

5 September 2013

NIPPON INDOSARI CORPINDO TBK

The Ripple Effect of Labor Strikes

BUY

We revised down our 2013 earnings estimates by 11% to IDR 170/share as the second quarter results fell short of expectations, bringing down the first half earnings to IDR 75/share, grew by 5% yoy. The drop was mainly caused by the higher interest expense as the company issued new bond on June 2013, higher salary expenses to comply with the new minimum wage regulation and higher travel expenses during the labor strikes. On the revenue side, the company scored 24% yoy growth, slightly below our prior expectation at 28% yoy.

Maintain BUY, Reduced TP to 7,400, 22% Upside Potential

We maintain our BUY rating with a lower price target of IDR 7,400 which implies a forward 2013 P/E of 36x. We derived our 2013 target price based on the company's plan to ramp up 5 - 10 production lines each year. Heretofore, the company has secured IDR 707 billion or 47% of our latest FY 2013 forecast at IDR 1,508 billion. Key risks to our target are: (1) higher raw material price, especially wheat price; (2) delay in factory construction; (3) tightening competition in mass-produced bread market.

Labor Strikes Trimming Down The Production Rate

During May 2013, three factories in West Java were hit by a series of labor strikes. The striking workers were demanding another wage increases after the first one taking effect in the first quarter. Fortunately, the company has managed to retain the production level on the second strike by sending the workers from the other factories and dispelled all the trouble workers without paying any severance. For the latter, the management said that they have made an agreement with the workers for not doing any strike, but unfortunately the workers broke it.

Targeting Lower Return Rate

It was clear that the sales return is one of the biggest risk faced by a short shelf-life bread producer, such as ROTI. It erodes the profitability as the defective products became a total waste. While the company has managed to reduce the sales return ratio to 11.4% in the first quarter, the ratio spiked up again lately due to lower-than-estimate sales in Palembang and Makassar, the latest sales point of ROTI. Nevertheless, the average sales return ratio for the first half of 2013 was at 12.5%, much below the last year's number at 14.3%, so we are still optimistic that the sales return are still on track to reach the 11.5% target ratio, up 200bp from a year before.

Christandi Rheza Mihardja

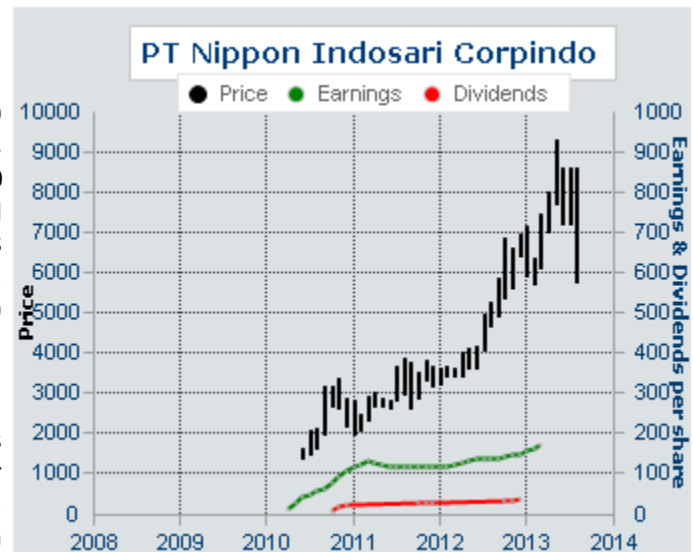
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Stock Data

Sector	FMCG
Price	6,000
12-month Target Price 2012	7,400
12-month Rating	Buy
Prior	Hold
Ticker	ROTI.IJ (BBG)
Market Cap	IDR 6,175 Bn
Shares Outstanding	1,012 Mn

ROTI Performance



Source: www.corporateinformation.com

In bn	FY 2011	FY 2012	2013F	2014F	2015F
Revenues	813	1,191	1,508	2,009	2,479
Growth	33%	46%	27%	33%	23%
EBIT	146	186	248	330	390
Net Income	116	149	172	215	256
EPS (IDR)	115	147	168	183	220
Growth	16%	29%	14%	9%	20%
Net DPS	25	29	36	33	28

In mn IDR except per share data; Source: Bloomberg, Company data, Sinarmas Sekuritas Research

Profitability	FY 2011	2012E	2013F	2014F	5y avg
Gross Margin %	46.7	46.7	45.9	45.8	46.1
EBIT Margin %	18	15.6	16.5	16.4	16.5
EBITDA Margin %	21.0	19.1	20.3	20.0	19.3
P/E x		48.5	35.9	28.7	24.2
Net DPR	22%	19%	20%	20%	20%

Source: Bloomberg, Company data, Sinarmas Sekuritas Research

Top Holders	
PT Dyviacom Intrabumi Tbk	31.5%
Bonlight Investments Ltd	26.5%
Shikishima Baking Co Ltd	8.5%

Source: Bloomberg

Soaring Wheat Price Would Not Cut The Level of Gross Margin

Wheat price has rebounded from the lowest level on July 2013 to near IDR 7,500,000/bushel amid the IDR depreciation against USD combined with heatwave in the US which threatened to devastate crop yields. However, while the company is using FIFO to manage their inventory, the price hike will only take effect starting from the fourth quarter of 2013. Hence we believe that even without increasing the ASP, ROTI would be able to maintain 2013 gross margin level at around 46% this year. For the next year, their plan to increase the ASP by at least 10% would help them to pass through the increasing raw materials cost.

Sixty Percent of The Allocated Capex Has Been Realized

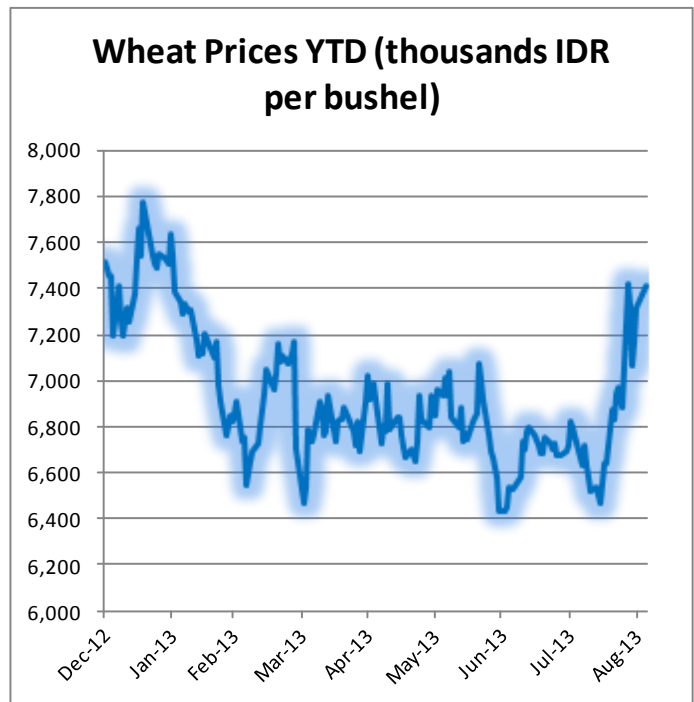
The company has issued IDR 500 billion bonds in June 2013 paying interest rate of 8% p.a. to finance construction of new plants. Starting from 2014, the company targets to ramp up 5 - 10 production lines each year to suffice ever growing convenience food demand. We estimate, the company's net debt to equity ratio will rise to 1.2x in 2013E and 1.4x in 2014F. On the other hand, it would lead to an additional interest expense of approximately IDR 30 bn. By contrast, we consider this level was still manageable and poses no significant threat. Up to the first half of 2013, ROTI has realized capex worth of IDR 237 billion in order to build 2 new factories in Cikande and Purwakarta, while expanding the existing ones in Pasuruan. The significant rise in each plant budget was caused by higher industrial land prices. We expect this year's expansion could add up production capacity by 30%.

Table 1: Sensitivity Analysis

Sensitivity Analysis FY13E	FY13E OP impact(%)	FY13E NOPAT impact(%)
Wheat Price +/- 1% change	0.8%	0.8%
Sugar Price +/- 1% change	0.1%	0.1%
Packaging Price +/- 1% change	0.3%	0.3%
Sales Return +/- 100bp changes	2.9%	2.3%
ASP Increase +/- 1% change	2.4%	2.5%
Delay in Factory Construction 1y delayed	6.2%	6.7%

Source: Company, Sinarmas Investment Research

Table 2: Wheat Price Has Surged Since End of July



Source: Bloomberg, Sinarmas Investment Research

IDR in bn	FQ2 2011	FQ2 2012	FQ2 2013	CQ2 2011	CQ2 2012	CQ2 2013	FY 2011	2012E	2013F
Revenue	194	297	350	366	570	707	813	1,191	1,508
<i>growth</i>		<i>53%</i>	<i>18%</i>		<i>56%</i>	<i>24%</i>	<i>35%</i>	<i>46%</i>	<i>27%</i>
<i>% of FY</i>	<i>24%</i>	<i>25%</i>	<i>23%</i>	<i>45%</i>	<i>48%</i>	<i>47%</i>			
Sweet Bread Sari Roti	133	227	196	253	361	398	574	862	1,091
White Bread Sari Roti	92	110	200	170	286	392	358	471	600
Sales Returns	(33)	(42)	(48)	(61)	(81)	(89)	(129)	(152)	(196)
<i>% of sales</i>	<i>17%</i>	<i>14%</i>	<i>13.7%</i>	<i>17%</i>	<i>14.3%</i>	<i>12.5%</i>	<i>16%</i>	<i>13%</i>	<i>13%</i>
Cost of Revenue	105	156	196	196	307	380	434	634	816
Gross Profit	89	140	154	171	264	327	379	556	692
Operating Expenses	56	90	124	103	173	223	233	370	443
Operating Income	33	50	30	67	91	104	146	186	248
<i>margin</i>	<i>17%</i>	<i>17%</i>	<i>8%</i>	<i>18%</i>	<i>16%</i>	<i>15%</i>	<i>18%</i>	<i>16%</i>	<i>16%</i>
Interest Expense	-	-	8	-	-	11	-	-	40
Pretax Income	33	53	27	69	97	102	161	199	229
Income Tax Expense	8	14	7	17	25	27	39	51	57
Net Income	25	40	20	52	72	76	116	149	172
<i>margin</i>	<i>13%</i>	<i>13%</i>	<i>6%</i>	<i>14%</i>	<i>13%</i>	<i>11%</i>	<i>14%</i>	<i>13%</i>	<i>11%</i>
<i>% of FY</i>	<i>21%</i>	<i>27%</i>	<i>11%</i>	<i>45%</i>	<i>48%</i>	<i>44%</i>			
<i>growth</i>		<i>61%</i>	<i>-50%</i>		<i>40%</i>	<i>5%</i>	<i>16%</i>	<i>29%</i>	<i>15%</i>
Basic EPS	24	39	20	51	71	75	115	147	170

Source: Company, Sinarmas Investment Research

Income Statement

IDR in bn	FY 11	FY 12E	FY 13E	FY 14E	FY 15E	Cash Flow IDR in bn	FY 11	FY 12E	FY 13E	FY 14E	FY 15E
Revenues	813	1,191	1,508	2,009	2,479	Net Income	116	149	172	215	256
<i>growth</i>	<i>35%</i>	<i>46%</i>	<i>27%</i>	<i>33%</i>	<i>23%</i>	Adjustments	24	41	58	72	89
EBITDA	170	227	306	403	479	Net Working Capital	6	1	(12)	1	(4)
<i>growth</i>	<i>26%</i>	<i>33%</i>	<i>35%</i>	<i>32%</i>	<i>19%</i>	Cash From Op.	146	191	218	289	340
EBIT	146	186	248	330	390	Net Change in Capex	(224)	(389)	(356)	(356)	(349)
<i>growth</i>	<i>28%</i>	<i>27%</i>	<i>33%</i>	<i>33%</i>	<i>18%</i>	Sales of FA	0	0	(0)	-	-
<i>EBIT Margin</i>	<i>18%</i>	<i>16%</i>	<i>16%</i>	<i>16%</i>	<i>16%</i>	Changes in minority	-	-	-	-	-
Net Interest	-	-	(40)	(68)	(80)	Changes in OA	(13)	(68)	31	(36)	(39)
Earnings before tax	157	200	229	287	341	Cash From Inv.	(238)	(457)	(326)	(392)	(389)
Tax	39	51	57	72	85	Capital Issues	-	-	-	-	-
<i>tax rate</i>	<i>25%</i>	<i>25%</i>	<i>25%</i>	<i>25%</i>	<i>25%</i>	Dividends Paid	(25)	(29)	(34)	(43)	(51)
Net income	116	149	172	215	256	Changes in Debt	33	270	397	300	-
<i>growth</i>	<i>16%</i>	<i>29%</i>	<i>15%</i>	<i>25%</i>	<i>19%</i>	Other Fin. Act.	11	15	2	17	15
Shares Outstanding	1,012	1,012	1,012	1,012	1,012	Cash From Fin.	19	255	364	274	(36)
EPS	115	147	170	212	252	Beginning Cash	121	48	38	294	465
<i>growth</i>	<i>16%</i>	<i>29%</i>	<i>15%</i>	<i>25%</i>	<i>19%</i>	Net Changes in Cash	(72)	(11)	256	171	(84)
						Ending Cash	48	38	294	465	381

Balance Sheet

IDR in bn	FY 11	FY 12E	FY 13E	FY 14E	FY 15E	Ratio Analysis	FY 11	FY 12E	FY 13E	FY 14E	FY 15E
Cash	48	38	294	465	381	EBITDA Margin	20.9%	19.1%	20.3%	20.0%	19.3%
AR	103	136	152	202	249	Operating Margin	18.0%	15.6%	16.5%	16.4%	15.7%
Inventories	16	23	46	62	76	Net Margin	14.3%	12.5%	11.4%	10.7%	10.3%
Others	22	23	29	38	47	Sales growth	35.3%	46.4%	26.6%	33.2%	23.4%
Current assets	190	220	521	767	753	Net profit growth	16.2%	28.7%	15.4%	25.0%	18.8%
Net fixed assets	546	894	1,193	1,476	1,736	EPS growth	16.2%	28.7%	15.4%	25.0%	18.8%
Others	23	91	60	97	136	Net debt to equity	0.39	0.81	1.21	1.40	1.22
Total Assets	759	1,205	1,774	2,340	2,626	Sales/assets	1.07	0.99	0.85	0.86	0.94
Short term Liabilities	148	195	422	299	865	Assets/equity	1.39	1.81	2.21	2.40	2.22
Long term Liabilities	64	343	548	1,065	580	ROE	21.2%	22.4%	21.4%	22.0%	21.6%
Total Liabilities	213	538	970	1,364	1,445						
Shareholders' Equity	546	667	804	976	1,181						
Minority Interest	-	-	-	-	-						
Total	759	1,205	1,774	2,340	2,626						

Source: Company, Sinarmas Investment Research

Date	Coverage	Recommendation	Valuation
18-Aug-10	Initiation	Buy	1,800
18-Feb-11	Update	Buy	3,000
19-Jul-11	Update	Overweight	3,800
1-Nov-11	Update	Buy	4,100
8-May-12	Update	Buy	4,600
6-Aug-12	Update	Buy	5,200
2-Nov-12	Update	Hold	6,200
10-Apr-13	Update	Hold	7,800
1-May-13	Update	Buy	8,800
5 Sep 13	Update	Buy	7,400

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