Initiating Coverage

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PT Matahari Department Store Tbk (LPPF)

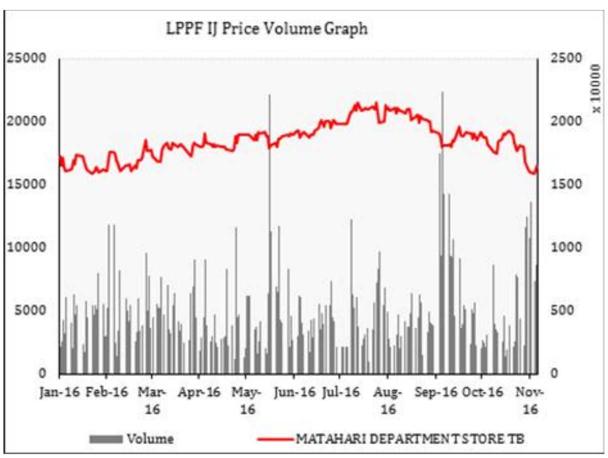
Reverting back to the Norm

BUY

PT Matahari Department Store Tbk engages in the retail business for several types of products including clothes, accessories, bags, shoes, cosmetics, household applicances and management consulting services.

Current Price: IDR 16,500

52-Week Target Price: IDR 20,510



Share Price Performance	
Price (IDR)	16,500
52- Week High (07/14/16)	22,575
52- Week Low (11/16/15)	14,500
52- Week Beta	1.45
YTD Change/%	-4.10%

Stock Information	
Market Cap (IDR)	48,145.6bn
Share Out/Float (M)	2917.9/ 2407.9

Source: Company Data, Bloomberg, Sinarmas Investment Research

We re-initiate our coverage on PT Matahari Department Store Tbk (LPPF) as a BUY, with a 52-week target price of IDR 22,550 representing a 20.6% upside. In light of PT Mulitpolar Tbk' (MLPL) recent sale of LPPF's shares (87.5million), MLPL's stake in LPPF has reduced from 20.5% to 17.5%, which has resulted in a correction in LPPF's valuations reverting back to it's historical mean. With LPPF currently trading at lower multiples compared to it's peers in the retail market, we feel current valuations as being mispriced hence we set our TP at IDR 22,550 based on 12 month forward PE of 25.9x, equivalent to the 3 year mean.

Valuation Mispriced. LPPF's currently trades at a normalized PE of 22.5x, significantly lower than it's 3 year average of 25.9x PE, despite sustainably maintaining vastly superior net margins compared to it's peers (~18% from 2013-2015). If history can be used as a guide, our analysis suggests EPS growth is likely to catalyze the stock in the short term.

Continued Growth despite weaker than expected Lebaran sales. As of 9M16, LPPF continues to see improvements in terms of net revenue, +10% yoy and net income, +16% yoy. Despite the recent management guidance lowering SSSG target for 2016 to below 7% , we remain optimistic that LPPF will book net revenues of IDR 9,919bn and a net income of IDR 2055bn for the year, representing improvements of 10.1%/ 15.4% respectively.

Cost Control. To make up for the substantial increase to the minimum wage level, LPPF has actively used other routes to control it's expenses by agreeing to only using fixed rental agreements for all new Matahari Department Stores (MDS) as well as future store openings. Given that 30% of all MDS' use variable rental agreements, we are encouraged by these pro active actions by management as we forecast that these cost control measures will allow for LPPF to maintain net margins close to 21% for 2017.

Potential Risks: Other than macro risks for 2017, potential delays in execution of store openings and the potential dilution of 10% stake in MatahariMall.com also pose as risks.

Financial Highlights	2014	2015	2016F	2017F	2018F
Net Revenue (IDR Bn)	7,926	9,007	9,919	11,099	12,645
% growth		*13.6%*	*10.1%*	*11.9%*	*13.9%*
Gross Profit (IDR Bn)	5,048	5,671	6,259	6,988	7,976
Net Profit (IDR Bn)	1,419	1,780	2,055	2,306	2,696
% growth		*25.4%*	*15.4%*	*12.2%*	*16.9%*
EV/ EBITDA (x)	3	12	15	22	22
Gross Margin (%)	63.7%	63.0%	63.1%	63.0%	63.1%
Net Margin (%)	17.9%	19.8%	20.7%	20.8%	21.3%
Return on Equity (%)	-608%	271%	136%	98%	81%
Return on Assets (%)	44%	49%	46%	41%	39%

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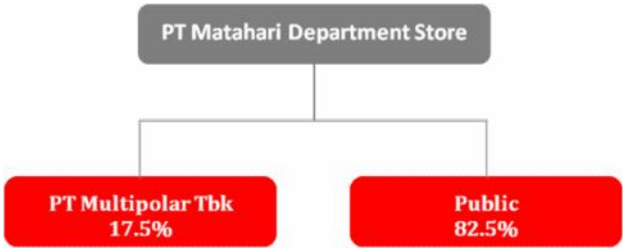
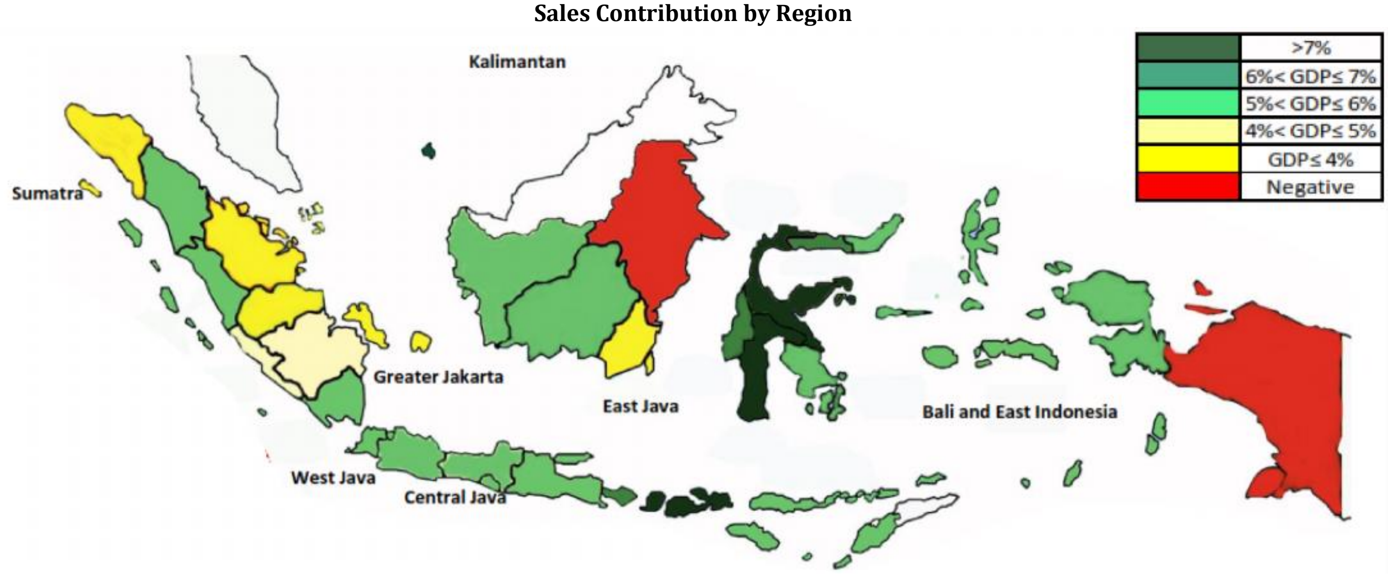
Company Profile



PT Matahari Department Store (LPPF) represents Indonesia's leading department store chain with a total of 148 operational stores in 68 cities across Indonesia. Since introducing the modern department store concept in 1972, LPPF has gone on to become the undisputed leader amongst department store retailers with over 40% market share by gross retail value as well as having the largest loyalty program with over 3.4 million Matahari Club Card (MCC) members.

In accordance with the recent sale of LPPF's shares by PT Multipolar Tbk (MLPL), MLPL's stakes in the company have been reduced to 17.5% from 20.5% previously.

Sales Contribution by Region



As part of LPPF's strong retail presence throughout Indonesia, the company receives sales contributions from all regions of Indonesia with total gross sales contributions of 37.4% , 34.5% and 28.1% for the areas of Outside Java, Java excluding the Greater Jakarta Area and the Greater Jakarta area respectively as of 9M16. In terms of SSSG, Java (excluding Greater Jakarta area) has achieved the highest SSSG at 8.3% whereas the Greater Jakarta area the lowest at 3.5%. Aside from it's nationwide retail presence, LPPF also has a self funding distribution center located in Balaraja (Banten) with 3 hubs located in Bandung, Medan and Surabaya as part of a network with over 1500 drop off points.

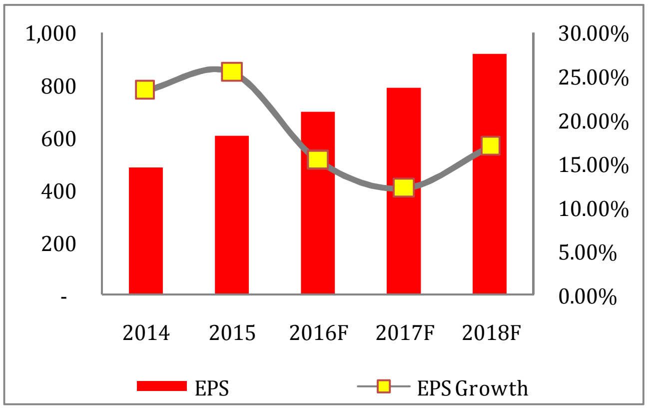
With an average ticket size ranging from IDR 200-250 thousand, LPPF's targeted customer base resides in the middle to low income class representing the largest portion of Indonesia's population. On offering to it's customers, LPPF offers it's own private/ house brand products including it's top selling brand Nevada, which accounts for more than 27% of total direct purchase sales. In addition, LPPF also offers consignment products for which the company takes ~30% overall sales from the vendors as well as additional revenue via consignment fees. As part of the agreement for consignment sales, the employees present in Matahari Department Stores are also supplied by the vendors. Overall, consignment sales contribute to ~65% of overall gross sales with an average selling price between IDR 120-150 thousand whereas direct purchase products range from IDR 60-80 thousand.

On offering to it's customers, LPPF has also begun (as of September 2015) it's penetration into the E-Commerce market by partnering with MatahariMall.com as an exclusive supplier of it's private label products. With an ownership stake of ~9.47% (total investment of IDR 179.8bn) in MatahariMall.com, the delivery method system used includes direct to address, office to office and via e-locker systems.

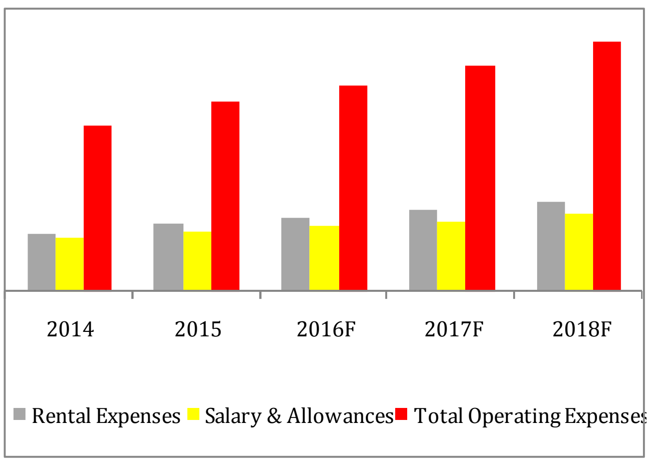
Investment Theses

Catalysts:

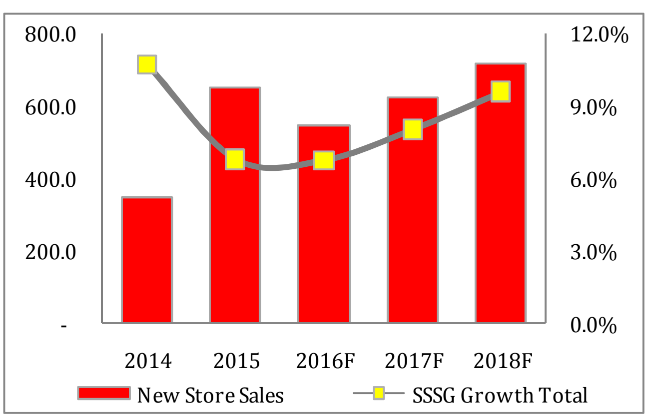
EPS Growth



Breakdown of Expenses



New Store Sales & SSSG



- **Mismatch between Fundamentals and Valuation.** LPPF currently trades at 22.25x PE, 1.8 standard deviations below it's 3 year mean of 25.9x PE. We view current valuations as being mispriced considering that from a fundamental standpoint, LPPF has a much stronger track record with EPS growth of ~24% dating back the past two years. Given favorable macro conditions and continued department store expansion across Indonesia for 2017, growth in EPS should catalyze LPPF's stock in the near term as we forecast LPPF to book EPS figures of IDR 704/ 790 for the years 2016/ 2017 respectively.

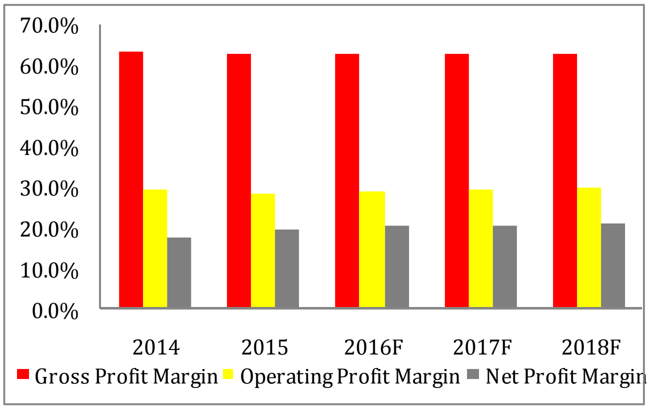
- **Tightening of Expenses.** In anticipation of the rising minimum wage level as LPPF currently have ~70% of employees close to minimum wage level, the company has taken steps to control expenses particularly by agreeing to have fixed rental agreements for all of it's new department stores. Prior to this years new department stores, ~30% of the department stores used variable rental agreements providing a barrier to cost control. On average, rental expenses have been equivalent to ~12% of net revenue and with that management has indicated that all new stores for the year and planned new stores will only be using fixed rental agreements in order to control costs. We feel these are very encouraging signs in order to maintain the high bottom line margins LPPF has historically been able to achieve. Hence for 2017F, we are confident LPPF will be able to control rental expenses to below the expected inflation level.

- **Expansions Set to Continue.** As of 2015, LPPF no longer had any outstanding debts and have been able to finance all planned store refurbishments as well as store openings internally. With a cash position of IDR 671bn as of 9M16 (down from IDR 1802bn as of 6M16), and a well maintained low cash conversion cycle, LPPF's increased budget allocation for 2016 of IDR 400-450bn including 35% for new stores and 20% for refurbishments indicates that expansions are set to continue heading into 2017.

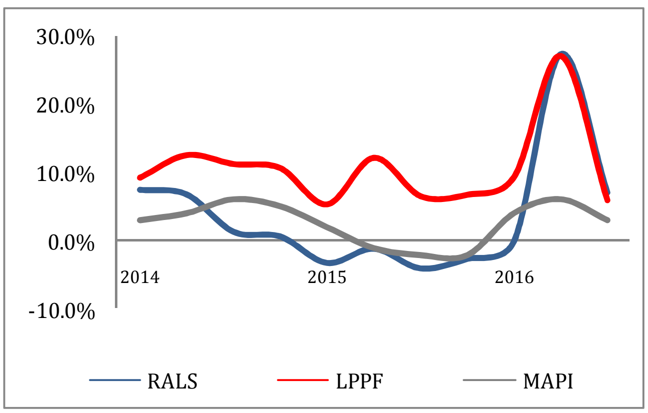
- **Contributions from end of year store openings to contribute to 2017 sales.** With recent store openings at Lippo Kemang Village and Semanggi (South Jakarta) plus two more store openings planned heading into 2017, we believe that significant sales contributions from these stores are likely to only be realized next year. Furthermore given LPPF's track record of sustained new store openings every year, we are optimistic that new store revenues will see improvements in comparison to this years new stores revenue as we forecast revenue from new stores to improve (IDR 623bn for 2017F, +14% yoy).

Source: Sinarmas Investment Research, Company data

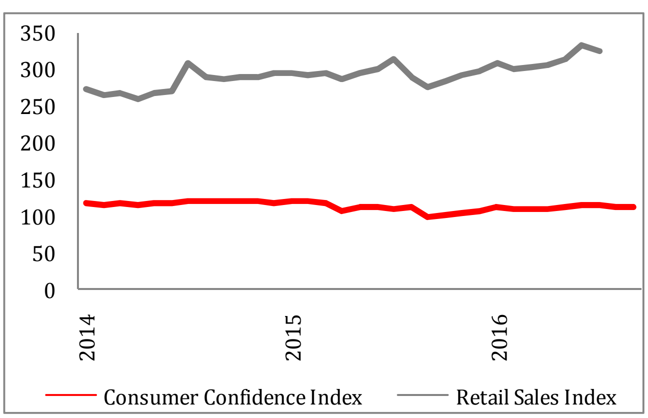
Profitability Margins



SSSG Comparison



National Index Data



Investment Theses

Key Risks:

- **Potential Delays in Store Expansion Plans.** Management tells us that store openings are large dependant on the condition of the economy for the targeted area of potential new stores. Ideally, new store openings should be completed before the Lebaran period as the 44 days prior to Idul Fitri on average has constituted ~27% from total gross sales for a full calendar year. Furthermore, any delays in store additions could impact margins as management tells us that it would typically require 4-5 years for a new store to reach sales levels of more matured stores. From an execution standpoint however, LPPF's track record would suggest that store openings are completed very efficiently as no external funding is required.

- **Potential Dilution of ownership stake in MatahariMall.com.** With the goal of becoming an omni-channel retailer within the next 2 years, LPPF had as of June 2016 invested over IDR 265bn into MatahariMall.com. However, with recent news of MatahariMall.com raising USD 100million in equity financing from investors led by Mitsui & Co, this could potentially dilute LPPF's stake of around 10% in MatahariMall.com. Given the substantial commitment already made by LPPF into the partnership, this news could affect their long term prospects of penetration into the growing online retail market. Furthermore, if LPPF's stake becomes diluted then LPPF may need to reinvest into MatahariMall.com whilst sacrificing company earnings in the near term.

Our Conclusion

- **Fundamentals will pave the way.** If the past is any guidance, short term corrections such as the one currently being endured by LPPF due to the sale of a 3% stake in the company or even threats of E-commerce are pure short term reactions. Historically, the share price has rebounded once fundamentals and valuations are more in line with one another.

- **Good prospects heading into 2017.** LPPF's track record in comparison to it's peers is also supported by a well maintained SSSG which should at the very least be sustainable for next year. Controlled inflation rates, sustained CCI levels and the rising wage level amongst the low to middle income class provides further growth opportunities for LPPF to grow.

- **E-Commerce on the rise, but not a Major Threat in the near term.** Looking ahead, we view online retail shopping as an additional sales channel for retailers but not one which is likely to pose a threat to retailers market share any time soon. Given the current macro challenges still being faced such as poor transport services nationally adding to the high logistic costs, we feel that direct shopping in specialty, department and traditional stores will maintain market share for the near future.

Source: Sinarmas Investment Research, Company data

Appendix I: Retail Sector Data

Matahari Department Store Tbk	2013	2014	2015	2016F	2017F
Number of Employees	13,654	12,594	13,364	14,290	15,410
Number of Stores	125	131	142	150	158
Total Retail Space (sqm)	807,662	856,862	947,062	1,012,662	1,076,662
Space Addition (sqm)	57,639	49,200	90,200	65,600	64,000
SSSG (%)	**12.1%**	**10.7%**	**6.8%**	**6.8%**	**8.1%**

Ramayana Lestari Sentosa Tbk	2013	2014	2015	2016F	2017F
Number of Employees	15,632	13,845	12,782	12,567	12,719
Number of Stores	116	114	112	113	116
Total Retail Space (sqm)	1,006,781	988,787	975,843	984,556	1,009,200
Space Addition (sqm)	44,214	(17,994)	(12,944)	8,713	24,644
SSSG (%)	**2.2%**	**0.6%**	**-2.7%**	**7.8%**	**8.1%**

Matahari Putra Prima Tbk	2013	2014	2015	2016F	2017F
Number of Employees	12,564	13,689	13,169	13,245	13,327
Number of Stores	221	267	296	321	352
Total Retail Space (sqm)	643,857	699,374	736,153	780,164	824,940
Space Addition (sqm)	89,158	49,795	36,779	44,011	44,776
SSSG (%)	**4.5%**	**5.4%**	**-1.9%**	**2.0%**	**5.6%**

Mitra Adi Perkasa Tbk	2013	2014	2015	2016F	2017F
Number of Stores	1,779	1,872	1,938	2,043	2,148
Total Retail Space (sqm)	650,478	669,179	698,082	728,322	758,562
Space Addition (sqm)	80,226	18,701	28,903	30,240	30,240
SSSG (%)	**3.0%**	**5.0%**	**-2.0%**	**5.0%**	**5.0%**

Ace Hardware Indonesia Tbk	2013	2014	2015	2016F	2017F
Number of Employees	10,915	11,746	11,348	10,913	11,208
Number of Stores	115	135	145	155	178
Total Retail Space (sqm)	275,994	309,494	328,324	347,324	392,374
Space Addition (sqm)	44,464	33,500	18,830	19,000	45,050
SSSG (%)	**4.9%**	**3.7%**	**0.5%**	**2.0%**	**3.0%**

Source: Sinarmas Investment Research, Company data

Appendix II: Financial Statements

Balance Sheet (IDR Bn)	2013	2014	2015	2016F	2017F	2018F
Cash & Cash Equivalents	772.22	785.90	946.66	1,737.09	2,694.95	3,990.33
Trade Receivables	32.79	45.06	39.31	42.89	47.98	54.67
Other Receivables	30.15	64.32	36.71	41.34	46.25	52.70
Inventory	723.81	955.23	1,007.81	1,099.44	1,176.36	1,278.99
Other Current Assets	144.14	266.69	242.45	268.20	297.26	337.31
Fixed Assets	727.19	725.95	876.57	1,039.24	1,157.41	1,235.25
Other Non-Current Assets	615.37	594.36	739.79	753.81	773.21	788.19
Total Assets	3,045.65	3,437.51	3,889.29	4,982.00	6,193.43	7,737.44
Account Payables	1,358.88	1,559.49	1,703.74	1,882.36	2,096.00	2,385.67
Other Current Liabilities	531.30	959.04	735.27	811.65	908.57	1,039.54
Other Non-Current Liabilities	1,828.07	712.26	344.11	373.27	406.68	447.76
Total Liabilities	3,718.25	3,230.78	2,783.12	3,067.29	3,411.25	3,872.97
Total Equity	(672.98)	206.26	1,106.17	1,914.71	2,782.18	3,864.47

Income Statement (IDR Bn)	2013	2014	2015	2016F	2017F	2018F
Retail Sales	4,043.6	4,898.7	5,729.1	6,250.0	6,993.0	7,967.4
Consignment Sales	8,695.1	9,552.0	10,353.9	11,295.3	12,638.1	14,399.0
Revenues	12,738.8	14,450.7	16,083.0	17,545.3	19,631.1	22,366.4
Net Revenue	6,754.3	7,925.5	9,006.9	9,919.3	11,098.5	12,644.9
Cost of Goods Sold	2,391.1	2,877.5	3,336.0	3,660.0	4,110.7	4,668.5
Operating Expense	2,369.3	2,701.9	3,089.6	3,381.7	3,730.2	4,161.8
Depreciation & Amortization	212.6	235.0	252.1	300.9	362.7	426.8
Operating Income	1,781.3	2,111.2	2,329.1	2,576.7	2,894.9	3,387.7
EBITDA	1,994.0	2,346.2	2,581.3	2,877.7	3,257.6	3,814.6
Finance Income	17.9	22.6	30.8	24.4	23.9	25.4
Income before Tax	1,523.8	1,850.7	2,244.4	2,601.1	2,918.8	3,413.2
Tax Expense	373.5	431.4	464.0	546.2	613.0	716.8
Net Profit	1,150.4	1,419.3	1,780.4	2,054.9	2,305.9	2,696.4
net profit growth		23.4%	25.4%	15.4%	12.2%	16.9%

Source: Sinarmas Investment Research

Appendix III: Financial Ratios

Financial Ratios	2013	2014	2015	2016F	2017F	2018F
Profitability						
ROE	-88.3%	-608.2%	271.3%	136.0%	98.2%	81.1%
ROA	38.5%	43.8%	48.6%	46.3%	41.3%	38.7%
Gross Profit Margin	64.6%	63.7%	63.0%	63.1%	63.0%	63.1%
Operating Profit Margin	29.5%	29.6%	28.7%	29.0%	29.4%	30.2%
Net Profit Margin	17.0%	17.9%	19.8%	20.7%	20.8%	21.3%
Valuation						
EPS	394.24	486.41	610.17	704.22	790.24	924.08
P/E	41.85	33.92	27.04	23.43	20.88	17.86
EV/EBITDA	3.93	3.32	12.07	14.61	19.08	18.84
Liquidity						
Current Ratio	0.90	0.84	0.93	1.18	1.42	1.67
Quick Ratio	0.44	0.36	0.42	0.68	0.93	1.20
Cash Conversion Cycle	(78.36)	(57.87)	(70.62)	(71.82)	(76.12)	(80.40)
Activity						
Receivables						
turnover	107.33	72.46	118.47	117.77	117.77	117.77
days	3.40	5.04	3.08	3.10	3.10	3.10
Inventories						
turnover	3.30	3.01	3.31	3.33	3.49	3.65
days	110.49	121.17	110.27	109.64	104.45	100.00
Payables						
turnover	1.90	1.98	1.98	1.98	1.99	1.99
days	192.25	184.07	183.97	184.56	183.67	183.49
Asset Turnover	5.35	5.95	6.13	5.82	5.96	6.40
Fixed Asset Turnover	**9.51**	**10.91**	**11.24**	**10.36**	**10.10**	**10.57**
NWC Turnover	**(6.04)**	**(7.43)**	**(8.08)**	**(7.52)**	**(7.28)**	**(6.93)**
Solvency						
Debt Equity Ratio	(2.37)	3.34	-	-	-	-
Financial Leverage	(13.89)	5.58	2.94	2.38	2.10	1.92

Source: Sinarmas Investment Research

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