

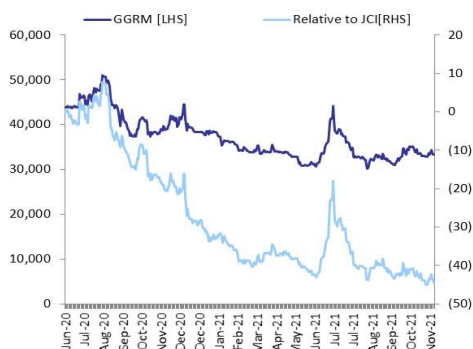
Friday, 26 November 2021

NEUTRAL
Maintain

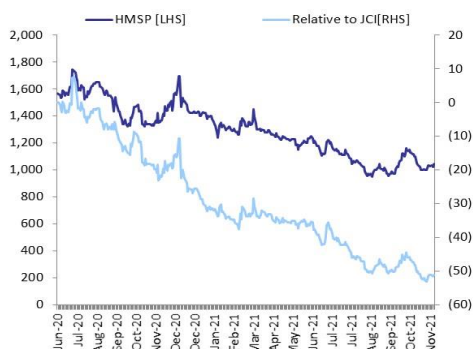
Cigarette

Set for recovery but uncertainty remains

GGRM relative to JCI Index



HMSP relative to JCI Index



Source : Bloomberg

The **2022** excise tax regulation will determine the future direction of Indonesia’s cigarette industry. The government’s focus on encouraging healthy lifestyles and a preventive approach toward treating illness/disease will translate into a narrowing gap of cigarette excise tariffs within the tier-1 and below tier-1 categories. This will create a more level playing field. We maintain our neutral stance on the sector.

Still awaiting news on 2022 excise. If we go back to see the realization of excise tax revenues in the past 9 years, we learnt that tobacco excise tax revenues only grew by double digits in 2 years: 2015 – when the government changed the payment of cigarette excise tax ribbons to cash and carry (previously H+2 months) and 2019 (zero excise tax increases for all categories). However, the growth in excise tax tariffs for the SKM Tier-1 category was mostly in double digits (except for 2019) in 2016-19. As the tier-1 cigarette players still account for around 70% of total industry volume, double-digit growth for 2022 excise tax tariffs may be possible.

9M21 excise tax realization reached 73.8% of the FY21 target. By the end of September 2021, the realization of tobacco excise tax was IDR128.3tn, +15.14% yoy or reaching 73.8% of the total FY21 target. The growth in 9M21 tobacco excise tax was supported by the growth in cigarette production (+4.3% yoy) and higher excise tax tariffs. Despite the positive growth in 9M21 tobacco production, this is still 5.7% lower compared to 2019 or the pre pandemic level. Customs and tax reported that the 9M21 cigarette production growth was supported by the production growth of the tier 2 category (+18.9% yoy) and the tier-3 category (+15.2% yoy). This data emphasizes the continued trading down undertaken by smokers.

Approach toward health issues may spark hope for tier-1 cigarette players. The government also plans to implement excise tax on sweetened beverages in 2022, targeting IDR6.2tn of excise tax revenues. Despite its small contribution, this shows the government’s commitment toward raising awareness on health matters. Taking this argument further, higher growth in tier-2 excise tax tariffs may be seen in 2022, leading to a more level playing field whilst also reducing the affordability of cigarette products. On a positive note, this will pave the way for volume and price growth in the tier-1 category.

Maintain neutral. In spite of the social mobility restrictions and Covid-19 pandemic, both cigarette players under our coverage still booked positive volume growth in 9M21. While we understand that the direction of the cigarette industry hinges upon the upcoming excise tax regulation, we believe cigarette companies will make the effort to increase prices and pass on higher excise to sustain profitability. As such, with our assumption of 12% yoy growth in SKM and SPM excise tax tariffs in 2022, we expect both companies to pass on higher excise and book positive earnings growth. We maintain our HOLD recommendation on both HMSP and GGRM. However, we expect to see a continued preference for higher impact cigarettes (i.e. SKM High Tar and SKT) ahead as cigarette prices will become more expensive with higher excise. As such, we prefer GGRM given its undemanding valuation and strong portfolio in SKM high tar. We maintain our neutral stance on the sector.



Natalia Sutanto

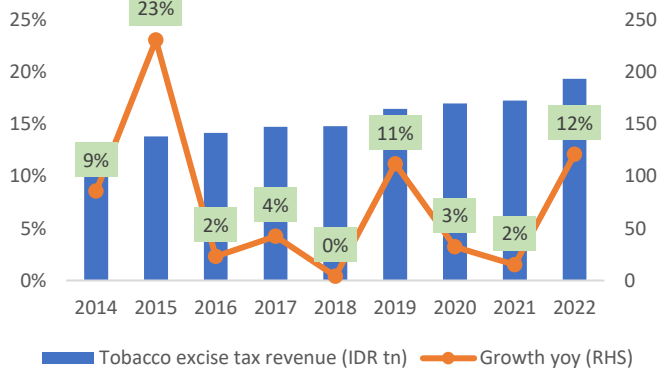
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Company	Ticker	Rec	Target	Market	P/E (x)		P/BV (x)		ROE (%)
			Price (Rp)	Cap. (RpBn)	2021F	2022F	2021F	2022F	2022F
Gudang Garam	GGRM IJ	Hold	31,500	64,024	11.1	10.6	1.1	1.0	10.0
HM Sampoerna	HMSP IJ	Hold	1,000	119,807	16.7	15.6	4.2	3.9	26.5

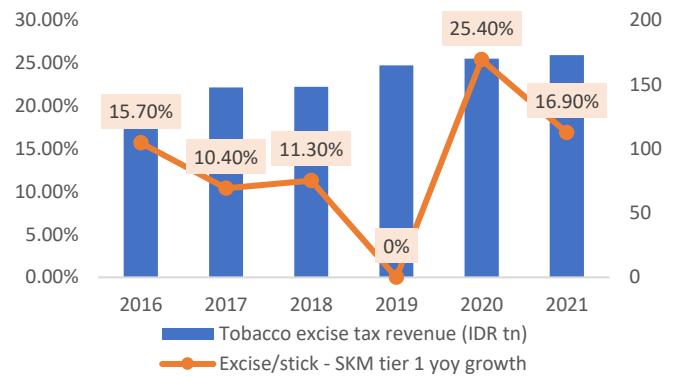
See important disclosure at the back of this report

Exhibit 1. Excise tax revenues and yoy growth



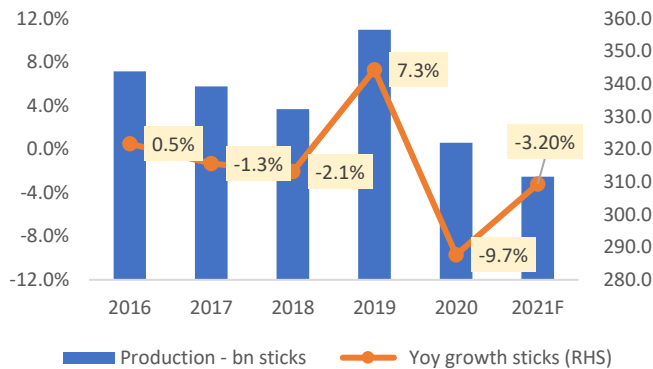
Source: MOF, BRI Danareksa Sekuritas estimates

Exhibit 2. Excise tax revenues vs yoy growth of SKM Tier-1



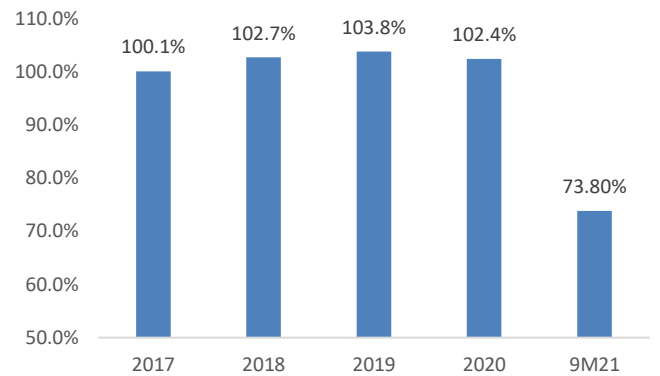
Source: MOF

Exhibit 3. Excise ribbon sold and yoy growth



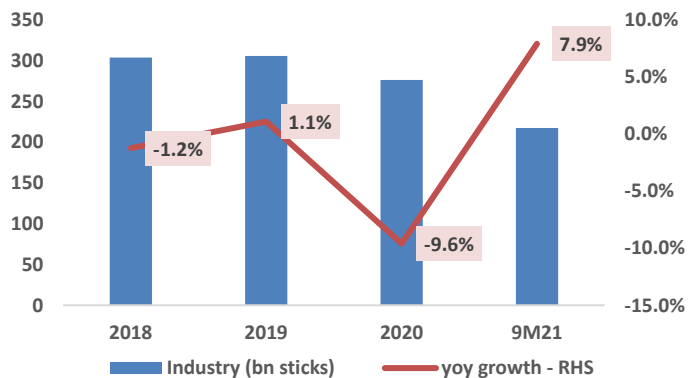
Source: MOF

Exhibit 4. Excise tax revenues realization vs its target



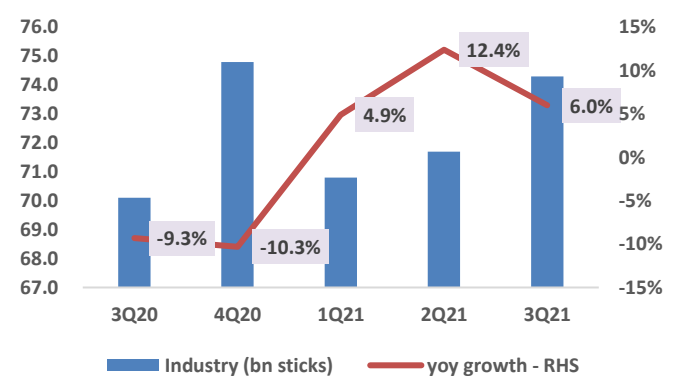
Source: MOF

Exhibit 5. Industry volume, 2019 – 9M21



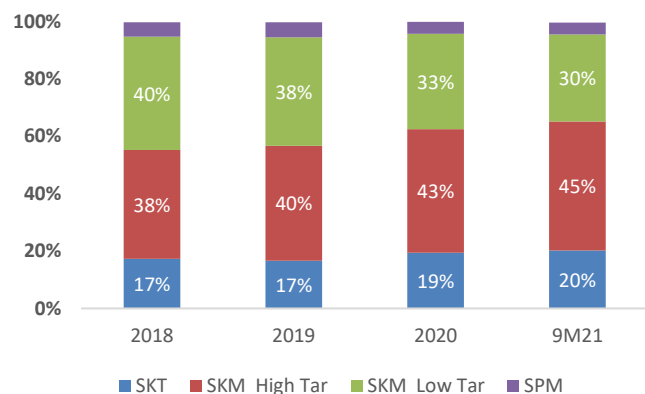
Source: HM Sampoerna

Exhibit 6. Quarterly industry volume



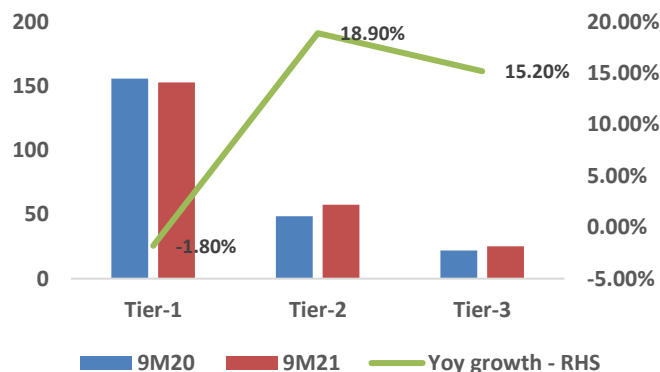
Source: HM Sampoerna

Exhibit 7. Industry share of market – by product category



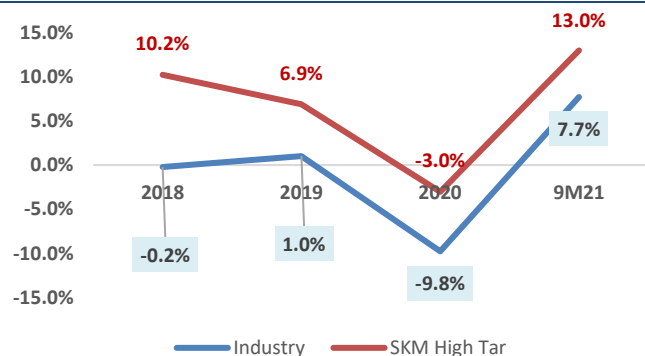
Source: HM Sampoerna

Exhibit 8. Industry volume (bn sticks) & growth by excise category



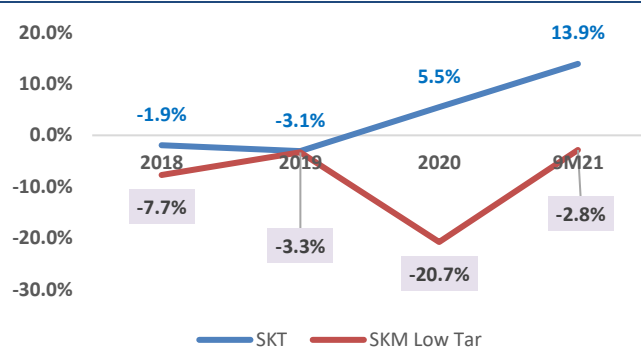
Source: Custom and tax, MOF

Exhibit 9. SKM FF drives the growth in the industry (yoy)



Source: HM Sampoerna

Exhibit 10. The yoy growth of SKM LT and SKT



Source: HM Sampoerna

Exhibit 11. Peers comparison - GGRM and HMSP

	GGRM		HMSP	
	2021F	2022F	2021F	2022F
Cigarette volume (bn sticks)	91.6	94.1	82.4	84.4
Volume growth %	2.0	2.8	3.8	2.4
SKM	2.5	3.0	1.2	3.0
SKT	(2.0)	1.0	6.2	5.0
SPM	-	-	3.6	3.0
SPT	-	-	2,804.2	20.0
Revenue contribution %				
SKM	92.3	93.1	66.6	67.8
SKT	6.7	6.0	22.7	21.4
SPM	-	-	9.4	9.6
SPT	-	-	0.5	0.5
Excise/stick - yoy growth				
SKM	16.9	12.0	16.9	12.0
SKT	-	-	-	-
SPM	-	-	18.4	12.0

Source: HM Sampoerna

Exhibit 12. Company outlook 2022

Ticker	Target Price (IDR)	Rating	Summary
GGRM	31,500	Hold	<ul style="list-style-type: none"> GGRM reported solid 9M21 volume growth, supported by the SKM High Tar category. Aggressive price increases from April to September 2021 gave a lift to the 3Q21 margins. Going into 4Q21, continued recovery is expected in the country. This will provide room for price increases supported by sustainable volumes to pass on higher excise tax. In our view, continued recovery with a preference for High Tar products from down trading should benefit GGRM in the future. We maintain our HOLD recommendation with a TP of IDR31,500 based on -1SD average 2y PE of 10x.
HMSP	1,000	Hold	<ul style="list-style-type: none"> By end-September 2021, SKT and SKM High Tar gained market share, an indication of continued down trading in the industry, following hikes in selling prices. The lower volume growth of HMSP compared to the industry also shows that the below tier-1 growth might be higher as these cigarettes are sold at lower prices. HMSP only managed to increase the revenues/stick by 2.6% yoy in 9M21, while the total excise expenses grew by 14% yoy in the same period. Therefore, pressure on gross margins led to lower 9M21 earnings. Going forward, the strong contribution from SKT should benefit HMSP and sustain margins. We maintain our HOLD recommendation on HMSP with a TP of IDR1,000 with an implied FY22 PE of 15x – close to the valuation of PMI.

Source: BRI Danareksa Sekuritas estimates

Exhibit 13. Financial ratios 2022F

Financial ratios	GGRM	HMSP
Sales growth (%)	12.5	11.4
EBITDA growth (%)	8.1	7.5
Operating profit growth (%)	6.0	7.5
Net profit growth (%)	5.5	7.0
Gross margin (%)	11.4	17.3
EBITDA Margin (%)	7.8	9.8
Operating margin (%)	5.4	8.6
Net margin (%)	4.2	6.9
ROAA (%)	7.5	15.6
ROAE (%)	10.0	26.5
Net gearing (x)	0.0	nc
Interest Coverage (x)	71.8	159.4

Source: Company, BRI Danareksa Sekuritas estimates