

Tuesday, 14 September 2021

## SELL Downgrade

Last price (IDR)	32,400
Target Price (IDR)	28,600
Upside/Downside	-11.8%
Previous Target Price (IDR)	32,000

### Stock Statistics

Sector	CIGARETTE
Bloomberg Ticker	GGRM IJ
No of Shrs (mn)	1,924
Mkt. Cap (IDRbn/USDmn)	62,341/4,374
Avg. daily T/O (IDRbn/USDmn)	61.9/4.3

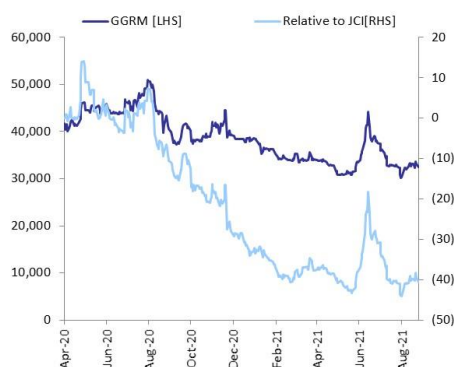
### Major shareholders (%)

SURYADUTA INVESTAMA	69.3
SURYAMITRA KUSUMA	6.3
Estimated free float	23.8

### EPS Consensus (IDR)

	2021F	2022F	2023F
Danareksa	2,894	2,978	3,271
Consensus	3,198	3,555	4,006
Danareksa/Cons	(9.5)	(16.2)	(18.3)

### GGRM relative to JCI Index



Source : Bloomberg



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## Gudang Garam (GGRM IJ)

### More headwinds ahead

**GGRM reported encouraging 1H21 sales volume. More price adjustments in 3Q21 may spark hopes of better profitability ahead. However, the 2022 excise tax tariff overhang remains with an announcement expected in October 2021. Following soft 1H21 results, with expectations of double-digit growth in 2022 that will push cigarette players to increase prices aggressively in subsequent months, we lower our FY21-22 earnings estimates. Downgrade to SELL.**

**1H21 volume growth of 7.3% yoy.** GGRM reported positive 1H21 volume growth of 7.3% yoy, driven by SKM (+8.1% yoy), while SKT fell 2.2% yoy. In 1H21, the ASP of SKM only grew 5.4% yoy while SKT ASP – with no excise tax increase this year – rose by 2.2% yoy. To pass on higher excise tax, GGRM increased the ASP of its products in April, May, July and September 2021. Based on our calculations, the ASP of GGRM's products will require additional increases of an average of 10% to pass on the 2021 excise tax.

**Expect lower FY21 earnings on lower margins.** The company emphasized that the price adjustments going forward will hinge on the market's response to current cigarette prices, affordability, and competition from peers. We estimate FY21 volume growth of 0.5% yoy, lower than the 1H21 growth of 7.3% as we expect slower volume growth with aggressive price increases to pass on 2021 excise tax and anticipation of 2022 excise tax to curb sales volume in 2H21. We estimate 11.2% blended ASP increases for 2021, leading to a lower FY21 gross margin at 11.7%. Lower-than-expected gross margins have prompted us to revise down our FY21 earnings by 26.7%.

**Unexciting FY22 earnings with double digit excise growth.** We need to wait on the MOF regulation regarding the 2022 excise tax tariff for cigarettes. We use the assumption of 12% yoy excise tax increases for SKM in 2022, while for SKT, we estimate 3.7% yoy increases. With brisker economic activities expected in 2022 to support +0.5% yoy FY22 volume growth, we expect the company to pass on higher excise, resulting in maintained FY22 gross margins at 11.8%. This will filter through to FY22 net profits of IDR5.7tn (+2.9% yoy).

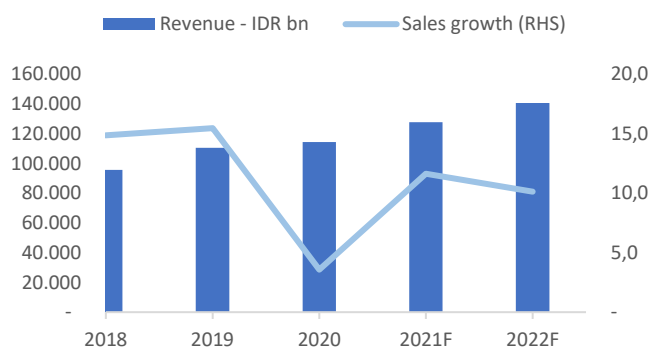
**Downgrade to SELL.** The preference for SKM FF will sustain GGRM's sales volume ahead. However, we think there will be a further downgrade from the consensus to take into account the soft 1H21. We see headwinds ahead until there is further clarity on 2022 excise tax. We downgrade our recommendation to SELL based on FY22F PE 9.6x with a TP of IDR28,600. Upside risks to our TP include simplification of the excise tax structure that benefits tier-1 producers and moderate (single digit) excise tax growth from the Tier-1 category.

### Key Financials

Year to 31 Dec	2019A	2020A	2021F	2022F	2023F
Revenue (IDRbn)	110,524	114,477	127,813	140,762	155,089
EBITDA (IDRbn)	17,320	12,532	10,132	10,768	11,997
EBITDA Growth (%)	29.7	(27.6)	(19.2)	6.3	11.4
Net profit (IDRbn)	10,881	7,648	5,569	5,731	6,294
EPS (IDR)	5,655.0	3,974.7	2,894.4	2,978.4	3,271.3
EPS growth (%)	39.6	(29.7)	(27.2)	2.9	9.8
BVPS (IDR)	26,470.0	30,415.6	30,726.3	32,257.5	34,039.6
DPS (IDR)	2,600.0	0.0	2,583.6	1,447.2	1,489.2
PER (x)	5.7	8.1	11.2	10.9	9.9
PBV (x)	1.2	1.1	1.1	1.0	1.0
Dividend yield (%)	8.0	-	8.0	4.5	4.6
EV/EBITDA (x)	4.4	5.1	6.2	6.0	5.4

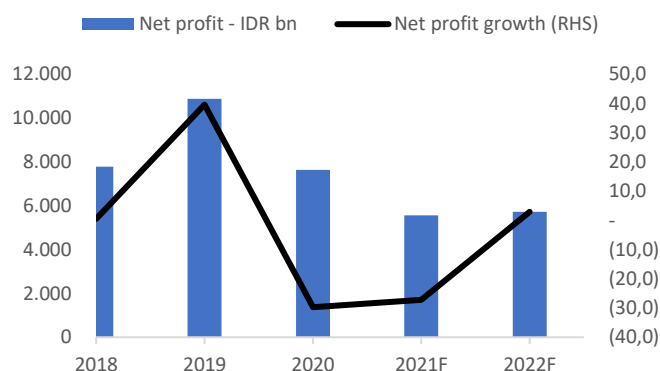
Source : GGRM, BRI Danareksa Estimates

### Exhibit 1. Revenues and Growth



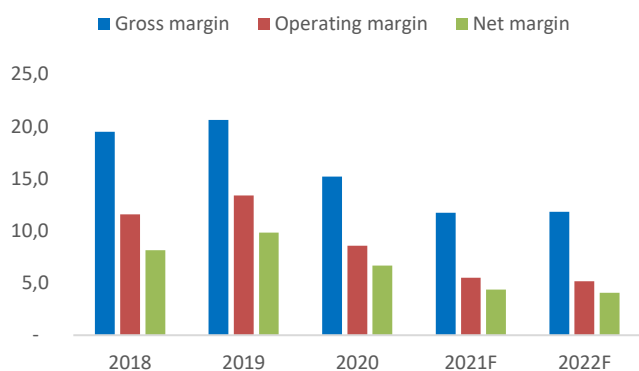
Source: Company, BRI Danareksa Sekuritas estimates

### Exhibit 2. Net Profits and Growth



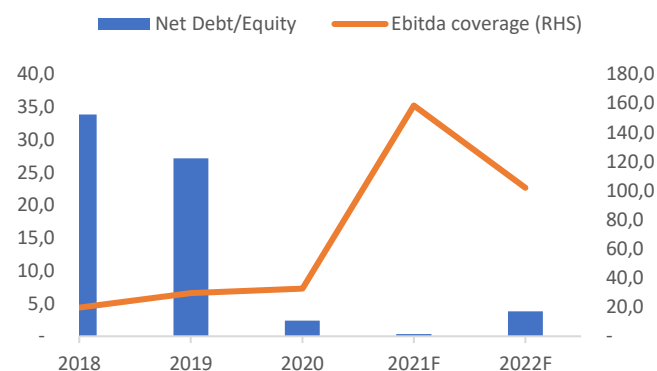
Source: Company, BRI Danareksa Sekuritas estimates

### Exhibit 3. Margins



Source: Company, BRI Danareksa Sekuritas estimates

### Exhibit 4. Gearing Level



Source: Company, BRI Danareksa Sekuritas estimates

### Exhibit 5. 2Q21 result

	GGRM	2Q20	1Q21	2Q21	qoq	yoy	1H20	1H21	yoy	2021F	A/F	A/Cons
Revenue, IDR bn		26,394	29,747	30,840	3.7%	16.8%	53,655	60,587	12.9%	127,813	47%	48%
Gross profit		3,719	3,909	2,634	-32.6%	-29.2%	8,661	6,543	-24.5%	14,979	44%	36%
Operating profit		1,867	2,117	678	-68.0%	-63.7%	5,105	2,795	-45.3%	7,041	40%	37%
Pretax profit		1,765	2,229	725	-67.5%	-58.9%	4,938	2,955	-40.2%	7,037		
Net profit		1,374	1,747	564	-67.7%	-59.0%	3,821	2,311	-39.5%	5,569	41%	38%
<b>By divisions</b>												
Revenue (IDR bn)												
Export		449	438	423	-3.3%	-5.6%	774	861	11.3%			
Domestic												
SKM		23,670	26,838	28,131	4.8%	18.8%	48,181	54,969	14.1%			
SKT		2,065	2,181	2,029	-7.0%	-1.7%	4,216	4,210	-0.2%			
Others		211	291	257	-11.5%	22.2%	483	548	13.3%			

Source: BRI Danareksa, Company

## Sensitivity analysis

Within 2019-21, the government targeted excise revenues growth of less than 10% yoy. However, the growth of average excise tax tariffs reached 12.5% yoy (in 2021) and 22.8% yoy (in 2020). This has put pressure on the tier-1 cigarette industry. The excise tax tariffs in 2022 will hinge on the government's assumption of industry cigarette volume along with the structure of excise tax in comparison with the tariff gap between tier-1 and below tier-1 categories. By the end of June 2021, the wider gap in excise tax tariffs between the Tier-1 and below Tier-1 categories paved the way for a greater volume contribution of below the Tier-1 category to 30% (2019: only 20%). As such, if the government emphasizes control of tobacco consumption, a narrow gap within the Tier-1 and below Tier-1 cigarette producers can be expected. Hopefully, this will provide a breather for our Tier-1 cigarette players in 2022.

We conduct sensitivity analysis on 2022 excise tax tariff growth (for SKM only, 90% of GGRM's total cigarette sales volume) and FY22 total volume. We estimate FY22 excise tax tariff growth for SKM of 12% yoy and 3.7% yoy for SKT. In an effort to maintain margins, we expect the company to pass on 85% of the excise tax growth via higher ASP, translating to 2022 ASP growth of 9.7% yoy. For 2022, higher vaccination rates with brisker economic activities will support our FY22 volume growth assumption of 0.5% yoy. We arrive at several possible 2022 net profit scenarios. The table below shows our net profit estimates for 2022:

**Exhibit 6. FY22 Net profits based on several excise tax and volume growth scenarios**

Volume	Excise*	6%	9%	12%	15%
-1.00%		5,602	5,638	5,675	5,711
0.50%		5,656	5,694	5,731	5,768
1.00%		5,677	5,714	5,752	5,789
3.00%		5,752	5,791	5,829	5,867

Source: BRI Danareksa, Company \*Excise tax growth for SKM only

**Exhibit 7. Earnings revision and key assumptions**

	Previous		New		Changes	
	2021F	2022F	2021F	2022F	2021	2022
Revenue	120,618	130,386	127,813	140,762	6.0%	8.0%
Gross profit	17,642	18,873	14,979	16,625	-15.1%	-11.9%
Operating profit	9,651	10,106	7,041	7,281	-27.0%	-28.0%
Net profit	7,597	7,907	5,569	5,731	-26.7%	-27.5%
Gross margin	14.6%	14.5%	11.7%	11.8%		
Operating margin	8.0%	7.8%	5.5%	5.2%		
Net margin	6.3%	6.1%	4.4%	4.1%		
<b>Assumption</b>						
Volume growth	-8.2%	-2.3%	0.5%	0.4%		
ASP blended growth	14.8%	10.7%	11.2%	9.7%		
<b>Excise growth</b>						
SKM	17%	11%	17%	12%		
SKT	0%	11%	0%	4%		

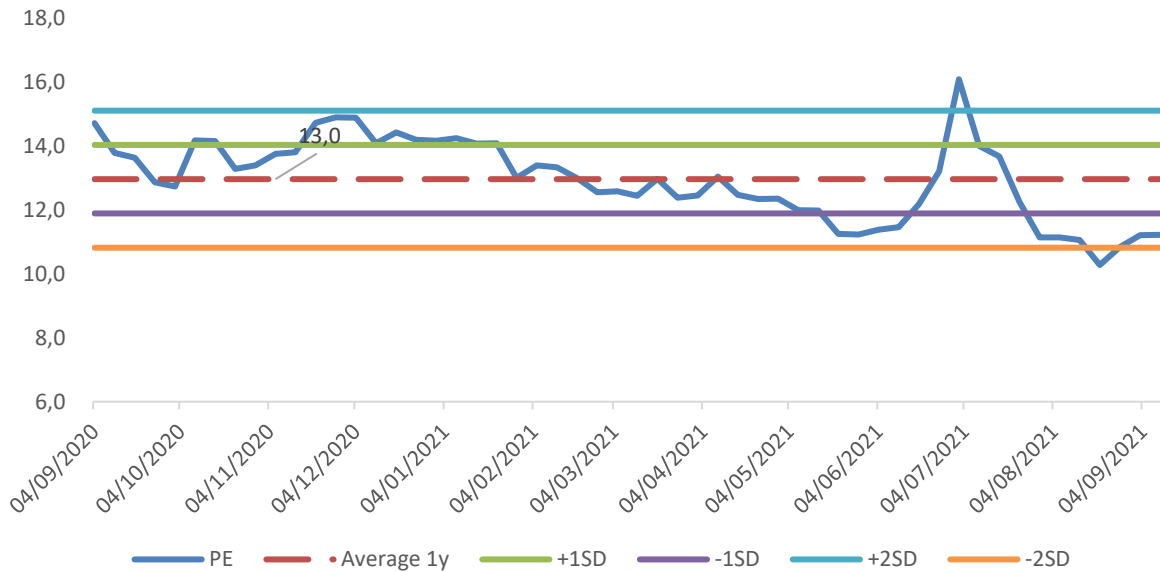
Source: BRI Danareksa, Company

**Exhibit 8. GGRM' net revenue margin on several products**

Price ex factory	Type	Jul-21	Excise/pack	NRM	Additional price increase	Target NRM
GG Merah SKT 12 sticks	SKT	12,050	3,960	67%	8%	70%
GG International SKM 12 sticks	SKM	17,550	10,380	41%	25%	55%
GG Surya SKM FF 16 sticks	SKM	23,500	13,840	41%	25%	55%
GG Surya Promild SKM FF 16 sticks	SKM	20,000	13,840	31%	5%	34%
GG Mild LTLN 16 sticks	SKM	21,700	13,840	36%	3%	38%
Simple average					13%	

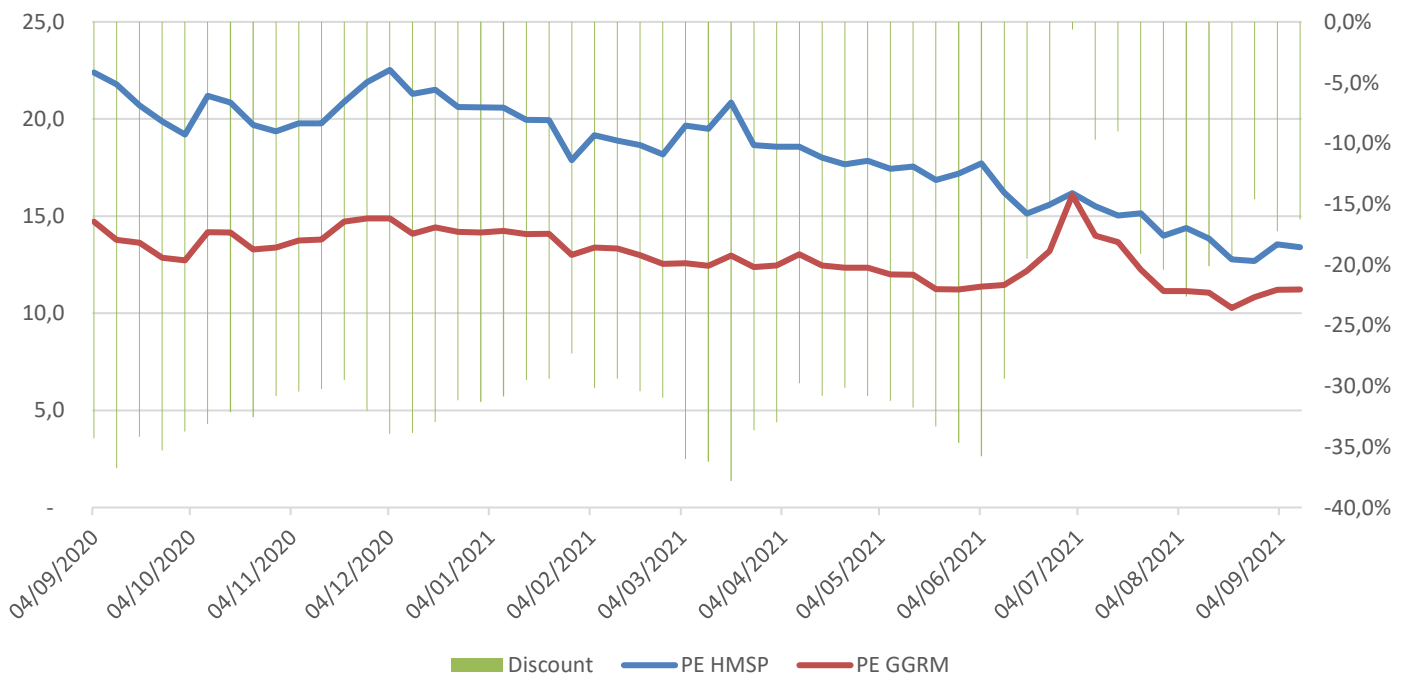
Source: BRI Danareksa estimates, Company

**Exhibit 9. PE Band**



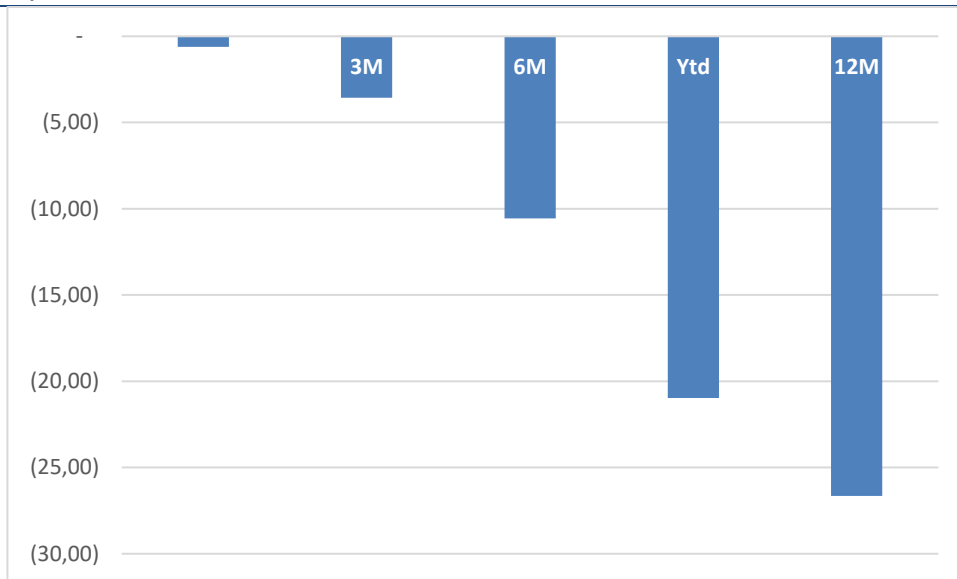
Source: BRI Danareksa, Bloomberg

**Exhibit 10. PE of HMSP Vs GGRM and the discount**



Source: BRI Danareksa

**Exhibit 11. The share price performance of GGRM**



Source: Bloomberg

### Exhibit 12. Income Statement

Year to 31 Dec (IDRbn)	2019A	2020A	2021F	2022F	2023F
<b>Revenue</b>	<b>110,524</b>	<b>114,477</b>	<b>127,813</b>	<b>140,762</b>	<b>155,089</b>
COGS	(87,741)	(97,089)	(112,834)	(124,138)	(137,012)
<b>Gross profit</b>	<b>22,783</b>	<b>17,388</b>	<b>14,979</b>	<b>16,625</b>	<b>18,077</b>
<b>EBITDA</b>	<b>17,320</b>	<b>12,532</b>	<b>10,132</b>	<b>10,768</b>	<b>11,997</b>
<b>Oper. profit</b>	<b>14,790</b>	<b>9,807</b>	<b>7,041</b>	<b>7,281</b>	<b>8,011</b>
Interest income	-	-	-	-	-
Interest expense	(585)	(383)	(64)	(106)	(116)
Forex Gain/(Loss)	(20)	(39)	-	-	-
Income From Assoc. Co's	-	-	-	-	-
Other Income (Expenses)	303	278	60	66	72
<b>Pre-tax profit</b>	<b>14,488</b>	<b>9,663</b>	<b>7,037</b>	<b>7,241</b>	<b>7,968</b>
Income tax	(3,607)	(2,015)	(1,468)	(1,510)	(1,673)
Minority interest	0	0	0	0	0
<b>Net profit</b>	<b>10,881</b>	<b>7,648</b>	<b>5,569</b>	<b>5,731</b>	<b>6,294</b>
<b>Core Net Profit</b>	<b>10,901</b>	<b>7,686</b>	<b>5,569</b>	<b>5,731</b>	<b>6,294</b>

### Exhibit 13. Balance Sheet

Year to 31 Dec (IDRbn)	2019A	2020A	2021F	2022F	2023F
Cash & cash equivalent	3,572	4,774	2,522	2,028	2,281
Receivables	1,876	2,556	2,485	2,737	3,016
Inventory	42,847	39,895	39,179	43,103	47,574
Other Curr. Asset	3,786	2,313	2,582	2,844	3,134
Fixed assets - Net	25,374	27,605	29,627	31,770	32,437
Other non-curr.asset	1,192	1,048	1,171	1,289	1,420
<b>Total asset</b>	<b>78,647</b>	<b>78,191</b>	<b>77,566</b>	<b>83,771</b>	<b>89,862</b>
ST Debt	17,236	6,029	2,556	4,223	4,653
Payables	1,297	1,124	1,567	1,724	1,903
Other Curr. Liabilities	6,725	9,857	11,372	12,524	14,264
Long Term Debt	177	157	157	157	157
Other LT. Liabilities	2,281	2,502	2,794	3,077	3,390
<b>Total Liabilities</b>	<b>27,717</b>	<b>19,669</b>	<b>18,445</b>	<b>21,704</b>	<b>24,366</b>
Shareholder's Funds	50,931	58,522	59,120	62,066	65,495
Minority interests	0	0	0	0	0
<b>Total Equity &amp; Liabilities</b>	<b>78,647</b>	<b>78,191</b>	<b>77,566</b>	<b>83,770</b>	<b>89,861</b>

#### Exhibit 14. Cash Flow

Year to 31 Dec (IDRbn)	2019A	2020A	2021F	2022F	2023F
Net income	10,881	7,648	5,569	5,731	6,294
Depreciation and Amort.	2,322	2,548	3,091	3,488	3,985
Change in Working Capital	(1,883)	6,073	2,652	(2,958)	(2,930)
Other Oper. Cash Flow	881	2,375	50	92	101
<b>Operating Cash Flow</b>	<b>12,200</b>	<b>18,643</b>	<b>11,361</b>	<b>6,352</b>	<b>7,450</b>
Capex	(4,937)	(4,779)	(5,113)	(5,630)	(4,653)
Others Inv. Cash Flow	-	-	-	-	-
<b>Investing Cash Flow</b>	<b>(4,937)</b>	<b>(4,779)</b>	<b>(5,113)</b>	<b>(5,630)</b>	<b>(4,653)</b>
Net change in debt	91	(11,227)	(3,473)	1,667	430
New Capital	-	-	-	-	-
Dividend payment	(5,003)	-	(4,971)	(2,785)	(2,865)
Other Fin. Cash Flow	(585)	(383)	(64)	(106)	(116)
<b>Financing Cash Flow</b>	<b>(5,497)</b>	<b>(11,610)</b>	<b>(8,508)</b>	<b>(1,224)</b>	<b>(2,552)</b>
<b>Net Change in Cash</b>	<b>1,766</b>	<b>2,254</b>	<b>(2,259)</b>	<b>(502)</b>	<b>246</b>
Cash - begin of the year	2,034	3,572	4,774	2,522	2,028
Cash - end of the year	3,572	4,774	2,522	2,028	2,281

#### Exhibit 15. Key Ratios

Year to 31 Dec	2019A	2020A	2021F	2022F	2023F
<b>Growth (%)</b>					
Sales	15.5	3.6	11.6	10.1	10.2
EBITDA	29.7	(27.6)	(19.2)	6.3	11.4
Operating profit	33.3	(33.7)	(28.2)	3.4	10.0
Net profit	39.6	(29.7)	(27.2)	2.9	9.8
<b>Profitability (%)</b>					
Gross margin	20.6	15.2	11.7	11.8	11.7
EBITDA margin	15.7	10.9	7.9	7.7	7.7
Operating margin	13.4	8.6	5.5	5.2	5.2
Net margin	9.8	6.7	4.4	4.1	4.1
ROAA	14.7	9.8	7.2	7.1	7.3
ROAE	22.7	14.0	9.5	9.5	9.9
<b>Leverage</b>					
Net Gearing (x)	27.2	2.4	0.3	3.8	3.9
Interest Coverage (x)	25.3	25.6	110.2	69.0	68.9

Source : GGRM, BRI Danareksa Estimates

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