Sector Update

Consumer Sector

22 October 2014

Samuel Equity Research

Neutral (Downgrade)

Consumer: 3Q14 earnings preview

We forecast aggregated revenue to grow 21% YoY in 3Q14 vs. 20% YoY in 2Q14 supported by stronger demand during Lebaran season and higher selling price. On the cost side, declining commodity prices should start to positively impact 3Q14 earnings and, to a greater extent, 4Q14 earnings. Although top-line growth has remained solid, we now turn cautious on the sector as we expect the upcoming fuel price increase to temporarily weaken consumers' sentiment in the near future. The strongest catalyst for the sector would be Rupiah appreciation—something that our economist does not expect to happen in 2015 given a challenging macro outlook.

Who's going to book the strongest growth? We expect ROTI to book the strongest 3Q14 revenue and earnings growth among consumer peers at 32% and 156% YoY respectively on last year's low base. Among the large cap group, INDF should remain the fastest-growing company after beating consensus' earnings estimates in the last two quarters. We forecasts INDF to book 25% YoY revenue growth and 29% YoY earnings growth in 3Q14 supported by Minzhong consolidation and improvement in agribusiness performance.

Soft commodity prices recede further. Consumer companies will enjoy lower production cost as most soft commodity prices continued to trend downward in 3Q14. Average USDIDR was 10% weaker YoY but remained stable on QoQ basis with only 1% depreciation. With USD-denominated raw materials making up more than 50% of most consumer companies' COGS, a stabilizing or appreciating Rupiah would be very positive for the sector that is currently above Rp12,000/US$.

Valuation above trend. Indonesia's promising demographic story, rising middle class and under penetration of most consumer products have boosted consumer stocks' valuation in the last couple of years with the sector now trading at +1 stdev. above historical mean PE although margin has remained lower on annual basis. Despite the robust revenue growth YTD, we now have turned cautious towards the sector for the following reasons: 1) fuel price increase could temporarily weaken consumer sentiment, 2) we do not expect substantial appreciation of Rupiah to occur in 2015 with our economist forecasting Rp11,800/US$ average in FY15, and 3) demanding valuation which should cap potential upside.

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Company	Rec.	Last price	Target price	Market cap. (Rp bn)	PE (x) 14E	PE (x) 15E	PEG (x)	PBV (x) 14E	PBV (x) 15E	ROE 15E	EPS CAGR 13A-16E
Unilever Indonesia (UNVR IJ)	Hold	31,625	33,400	241,299	41.1	37.7	3.1	50.5	45.4	116%	12%
Kalbe Farma (KLBF IJ)	Buy	1,700	2,000	79,688	37.3	30.4	1.7	8.2	7.1	23%	18%
Indofood CBP (ICBP IJ)	Hold	11,325	11,100	66,036	26.6	22.9	1.4	4.5	4.0	18%	17%
Indofood SM (INDF IJ)	Buy	6,800	8,100	59,707	14.0	12.3	0.4	2.2	2.0	16%	29%
Ultrajaya Milk (ULTJ IJ)	Buy	3,870	4,470	11,178	28.0	19.2	0.7	4.6	3.7	19%	29%
Nippon Indosari Co. (ROTI IJ)	Hold	1,175	1,490	5,948	25.7	18.6	0.6	5.9	4.6	25%	33%
Weighted average*					**34.4**	**30.4**	**1.2**	**5.3**	**4.6**	**19%**	**22%**

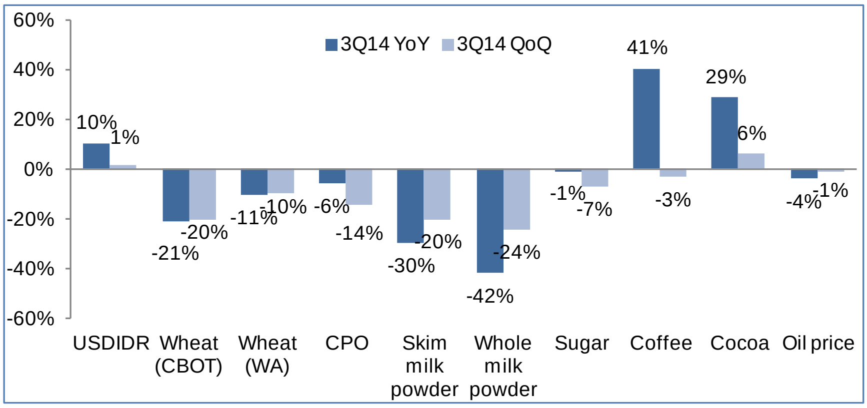
**Excl. UNVR, except for PE ratio & EPS CAGR*

Soft commodity prices recede further

On the cost side, we expect consumer companies to enjoy lower production cost in the next 1-2 quarters after factoring in some inventory lag as most soft commodity prices continued to trend downward in 3Q14. Average USDIDR was 10% weaker YoY but remained stable on QoQ basis with only 1% depreciation. With USD-denominated raw materials making up more than 50% of most consumer companies' COGS, a stabilizing or appreciating Rupiah would be very positive for the sector that is currently above Rp12,000/US$.

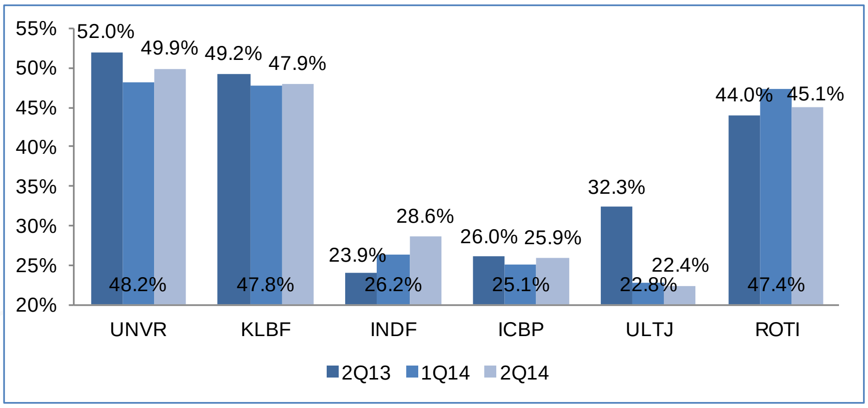
In 2Q14, margin pressure was seen in consumer companies with most of them reporting lower gross and operating margins YoY, although on quarterly basis, we see that most company's margins improved due to ASP increases, efficiency improvement and tighter advertising and promotion (A&P) spending. Companies continued to gradually pass through the increasing cost to buyers who have been able for the most part to absorb the price hikes. This has supported the solid top-line growth of the sectors.

Figure 1. Soft commodity prices extended decline



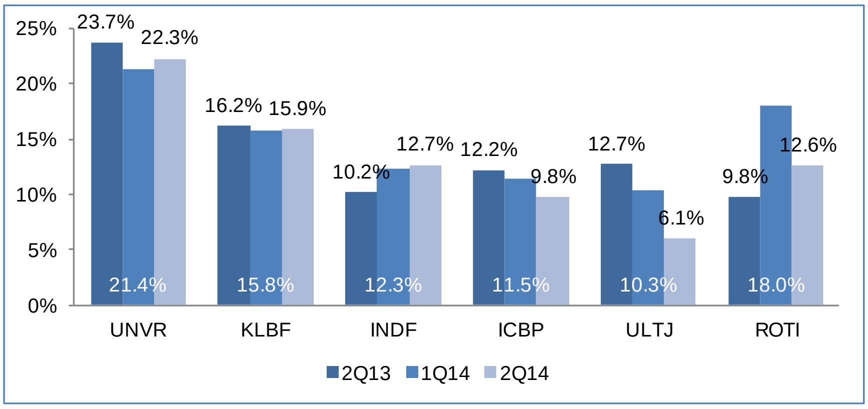
Source: Bloomberg

Figure 2. Gross margin trend



Source: Companies

Figure 3. Operating margin trend



Source: Companies

Company update

Unilever Indonesia (UNVR.IJ, Hold, TP Rp33,400)

- While we expect F&B segment will benefit from higher consumers' spending during Lebaran season, our concern lies on the weakening sales growth of UNVR's Home and Personal Care (HPC) products that was reflected in a muted sales growth of 8% YoY recorded in 2Q14 vs. F&B 26% YoY. HPC remains UNVR major segment with sales contribution of around 70%.
- UNVR has raised its ASP by 5% in the second week of September, but impact to 3Q14 financial performance will be quite minimal. We do not expect substantial margin recovery to occur in 3Q14.

Kalbe Farma (KLBF.IJ, Buy, TP Rp2,000)

- We expect Distribution sales growth to remain weak but will be partly offset by growth in Consumer Health segment as contribution from new products materialize. Management has revised down its FY14 sales target by around 3% post 2Q14 result on the back of weak sales of 3rd party principal in Distribution segment.
- Margin should improve as Nutritional division, which contributes around 30% to consolidated gross profit, benefits from declining skim milk powder cost. Skim milk powder price has been continuously falling since Feb'14 by almost 50%. Since KLBF normally locks in milk powder price for around 3 months, the impact to margin should be seen starting in 3Q14.

Indofood CBP (ICBP.IJ, Hold, TP Rp11,150) & Indofood SM (INDF.IJ, Buy, TP Rp8,100)

- Recovery momentum has been strong for ICBP on the back of declining soft commodities price for wheat, milk powder and CPO along with company's decision to raise noodle selling price by 3%-4% back in July ahead of Lebaran during which sales normally peaks.
- Key to watch is ICBP's advertising & promotion (A&P) expense which we think may climb and causes opex to increase. Ratio of A&P expense to sales for ICBP had only reached 3.4% in 1H14 vs. company's FY14 guidance at 4.5%-5%, indicating that most of the A&P budget will be deployed in 2H14.
- Top-line growth should be weaker for Bogasari as INDF has cut selling price by 2% in mid-August on tightening competition. On the other hand, ICBP will benefit from lower wheat flour price which is the main ingredients of its instant noodles.

Ultrajaya Milk Industry (ULTJ.IJ, Buy, TP Rp4,470)

- Strong improvement should be seen in ULTJ's 3Q14 earnings on the back of higher ASP and subsiding milk powder price, which makes up between 30%-40% of its raw material cost.
- Average cost of imported milk powder decreased by more than 20% QoQ in 2Q14. With lower production cost and 5% rise in ASP at the end of July, we expect gross margins should improve significantly by around 600bps QoQ and be slightly better YoY.
- We forecast ULTJ to book 24% YoY top-line growth and 85% YoY earnings growth in 3Q14.

Nippon Indosari Corpindo (ROTI.IJ, Hold, TP Rp1,490)

- We expect ROTI to book 32% YoY sales growth and 156% YoY earnings growth in 3Q14 on last year's low base during which labor strike occurred in West Java factory.
- 3Q14 net margin should improve significantly on annual basis although QoQ contraction may be seen as ROTI starts to expense its borrowing costs after they had capitalized most of their interest charges in 1H14.
- ROTI raised its product selling price by an average of 10% effective Oct 1st. Substantial margin expansion should be seen in 4Q14 as higher selling price kicks in.

Figure 4. 3Q14 revenue estimates

(in Rp bn)	3Q13	2Q14	3Q14	QoQ	YoY	9M13	9M14	YoY	9M14/ 2014E Cons.
UNVR	7,595	8,857	8,937	0.9%	17.7%	23,025	26,520	15.2%	74.8%
KLBF	4,019	4,313	4,508	4.5%	12.2%	11,440	12,888	12.7%	70.8%
ICBP	6,299	8,167	7,643	-6.4%	21.3%	18,877	23,165	22.7%	76.3%
INDF	14,346	17,700	17,969	1.5%	25.3%	41,279	52,035	26.1%	74.2%
ROTI	350	450	461	2.5%	31.8%	1,057	1,376	30.2%	70.8%
ULTJ	840	1,002	1,042	4.0%	24.0%	2,530	2,945	16.4%	72.1%

Source: SSI estimates, Bloomberg

Figure 5. 3Q14 net income estimates

(in Rp bn)	3Q13	2Q14	3Q14	QoQ	YoY	9M13	9M14	YoY	9M14/ 2014E Cons.
UNVR	1,267	1,487	1,383	-7.0%	9.2%	4,090	4,231	3.4%	73.0%
KLBF	444	500	530	6.0%	19.2%	1,366	1,523	11.4%	69.5%
ICBP	598	650	610	-6.3%	1.9%	1,854	1,949	5.1%	75.2%
INDF	792	1,322	1,025	-22.5%	29.4%	2,566	3,272	27.5%	77.6%
ROTI	15	39	39	-1.0%	155.6%	91	139	53.0%	65.1%
ULTJ	58	35	108	211.0%	84.7%	278	231	-16.7%	58.0%

Source: SSI estimates, Bloomberg

Figure 6. 9M14 earnings announcement date

Company	Date
Unilever Indonesia (UNVR.IJ)	Oct 23-24
Kalbe Farma (KLBF.IJ)	Oct 31
Indofood CBP (ICBP.IJ)	Oct 30-31
Indofood SM (INDF.IJ)	Oct 30-31
Ultrajaya Milk (ULTJ.IJ)	to be confirmed
Nippon Indosari Co. (ROTI.IJ)	to be confirmed

Source: Company

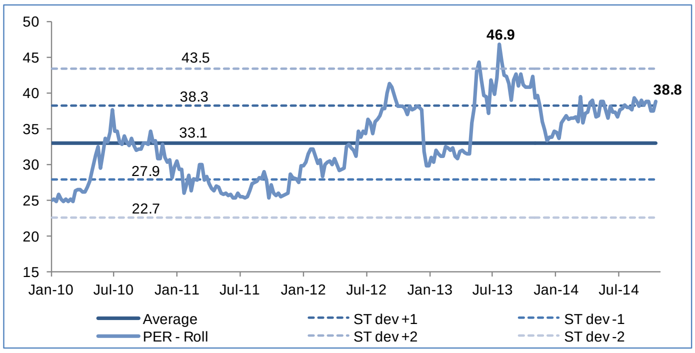
Valuation above trend; upside is limited

Indonesia's promising demographic story, rising middle class and under penetration of most consumer products have boosted consumer stocks' valuation in the last couple of years with the sector is now trading at +1 stdev. above historical mean PE despite the contraction on margins in 1H14. Long term potential remains intact, in our view, supported with continuing development in infrastructure which should lead to increasing penetration of consumer goods nationwide. However, we expect the road to be bumpy in 2015 with government's plan to raise subsidized fuel price now looking imminent in 4Q14. We now have turned cautious on the sector as we expect fuel price increase could temporarily weaken consumer sentiment and demand in the near future, hence creating a tougher environment for consumer companies to pass through the resulting increasing costs. The strongest catalyst for the sector would be Rupiah appreciation—something that our economist does not expect to happen in 2015 given the challenging macro outlook.

The already high valuation and challenges mentioned above should dim the sector's near-term outlook and cap upside potential. However, we believe companies with strong brand equity, competitive position and fundamentals will still be able to generate value to investors. We like INDF and ROTI for their undemanding valuation and strong earnings momentum, and KLBF due to the defensive nature of its pharmaceutical business and its fast-growing, niche market-targeting consumer business which should be resilient during rising inflation environment.

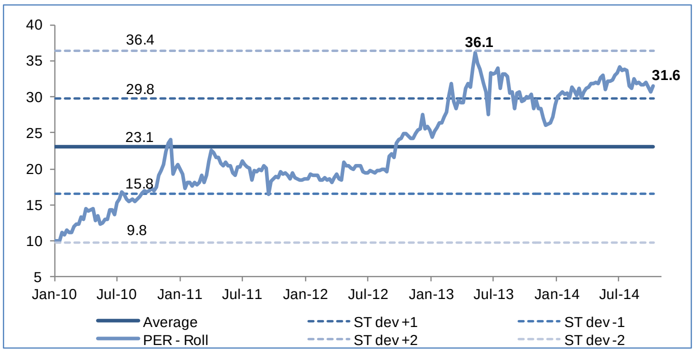
Key charts

Figure 7. UNVR's PE band



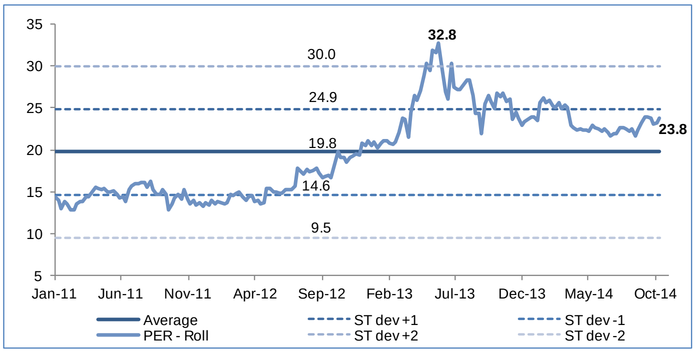
Source: SSI estimates, Bloomberg

Figure 8. KLBF's PE band



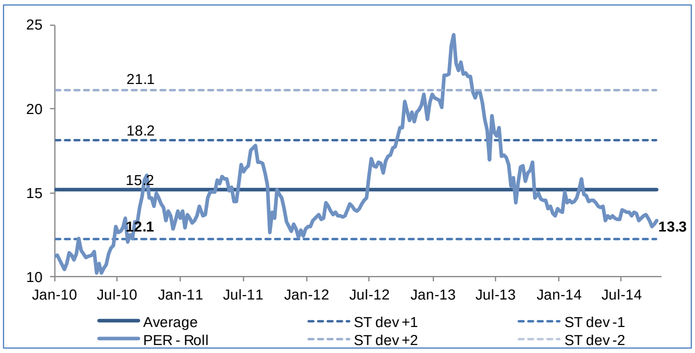
Source: SSI estimates, Bloomberg

Figure 9. ICBP's PE band



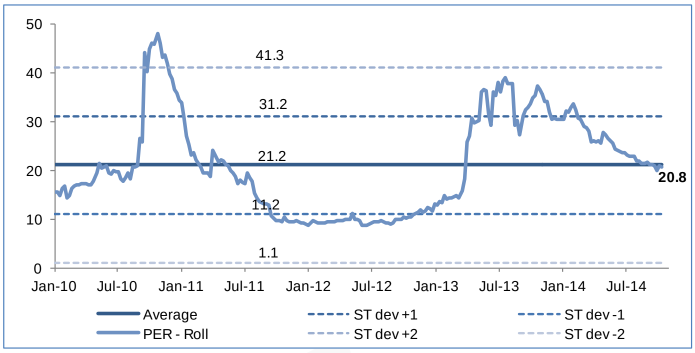
Source: SSI estimates, Bloomberg

Figure 10. INDF's PE band



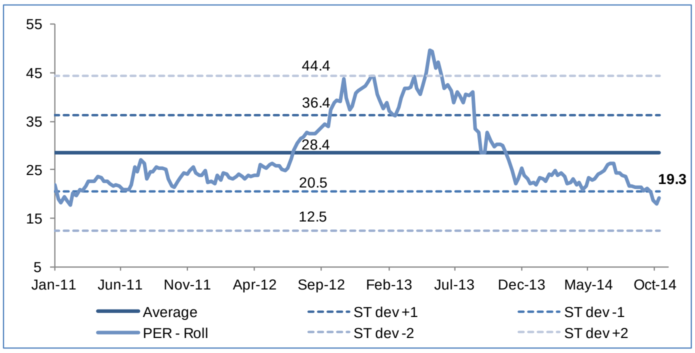
Source: SSI estimates, Bloomberg

Figure 11. ULTJ's PE band



Source: SSI estimates, Bloomberg

Figure 12. ROTI's PE band



Source: SSI estimates, Bloomberg

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