selling prices of 4 of 5 products under the Marlboro brand (based on our survey) were significantly hiked by 4-5% mom given the steep hike in HJE for SPM (58% vs 52% for SKM - compared to the last HJE adjustment in 2018). It is also worth noting that Marlboro Filter Black 12s - the product that drives growth for Marlboro - is trading at a 25% discount to its competitor Surya International 12s. In addition, we also note that the retail selling prices for SKT products (Sampoerna Kretek Hijau 12s and DSS premium 12s) rose sharply by 5-6% mom. The retail selling prices of another low-priced product in the LTLN category, U Mild, were raised by around 4%.

Exhibit 6. Discount to the 2020 HJE – based on the November retail selling prices



Source: Danareksa survey

Earnings revision

We estimate that HMSP will book 10.3% yoy lower volume in 2020, yet better than the expected performance for the industry (-12% yoy), supported by the wide variety of products in its portfolio. Given the aggressive price hikes since November 2019, we estimate 18.9% blended ASP adjustments in 2020. This will support FY20F top line growth of 6.7% yoy. We view that the steep price hikes will offset the high excise tax increases in 2020, allowing HMSP to maintain its gross margin at 24.4%. In turn, this will filter through to the bottom line of IDR15.4tn, +7.5% yoy.

Exhibit 7. Earnings revision for HMSP

	Old		New		Changes	
	2019	2020	2019	2020	2019	2020
Revenue	111,898	118,504	110,522	117,907	-1.2%	-0.5%
Gross profit	27,380	25,210	27,120	28,790	-0.9%	14.2%
Operating profit	18,359	15,489	17,995	19,387	-2.0%	25.2%
Net profit	14,601	12,304	14,304	15,379	-2.0%	25.0%
Gross margin	24.5%	21.3%	24.5%	24.4%		
Operating margin	16.4%	13.1%	16.3%	16.4%		
Net margin	13.0%	10.4%	12.9%	13.0%		
Assumption						
Volume	-0.2%	-5.0%	-2.4%	-10.3%		
ASP Blended	5.0%	11.5%	6.1%	18.9%		
Excise/stick growth						
SKM	0.0%	23.0%	0.0%	25.4%		
SKT	0.0%	23.0%	0.0%	16.4%		
SPM	0.0%	23.0%	0.0%	26.4%		

Source: HMSP, Danareksa' estimates

Exhibit 8. Sensitivity analysis to the volume changes

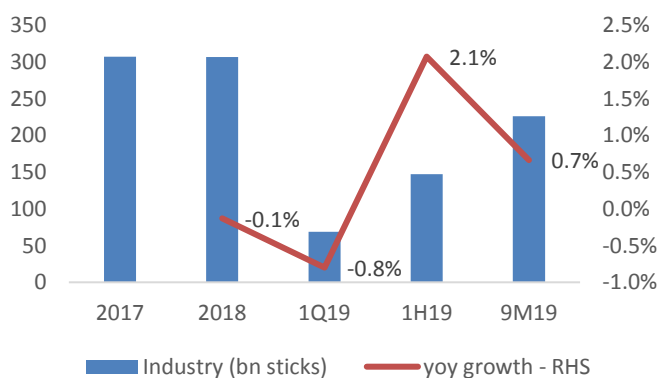
Sensitivity to	Base		New		% changes in		Base	New
	Revenue	Net profit	Revenue	Net profit	Revenue	Net profit	FY20F Earnings growth	
-15% lower volume	117,907	15,379	111,229	14,553	-5.7%	-5.4%	7.5%	1.7%
-20% lower volume	117,907	15,379	104,550	13,727	-11.3%	-10.7%	7.5%	-4.0%
-25% lower volume	117,907	15,379	97,872	12,901	-17.0%	-16.1%	7.5%	-9.8%

Source: Danareksa

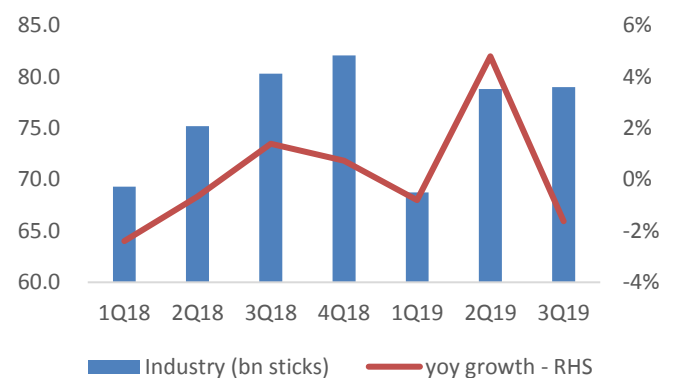
Exhibit 9. 3Q19 volume

	9M18	9M19	yoy	3Q18	2Q19	3Q19	yoy	qoq
HMSP (mn sticks)	74,500	72,100	-3.2%	26,500	24,975	25,000	-5.7%	0.1%
Volume by brands								
Sampoerna A (mn sticks)	29,131	26,012	-10.7%	10,333	9,355	8,756	-15.3%	-6.4%
Dji Sam Soe (mn sticks)	21,151	23,089	9.2%	7,578	7,839	8,599	13.5%	9.7%
Others (mn sticks)	24,218	22,999	-5.0%	8,589	7,781	7,645	-11.0%	-1.7%
Market share								
	33.1%	31.9%		33.0%	31.7%	31.7%		
Industry volume (mn sticks)	224,800	226,300	0.7%	80,300	78,810	79,000	-1.6%	0.2%

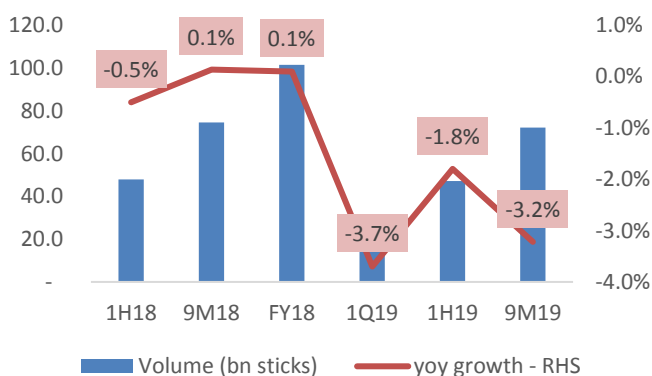
Source: Company

Exhibit 10. Industry volume and growth


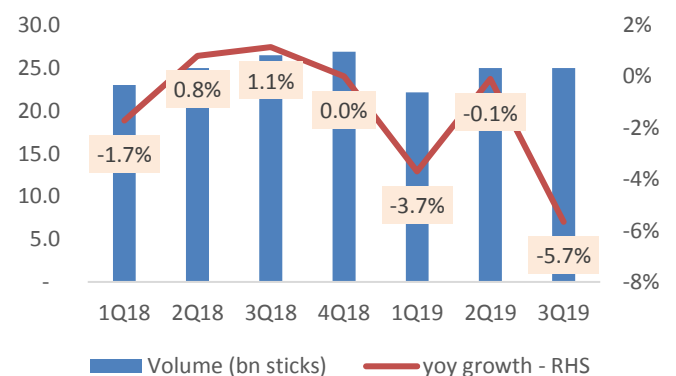
Source: PMI

Exhibit 11. Industry quarterly volume and growth


Source: PMI

Exhibit 12. HMSP volume and growth


Source: PMI

Exhibit 13. HMSP quarterly volume and growth


Source: PMI

Exhibit 14. Income Statement

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Revenue	99,091	106,742	110,522	117,907	120,516
COGS	(74,876)	(81,251)	(83,402)	(89,118)	(90,941)
Gross profit	24,216	25,491	27,120	28,790	29,576
EBITDA	16,976	17,835	19,095	20,608	21,435
Oper. profit	16,111	16,882	17,995	19,387	19,969
Interest income	817	1,004	1,031	1,070	1,126
Interest expense	(9)	(12)	(12)	(13)	(13)
Forex Gain/(Loss)	(16)	(19)	0	0	0
Income From Assoc. Co's	6	7	7	7	7
Other Income (Expenses)	(14)	99	102	109	112
Pre-tax profit	16,895	17,961	19,123	20,560	21,201
Income tax	(4,224)	(4,423)	(4,819)	(5,181)	(5,343)
Minority interest	0	0	0	0	0
Net profit	12,671	13,538	14,304	15,379	15,858
Core Net Profit	12,687	13,557	14,304	15,379	15,858

Exhibit 15. Balance Sheet

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Cash & cash equivalent	7,502	15,516	15,932	16,535	17,408
Receivables	3,781	3,815	3,950	4,214	4,308
Inventory	18,023	15,183	15,585	16,653	16,994
Other Curr. Asset	2,500	2,043	2,115	2,256	2,306
Fixed assets - Net	6,891	7,288	7,294	7,252	6,871
Other non-curr.asset	2,070	1,483	1,494	1,531	1,534
Total asset	43,141	46,602	47,644	49,716	50,694
ST Debt	0	0	0	0	0
Payables	3,666	3,450	3,541	3,784	3,862
Other Curr. Liabilities	2,376	4,825	4,996	5,330	5,448
Long Term Debt	0	0	0	0	0
Other LT. Liabilities	2,985	2,969	3,074	3,279	3,352
Total Liabilities	9,028	11,244	11,612	12,393	12,661
Shareholder's Funds	34,113	35,358	36,033	37,322	38,033
Minority interests	0	0	0	0	0
Total Equity & Liabilities	43,141	46,602	47,644	49,716	50,694

Exhibit 16. Cash Flow

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Net income	12,671	13,538	14,304	15,379	15,858
Depreciation and Amort.	(2,430)	(2,589)	446	1,089	356
Change in Working Capital	2,430	2,589	(446)	(1,089)	(356)
Other Oper. Cash Flow	(530)	1,993	(902)	(829)	(1,032)
Operating Cash Flow	12,141	15,531	13,402	14,550	14,826
Capex	(511)	(968)	(1,110)	(1,184)	(1,090)
Others Inv. Cash Flow	(132)	2,675	1,003	1,016	1,107
Investing Cash Flow	(642)	1,707	(107)	(168)	17
Net change in debt	0	0	0	0	0
New Capital	(18)	97	0	0	0
Dividend payment	(12,527)	(12,480)	(13,630)	(14,089)	(15,148)
Other Fin. Cash Flow	443	(16)	75	157	47
Financing Cash Flow	(12,103)	(12,400)	(13,555)	(13,933)	(15,101)
Net Change in Cash	(604)	4,839	(260)	450	(258)
Cash - begin of the year	5,056	7,502	15,516	15,932	16,535
Cash - end of the year	7,502	15,516	15,932	16,535	17,408

Exhibit 17. Key Ratios

Year to 31 Dec	2017A	2018A	2019F	2020F	2021F
Growth (%)					
Sales	3.8	7.7	3.5	6.7	2.2
EBITDA	1.4	5.1	7.1	7.9	4.0
Operating profit	0.6	4.8	6.6	7.7	3.0
Net profit	(0.7)	6.8	5.7	7.5	3.1
Profitability (%)					
Gross margin	24.4	23.9	24.5	24.4	24.5
EBITDA margin	17.1	16.7	17.3	17.5	17.8
Operating margin	16.3	15.8	16.3	16.4	16.6
Net margin	12.8	12.7	12.9	13.0	13.2
ROAA	29.6	30.2	30.4	31.6	31.6
ROAE	37.1	39.0	40.1	41.9	42.1
Leverage					
Net Gearing (x)	(0.2)	(0.4)	(0.4)	(0.4)	(0.5)
Interest Coverage (x)	1,715.3	1,447.8	1,490.5	1,505.2	1,516.9

Source : HMSP, Danareksa Estimates

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Friday, 13 December 2019

BUY Upgrade

Last price (IDR)	51,850
Target Price (IDR)	60,850
Upside/Downside	+17.4%
Previous Target Price (IDR)	63,900

Stock Statistics

Sector	CIGARETTE
Bloomberg Ticker	GGRM IJ
No of Shrs (mn)	1,924
Mkt. Cap (IDRbn/USDmn)	99,764/7,109
Avg. daily T/O (IDRbn/USDmn)	113.7/8.1

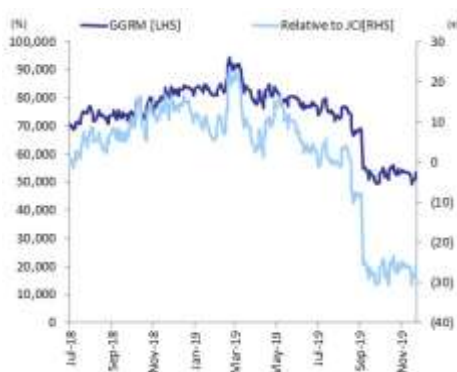
Major shareholders (%)

SURYADUTA INVESTAMA	69.3
SURYAMITRA KUSUMA	6.3
Estimated free float	23.8

EPS Consensus (IDR)

	2019F	2020F	2021F
Danareksa	5,246.1	5,738.7	6,764.5
Consensus	5,009.9	4,638.0	5,139.9
Danareksa/Cons	4.7	23.7	31.6

GGRM relative to JCI Index



Source : Bloomberg



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Gudang Garam (GGRM IJ)

Rising to the challenge

As the company has a strong portfolio of high-tar products, steep retail price (HJE) adjustments will pave the way for positive earnings growth in 2020, we believe. We see upside for the share price given the expectation of solid quarterly results despite continued headwinds in the sector. Upgrade to BUY.

Volume driven by value-for-money products. We learnt that GGRM has recorded positive volume growth Ytd, driven by lower priced products (i.e. Surya Pro) on continued soft purchasing power among the nation's grassroots. In August 2019, GGRM launched a new SKT product named Gudang Garam Patra (approximately IDR11,000/pack for 12s) in several cities in West Java. This product is more affordable than its major SKT product GG Merah (IDR 13,700/pack for 12 sticks). The launch of the lower priced product suggests the company is trying to take advantage of the lower 2020 excise tax and lower HJE increases for SKT.

Strong forecast FY19F earnings. To comply with the government regulation for 2020 retail prices (HJE), Gudang Garam is raising its retail selling prices. Prices will continue to be raised until the end of March 2020. In our survey on 20 November 2019, from a total of 9 GGRM products, retail selling prices increased from between 2% to 7% mom for 6 of them. Based on our survey, GGRM's products are currently trading at a 7% to 36% discount to the 2020 HJE. The higher selling prices in 4Q19 should support 17.5% yoy FY19 revenues growth (FY18: 14.9% yoy). The higher selling prices will also help lift the gross margin to 19.8% in FY19 (FY18: 19.5%). In turn, this will filter through to strong FY19 earnings of IDR10tn (+29.5% yoy).

Beneficiary of high-tar consumer preferences. Consumer preferences for high-tar products will benefit GGRM, in our view. As such, we estimate that the FY20 volume will decline by 9.3% yoy, yet better than the expected performance for the industry (-12% yoy). However, with higher HJE in 2020, we use the assumption of +20% yoy revenues/stick. This will support 8.7% yoy top line growth in FY20. The steep HJE adjustments will offset higher excise tax, allowing GGRM to maintain its gross margin, we believe. We estimate solid FY20 earnings growth of 9.4% yoy to IDR11tn.

Upgrade to BUY. Based on our sensitivity analysis, if GGRM's FY20F volume declines 20% yoy, the company will still manage to book flattish earnings growth in 2020 – ceteris paribus. The share price has tanked 33% yoy due to the headwinds in the industry. Upgrade to BUY with a lower TP of IDR60,850 – based on -2SD average 2-y PE of 10.6x.

Key Financials

Year to 31 Dec	2017A	2018A	2019F	2020F	2021F
Revenue (IDRbn)	83,306	95,708	112,481	122,288	125,585
EBITDA (IDRbn)	13,363	13,358	16,823	18,443	21,189
EBITDA Growth (%)	10.8	0.0	25.9	9.6	14.9
Net profit (IDRbn)	7,754	7,792	10,094	11,042	13,016
EPS (IDR)	4,029.8	4,049.6	5,246.1	5,738.7	6,764.5
EPS growth (%)	16.1	0.5	29.5	9.4	17.9
BVPS (IDR)	21,917.4	23,456.9	26,103.0	28,473.6	32,368.7
DPS (IDR)	2,599.2	2,600.0	2,600.0	3,368.2	2,869.4
PER (x)	13.1	13.1	10.1	9.2	7.8
PBV (x)	2.4	2.3	2.0	1.9	1.6
Dividend yield (%)	4.9	4.9	4.9	6.4	5.4
EV/EBITDA (x)	9.0	8.8	7.0	6.3	5.2

Source : GGRM, Danareksa Estimates

Exhibit 1. Revenues and Growth

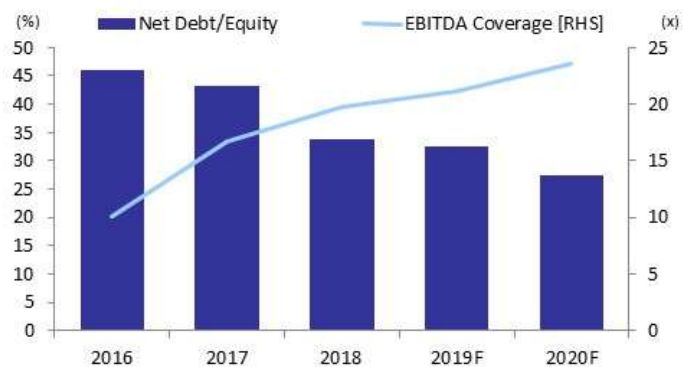

Source: Company, Danareksa Sekuritas estimates

Exhibit 2. Net Profits and Growth


Source: Company, Danareksa Sekuritas estimates

Exhibit 3. Margins


Source: Company, Danareksa Sekuritas estimates

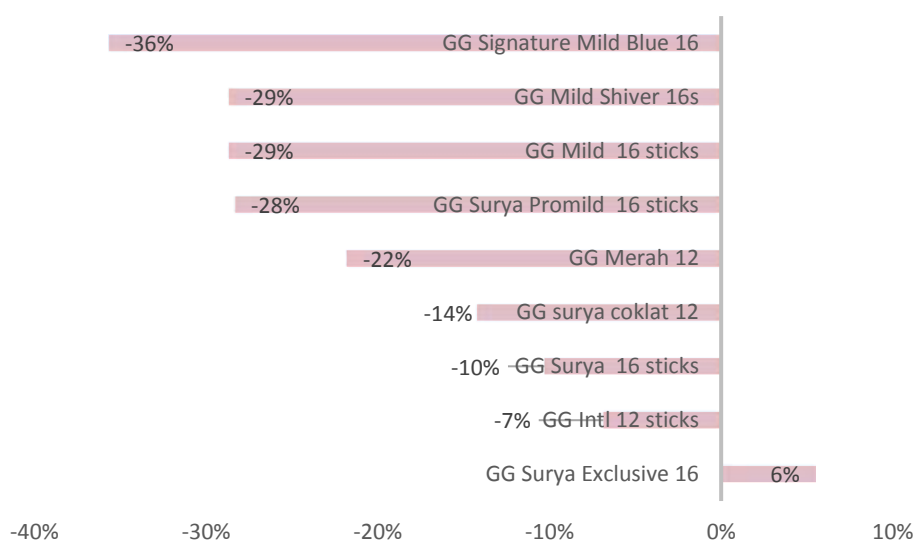
Exhibit 4. Gearing Level


Source: Company, Danareksa Sekuritas estimates

Pricing adjustments began in November 2019

In November 2019, the retail selling prices of GGRM's products were increased by around 2-7% mom as the company seeks to meet the 2020 HJE by the end of March 2020. The selling prices of 3 of 5 products in the SKM FF category were increased by between 2% to 3% mom. In the SKM LTLN category, in which GGRM's prices are lower than those of its main rival, prices were raised sharply by 4% mom (GG Signature Mild Blue 16s) and by 7% mom (GG Mild 16s). We believe the company will continue to raise its selling prices gradually as several products in the low-price category (i.e. Surya Pro) still trade at deep discounts to the 2020 HJE.

Exhibit 5. Discount to 2020 HJE – based on November's retail selling prices



Source: Danareksa survey

A new product in the SKT category: GG Patra

In August 2019, GGRM launched a new SKT product named Gudang Garam Patra (approximately IDR11,000/pack for 12s) in several cities in West Java. This product has a lower tar and nicotine content (29 mg and 2mg) compared to GG Merah (Tar 39 mg, Nicotine 2.5mg), and has a similar taste to GG Surya. This product is more affordable than its major SKT product GG Merah (IDR 13,700/pack for 12 sticks). The launch of the lower priced product suggests the company is trying to take advantage of the lower 2020 excise tax and lower HJE increases for SKT.

Earnings revision

We estimate that the FY20 volume will decline by 9.3% yoy, yet better than the expected performance for the industry (-12% yoy), supported by sales from its strong portfolio in the Full Flavor category. Following aggressive price hikes since November 2019, we estimate 20% blended ASP adjustments in 2020. This will support FY20F top line growth of 8.7% yoy. We view that the steep price adjustments will offset the high excise tax increases in 2020, allowing GGRM to maintain its gross margin at 19.9%. In turn, this will filter through to a bottom line of IDR11tn, +9.4% yoy.

Exhibit 6. Earnings revision for GGRM

	Old		New		Changes	
	2019	2020	2019	2020	2019	2020
Revenue	112,583	119,146	112,481	122,288	-0.1%	2.6%
Gross profit	21,901	20,490	22,255	24,295	1.6%	18.6%
Operating profit	13,115	11,346	14,223	15,460	8.4%	36.3%
Net profit	9,214	7,795	10,094	11,042	9.6%	41.6%
Gross margin	19.5%	17.2%	19.8%	19.9%		
Operating margin	11.6%	9.5%	12.6%	12.6%		
Net margin	8.2%	6.5%	9.0%	9.0%		
Assumption						
Volume	14.0%	-5.0%	13.1%	-9.3%		
ASP Blended						
SKM	3.2%	11.5%	4.0%	19.7%		
SKT	3.2%	11.5%	4.0%	26.6%		
Excise/stick growth						
SKM	0%	23%	0%	25%		
SKT	0%	23%	0%	16%		

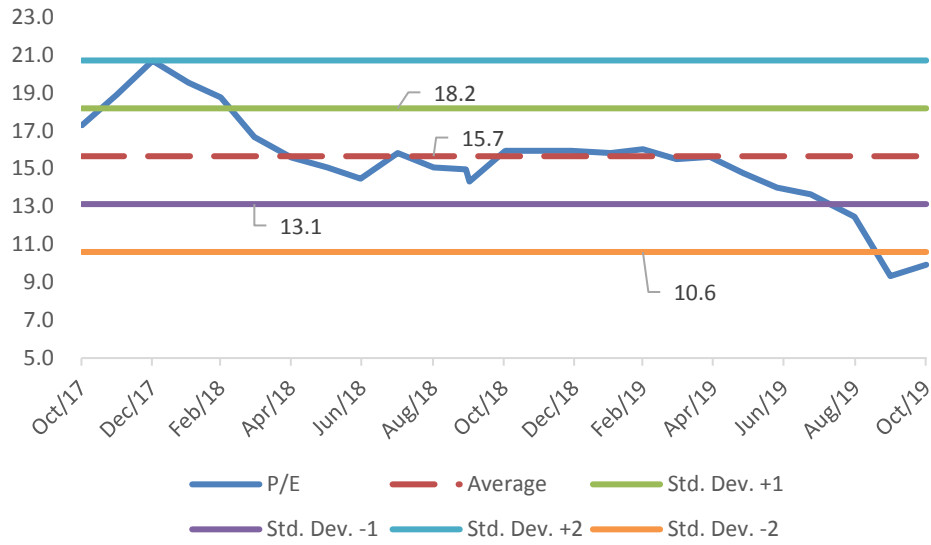
Source: GGRM, Danareksa' estimates

Exhibit 7. Sensitivity analysis to the volume changes

Sensitivity to	Base		New		% changes in		Base	New
	Revenue	Net profit	Revenue	Net profit	Revenue	Net profit	FY20F Earnings growth	
-15% volume growth	122,288	11,042	114,655	10,576	-6.2%	-4.2%	9.4%	4.8%
-20% volume growth	122,288	11,042	107,516	10,140	-12.1%	-8.2%	9.4%	0.5%
-25% volume growth	122,288	11,042	101,114	9,749	-17.3%	-11.7%	9.4%	-3.4%

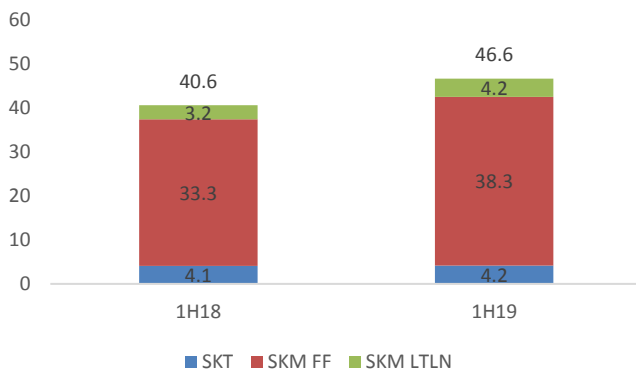
Source: Danareksa

Exhibit 8. PE Band



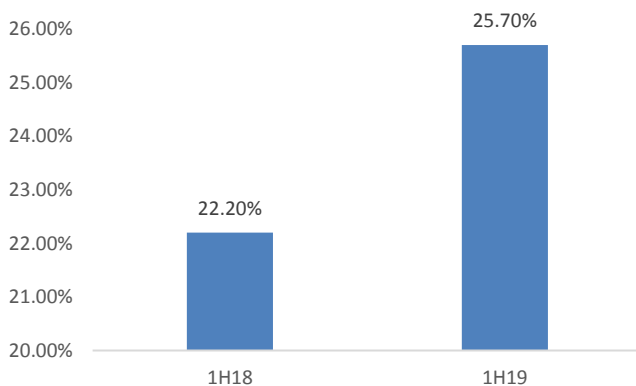
Source: Company, Danareksa Sekuritas estimates

Exhibit 9. 1H19 and 1H18 sales volume (bn sticks)



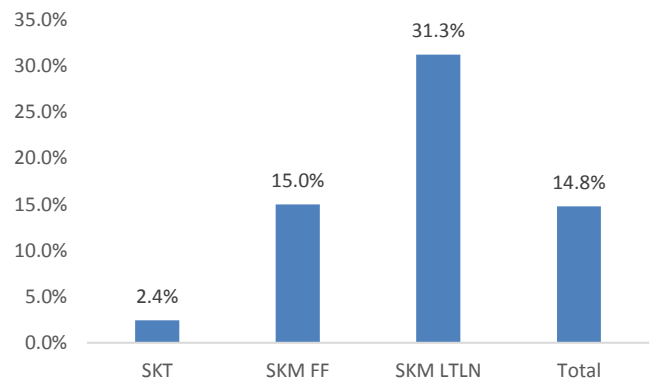
Source: Company

Exhibit 11. Market share 1H18 vs 1H19



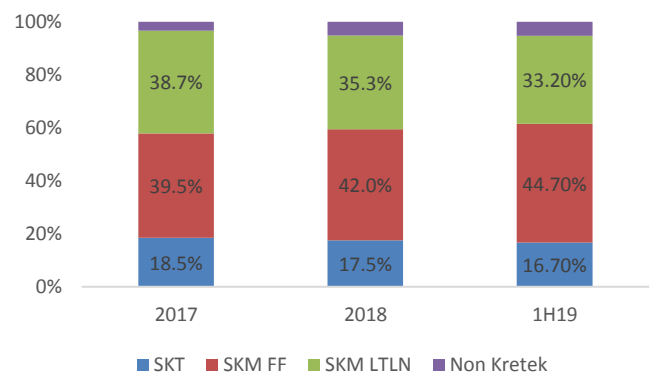
Source: Company, Danareksa Sekuritas estimates

Exhibit 10. 1H19 yoy volume growth by category & total



Source: Company

Exhibit 12. Industry market share by category



Source: Company

Exhibit 13. Income Statement

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Revenue	83,306	95,708	112,481	122,288	125,585
COGS	(65,084)	(77,063)	(90,226)	(97,992)	(99,011)
Gross profit	18,222	18,644	22,255	24,295	26,575
EBITDA	13,363	13,358	16,823	18,443	21,189
Oper. profit	11,119	11,093	14,223	15,460	17,742
Interest income	166	141	280	316	663
Interest expense	(801)	(678)	(796)	(783)	(754)
Forex Gain/(Loss)	(15)	35	0	0	0
Income From Assoc. Co's	0	0	0	0	0
Other Income (Expenses)	(33)	(113)	(132)	(144)	(148)
Pre-tax profit	10,437	10,479	13,575	14,849	17,504
Income tax	(2,681)	(2,686)	(3,480)	(3,806)	(4,487)
Minority interest	(2)	(1)	(1)	(1)	(1)
Net profit	7,754	7,792	10,094	11,042	13,016
Core Net Profit	7,768	7,757	10,094	11,042	13,016

Exhibit 14. Balance Sheet

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Cash & cash equivalent	2,329	2,034	4,030	4,547	9,532
Receivables	2,229	1,726	2,028	2,205	1,744
Inventory	37,920	38,560	42,607	43,552	44,005
Other Curr. Asset	1,286	2,965	3,484	3,788	3,890
Fixed assets - Net	21,409	22,759	24,995	27,393	29,472
Other non-curr.asset	1,587	1,054	1,239	1,347	1,383
Total asset	66,760	69,097	78,383	82,831	90,025
ST Debt	20,600	17,322	20,358	19,566	18,838
Payables	1,214	1,130	1,322	1,436	1,674
Other Curr. Liabilities	797	3,552	4,174	4,538	4,661
Long Term Debt	0	0	0	0	0
Other LT. Liabilities	1,961	1,960	2,304	2,505	2,572
Total Liabilities	24,572	23,964	28,159	28,045	27,745
Shareholder's Funds	42,171	45,133	50,225	54,786	62,280
Minority interests	17	0	0	0	0
Total Equity & Liabilities	66,760	69,097	78,383	82,831	90,025

Exhibit 15. Cash Flow

Year to 31 Dec (IDRbn)	2017A	2018A	2019F	2020F	2021F
Net income	7,754	7,792	10,094	11,042	13,016
Depreciation and Amort.	0	0	0	0	0
Change in Working Capital	0	0	0	0	0
Other Oper. Cash Flow	(767)	(554)	305	343	49
Operating Cash Flow	6,986	7,238	10,399	11,385	13,065
Capex	(2,780)	(3,539)	(4,837)	(5,381)	(5,526)
Others Inv. Cash Flow	166	141	280	316	663
Investing Cash Flow	(2,614)	(3,398)	(4,556)	(5,065)	(4,863)
Net change in debt	847	(3,278)	3,036	(792)	(728)
New Capital	(15)	(2)	0	0	0
Dividend payment	(5,001)	(5,003)	(5,003)	(6,481)	(5,521)
Other Fin. Cash Flow	(801)	(678)	(796)	(783)	(754)
Financing Cash Flow	(4,970)	(8,960)	(2,763)	(8,055)	(7,003)
Net Change in Cash	(598)	(5,119)	3,079	(1,735)	1,199
Cash - begin of the year	1,595	2,329	2,034	4,030	4,547
Cash - end of the year	2,329	2,034	4,030	4,547	9,532

Exhibit 16. Key Ratios

Year to 31 Dec	2017A	2018A	2019F	2020F	2021F
Growth (%)					
Sales	9.2	14.9	17.5	8.7	2.7
EBITDA	10.8	0.0	25.9	9.6	14.9
Operating profit	11.5	(0.2)	28.2	8.7	14.8
Net profit	16.1	0.5	29.5	9.4	17.9
Profitability (%)					
Gross margin	21.9	19.5	19.8	19.9	21.2
EBITDA margin	16.0	14.0	15.0	15.1	16.9
Operating margin	13.3	11.6	12.6	12.6	14.1
Net margin	9.3	8.1	9.0	9.0	10.4
ROAA	12.0	11.5	13.7	13.7	15.1
ROAE	19.0	17.8	21.2	21.0	22.2
Leverage					
Net Gearing (x)	0.4	0.3	0.3	0.3	0.1
Interest Coverage (x)	13.9	16.4	17.9	19.8	23.5

Source : GGRM, Danareksa Estimates

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