

We had the chance to visit one PT Surya Pertiwi Tbk. (SPTO)'s manufacturing factory located at Surabaya, named Surya Pertiwi Nusantara (SPN). Here are some of the key takeaways and management updates. TOTO is a Japanese brand which leads in current Indonesia's sanitary industry. The factory was fully operated since Oct 2018 and is built on 34k ha of land. PT Surya Pertiwi Tbk. (SPTO) and PT Surya Toto Indonesia Tbk. (TOTO) hold 51%/49% of ownership in SPN respectively. In terms of production, SPN currently has one production line with the capacity of producing 58k goods per month. SPN's total field is able to accommodate up to 10 production lines.

Brief introduction of SPTO. SPTO is the sole distributor of TOTO products in Indonesia which holds ~50-55% of market share in sanitary products and bathroom fittings products. The company has been exclusively distributing the brand, which is produced by the sister company, TOTO, from 1978. In addition, the company also distributes several higher-end brands which are Geberit, Stiebel Eltron, and Villeroy and Boch. Starting from 2018, SPTO also manufactures lower-end TOTO products which are capable of supporting significant capacity growth over the next decades.

SPN's 1st production line. It manufactures squatting and sitting toilet as well as lavatory products with 58k units of monthly products capacity. The line combines manual and robotic method within the process (~80%/20% manual and robotic proportion). Management reports that currently its average yield is at 82% (Robotic yield: 85-90%; Manual yield: 65-75%). It currently manufactures 14 SKUs.

Plan to add the second production line. The company is currently planning to establish the second production line with a capacity of 45k products each month and is targeted to start operations in 2020. This line is going to be 100% manual. The expansion is forecasted to cost around IDR 390bn of investment which is financed by the remaining IPO proceeds and bank loans. Through the additional line, SPTO aims to add more varieties of products which have higher varieties (23 SKUs).

Production process:

SPTO applies the same productions and quality control with that of applied in TOTO's factories all over the world. Raw materials required for the production consist of around 80% import of materials. Firstly, clay and some other basic materials are mixed continuously. The mixture then flows through pipes into the designated mold. After being left for about 7 hours, the hardened mold is pulled out and is checked thoroughly. It is then left dried for a few hours until completely ready for the next steps. The half finished products are washed and then put into glazing process. Afterwards, they are painted by using robotic paint sprayer. Having done painted and stamped by brand, the products are burned for 16 hours. Following the cooling down process, the products enter several steps of quality control process which then continued by attaching spare parts. Finally, they go into packaging process and are ready to be shipped.

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Production process at SPN

Raw materials are processed



Channeled through pipe into mold



Body is checked before pulled out



Left for drying



Glazing process



Painting process



Burning process



Quality control process



Source: Sinarmas Investment Research

Robotic production process for one series of SKU



Source: Sinarmas Investment Research

Key catalysts for SPTO:

- **Higher demand.** Driven by stricter government's policies on the back of concerns from environmental issues, Surya Toto receives abundant demand for exports to China. Therefore, SPTO plans to expand its production lines as it receives more demand for production on the back of shifting production for lower-end products from Surya Toto.
- **Improving margin from the manufacturing business.** The manufacturing business line should contribute higher margin at the gross level. The higher capacity that SPN would have through the additional second production line would drive to better profitability. Currently the first line is still loss making due to relatively high defect rate as employees are still learning and high fixed costs incurred (salary and depreciation expense). Going ahead, SPN is expected to start turning profitable as utilization would improve and labors have better skills and experience which is supposed to lead to lower defect rate.
- **More product varieties.** SPTO aims to serve wider range of the sanitary market by having 23 SKUs for its next production line (vs 14 SKUs at the first line). The products would touch lower pricing points which is beneficial for attracting customers to switch from squatting to sitting toilet.

Challenges toward the factory development:

- **Labor-intensive business nature.** The company adopts a labor-intensive manufacturing process since robotic machine is still very costly. SPN has 520 of total employees at this time and expects to see additional workers at around 400 persons for operating the second line. SPN's labor cost currently stands at average of IDR 6mn per month, while TOTO's labor cost is at avg. of IDR 12mn per month. The company has to offer attractive wages to minimize turnover since the manufacturing process requires relatively high labor skills. Hence the workers need several months of training process and that high turnover might would to higher defect rate.
- **Bottleneck production process.** There is a bottleneck process in the production line at kiln as the products require to be burned for about 16 hours where capacity is limited. This should be improved by the construction of second kiln in 2019.

Overall development for SPN's site. In addition to the second production line, the company would be developing warehouse for inventories, water pond to better improve efficiency as it has high usage of water, as well as employee facilities.

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