

We initiate coverage on PT Pabrik Kertas Tjiwi Kimia Tbk (TKIM) with BUY recommendation and 52-week target price of IDR 23,250.

Our TP represents a potential upside of 57.4%, derived from 12x FY19F PE. TKIM's performances are expected to grow significantly this year, on the back of supportive pulp supply-demand which translates to favorable pulp price, along with larger contributions from its subsidiary, OKI mills. In addition, TKIM's strategy to convert some of their production lines from white paper to industrial brown paper should support their profitability in the next upcoming years. Valuation wise, we believe TKIM is attractive as it is trading at 7.8x forward PE.

Supportive supply-demand translates to strong pulp price. We maintain our optimism on pulp and paper industry due to: 1) pulp supply consolidation as there is no any addition after OKI's 2.8mn tons, 2) strong demand on pulp and its downstream products (pulp, packaging and tissue is expected to grow with 4%, 3% and 5% CAGR FY16-20F from RISI). Moreover, pulp demand is accelerating supported by China's policy to ban recycle and waste paper, which was effectively implemented since January 2018. Tight supply coupled with strong demand has led global pulp price to ride the uptrend wave. As of June 2018, China BHKP pulp price has stood at USD 769/ton and is expected to further rise and past USD 800/ton in the upcoming months.

OKI: the game changer for TKIM. The huge investment in OKI has started bringing positive results to TKIM since 2017, and should grow significantly this year and afterwards, given the ramping up of pulp production to 2.5mn tons (89.2% utilization rate) this year alongside with the commencement of tissue plant in 2H18. Equipped with the most advanced technology, OKI has become one of the most efficient pulp and paper mills in the world, with an advantage in lower cash cost (~20% compared to INKP's). In addition, OKI will enjoy 10-years tax holiday (0% for the first 8 years, followed by 50% for the last 2 years) once it operates the tissue plant. As OKI's performance jumps, we expect it will contribute USD 300mn to TKIM in 2018, increasing significantly from USD 50mn from the previous year.

Shifting to industrial brown paper. To boost profitability in TKIM, the company will convert some portion of its white paper into industrial brown paper production. Note that industrial brown paper generates much better profitability despite its lower pricing compared to white paper. Therefore, we expect TKIM non OKI's margin to expand in the upcoming years.

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Stock Information

Sector	Pulp and Paper
Bloomberg Ticker	TKIM IJ
Market Cap. (IDR tn)	45.6
Share Out./Float (mn)	3,113/1,255
Current Price	IDR 14,775
End-of-FY19 Target Price	IDR 23,250
Upside (%)	57.4%

Share Price Performance

52W High (06/22/18)	18,450
52W Low (08/14/17)	1,215
52W Beta	0.36
YTD Change (%)	405.9%

Relative Valuations

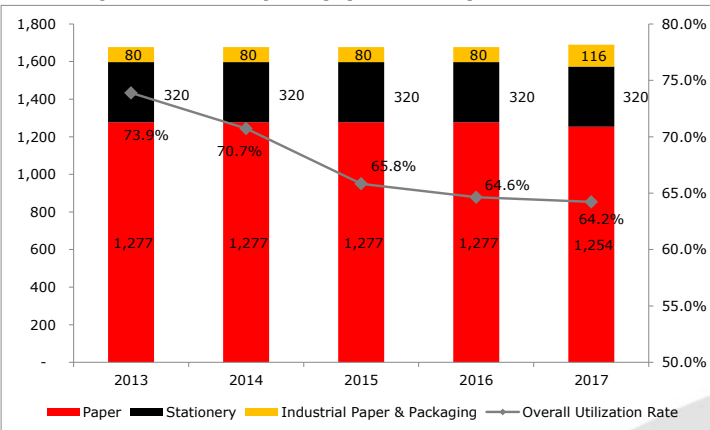
Trailing P/E	18.4x
Forward P/E	7.8x
P/BV	1.9x
EV/EBITDA	38.3x

Highlights (USD Mn)	2016	2017	2018E	2019F	2020F
Revenue	997	1,012	1,064	1,086	1,071
% growth	-6.2%	1.5%	5.2%	2.0%	-1.4%
Gross Profit	110	109	112	123	133
Net Profit	8	27	330	415	435
% growth	427.1%	256.9%	1106.5%	26.1%	4.8%
Gross Margin (%)	11.0%	10.8%	10.5%	11.3%	12.4%
Net Margin (%)	0.8%	2.7%	31.0%	38.2%	40.6%
Return on Equity (%)	0.8%	2.8%	25.0%	24.4%	20.8%
Return on Assets (%)	0.3%	1.1%	11.5%	12.7%	12.1%
EPS (USD)	0.003	0.009	0.106	0.133	0.140

Company Background

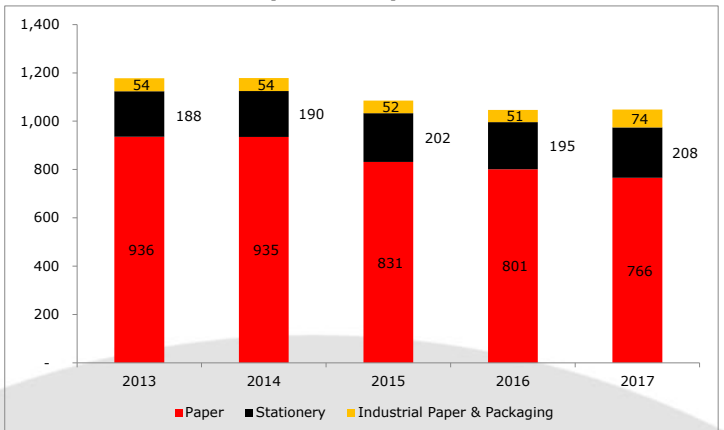
TKIM at a glance. PT Pabrik Kertas Tjiwi Kimia Tbk (TKIM), which was established in 1972, is one part of Sinarmas Asia Pulp and Paper (APP). At first, TKIM started its business producing only soda and other chemicals. In 1978, the company began producing paper products with capacity of 12,000 tons per annum. Currently, the company has production facilities in Sidoarjo, East Java with total annual production capacity in 2017 of 1,253,500 tons of paper, 116,000 tons of packaging and 320,000 tons of stationary. With a total of 1,690,000 tons production capacity, overall utilization rate has reached 64.2% in 2017.

TKIM's production capacity ('000 tons) and utilization rate



Source: Company Data, Sinarmas Investment Research

TKIM's sales volume ('000 tons)



Source: Company Data, Sinarmas Investment Research

TKIM's products and brands



Office Supplies



School Stationery



Drawing Books

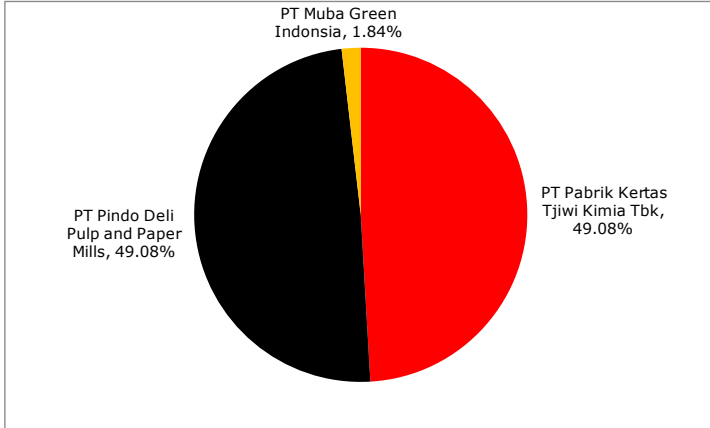


Photocopy Papers

Source: Company Data

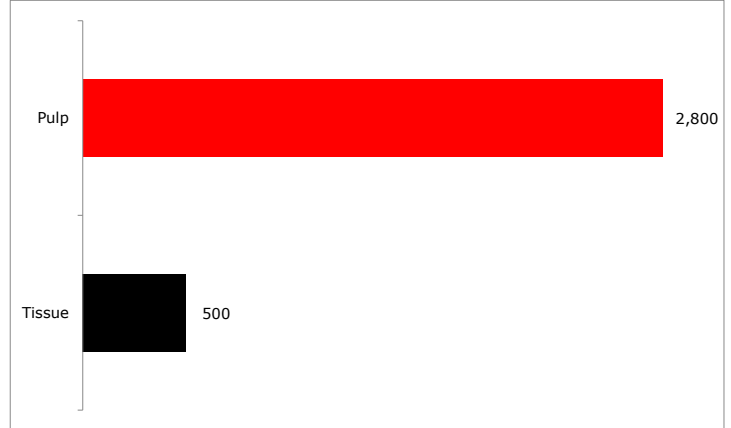
OKI Pulp and Paper Mills. OKI mills, located in Palembang, South Sumatra is an associate company of TKIM (49.08% ownership), built with total area of 1,700ha. OKI engages in pulp production since 2017 with total annual capacity of 2,800,000 tons. In addition, it will commence its tissue production (jumbo roll size) starting 2H18 and is expected to have a total annual production capacity of 500,000 tons. Note from the management, OKI's products will mostly be aimed at the export market (80% and 95% from pulp and tissue respectively).

OKI's structure



Source: Company Data, Sinarmas Investment Research

OKI's target production capacity ('000 tons)



Source: Company Data, Sinarmas Investment Research

Source: Company Data

Investment Theses

Bullish industry outlook. At current, pulp price continued to ride its uptrend wave following the stellar jump in 2017 supported by favorable supply-demand. Consolidation in supply bounds to happen as there should be no further addition after the 2.8mn tons from OKI mills in 2018, coupled with several shutdowns of China's small and medium pulp manufacturer (Guaiba CMPC, Rizhao April and Jiangmen April plants) due to maintenance. Contrariwise, pulp demand remain robust and still growing. China, one of the largest economy in the world, is still seeing potential growth in their paper and board (P&B) consumption (+1.5% CAGR FY11-16), driven by two leading contenders namely packaging and tissue demand (+1.9% and +4.5% CAGR respectively). China's tissue consumption is seen at 5.6kg/capita, comparatively low compared to the mature markets' at >10kg/capita. We believe this would translate to strong pulp demand given China's huge dependence on imported pulp to satisfy 2/3 of its domestic needs. Moreover, China's commitment to resolve pollution by banning 24 recyclables and solid waste, which was effectively implemented since January 2018, became a blessing for pulp demand. Indonesia as one of the biggest producer of hardwood pulp, should be benefited from this growing pulp demand. Pulp price has stood strong at USD 769/ton as of June 2018, and is expected to keep rising and could past USD 800/ton in the near future.

No major addition of pulp supply in the near term



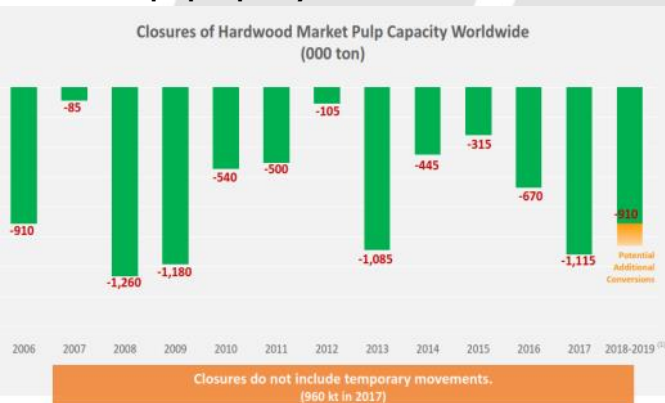
Source: Hawkins Wright, Poyry and Fibria Analysis

Downstream paper products capacity expansion

	2016	2017	2018F
Woodfree	-355	150	715
China	155	890	510
Rest of the World	-510	-740	205
Tissue	1535	2380	3525
China	1000	1170	1945
Rest of the World	535	1210	1580
Cartonboard & Specialty	2630	110	765
China	1550	0	100
Rest of the World	1080	110	665

Source: Fibria, Sinarmas Investment Research

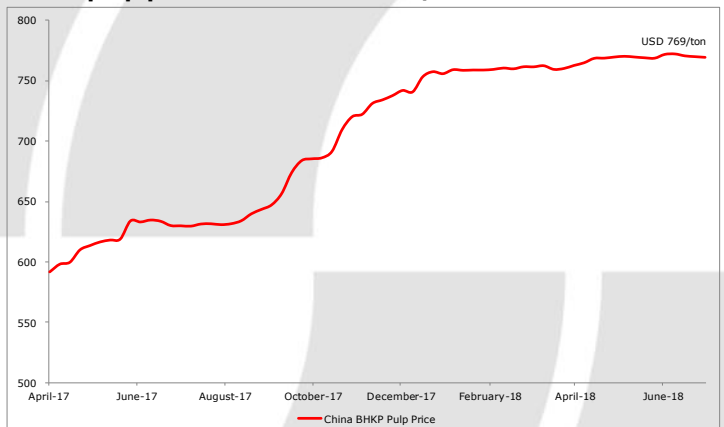
Closures of pulp capacity



(1) Closures/Conversion/Integration 2018: April Rizhao (500 kt), Navigator (50 kt) and 2019: April Rizhao (360 kt).

Source: Poyry, PPPC, RISI, Fibria

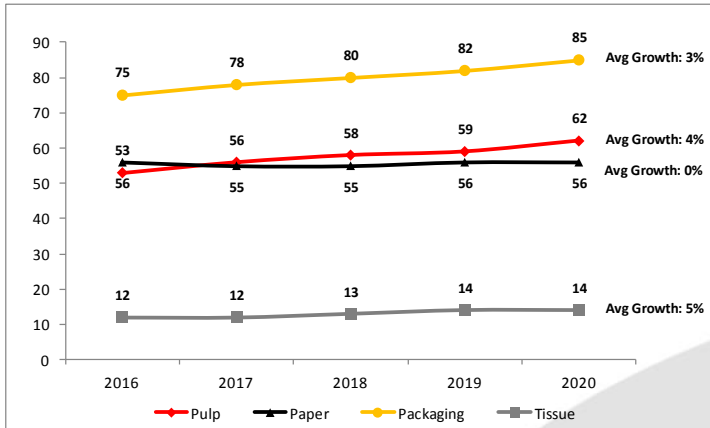
China pulp price stood at USD 769/ton as of June 2018



Source: Fibria, Sinarmas Investment Research

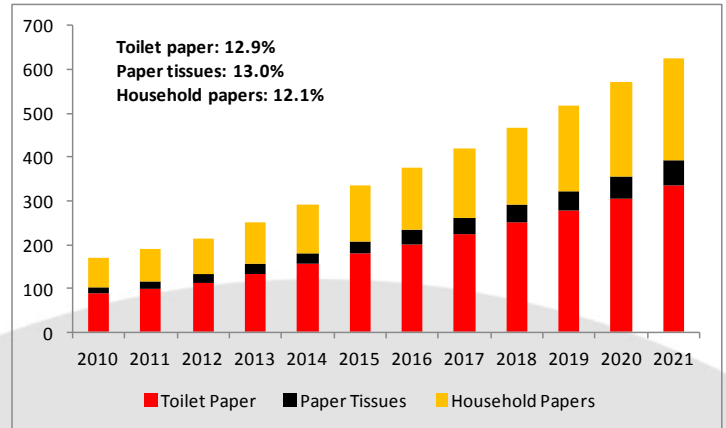
Based on RISI, Asia's demand on pulp and its downstream products are forecasted to further grow in the upcoming years. Asia's pulp demand is expected to grow by 3% CAGR FY16-20F. In the downstream, while paper demand is forecasted to be flat due to the digitalization era, other downstream products such as packaging and tissue are estimated to further grow at 4% and 5% CAGR FY16-20F. Packaging products is projected to grow alongside the rise of e-commerce industry. For instance in Indonesia, Statista estimates the e-commerce revenue to grow by 20.1% CAGR FY17-21F. More people are shifting from offline to online shopping in the recent years, such as Tokopedia, JD.id, Shopee, etc. Not only carton boxes, food grade packaging has also become very famous as many people use third party food delivery services such as Gofood and Grabfood.

Asia demand forecast (mn tons)



Source: RISI 2016 Vol 16, Sinarmas Investment Research

Projected Indonesia tissue revenue (USD mn)



Source: Statista, Sinarmas Investment Research

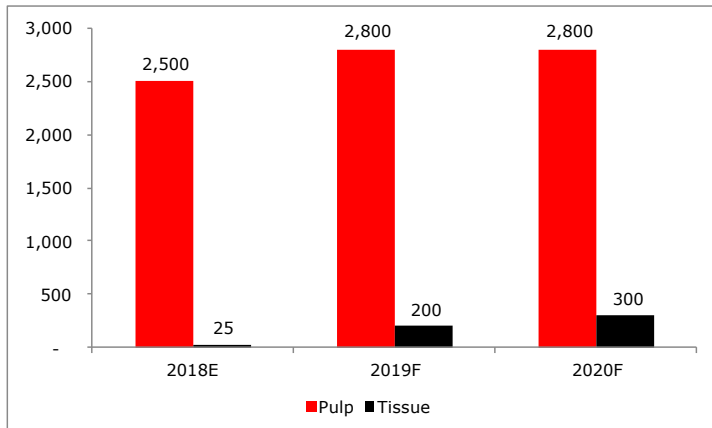
Larger contributions from OKI. OKI, a subsidiary of TKIM with 49.02% ownership, has started being fruitful since 2017. In 2017, TKIM has booked a USD 43.8mn NPAT derived from OKI, which eventually supported TKIM's bottom line to USD 27.3mn (+256.9% YoY). Along with the improving OKI's performance due to the ramping up of pulp production as well as the commencement of the tissue line, OKI's contribution to TKIM will be even bigger this year and the years after.

Starting its operations in 2017, we estimate OKI's annual pulp production to reach around 1.5mn tons. The company targets to ramp up its pulp production this year to around 2.5mn tons (~89.3% utilization rate) and later reach its full utilization level in 2019. Starting in 2H18, the company has planned to start its tissue line operation and forecasts 50,000 tissue production until the end of 2018. These factors coupled with the rising global pulp price will significantly boost OKI's top-line this year, with management's guidance at IDR 22tn, equivalent to USD 1.52bn (assuming USDIDR rate at 14,400).

Optimal efficiency may become another interesting factor about OKI. Equipped with the most advanced technology in the industry and close location to the wood concession, OKI is a pulp producer with one of the lowest cash cost in the world. OKI owns a power boiler and recovery boiler which could generate energy from non-fossil fuel, i.e. tree bark and wood sap. Furthermore, the close location to raw materials has resulted in lower transportation cost. According to the management, OKI's cash cost is ~20% lower compared to INKP's, hence will translate to better profitability. In all, management forecasts OKI to book EBITDA of USD 14.4tn, or USD 1bn in 2018, translating to EBITDA margin at ~65%.

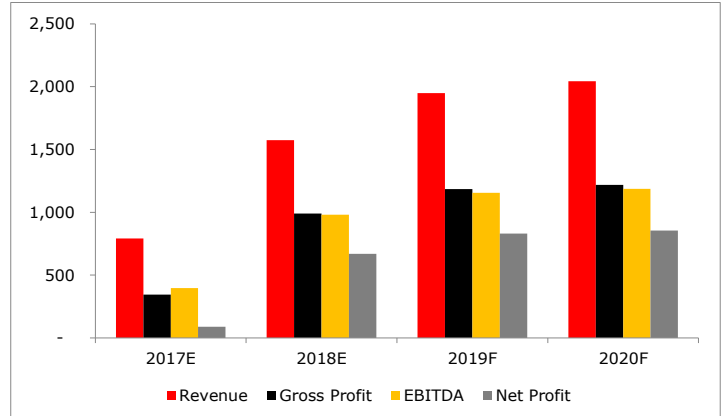
OKI is also granted a 10-year tax holiday, which is expected to start this year as its tissue line operates. OKI will pay 0% tax for the first 8 years, followed by 50% of normal tax rate for the last 2 years. Without any taxes, OKI's bottom-line will soar, hence contributions to TKIM will also expand.

OKI is expected to ramp up production



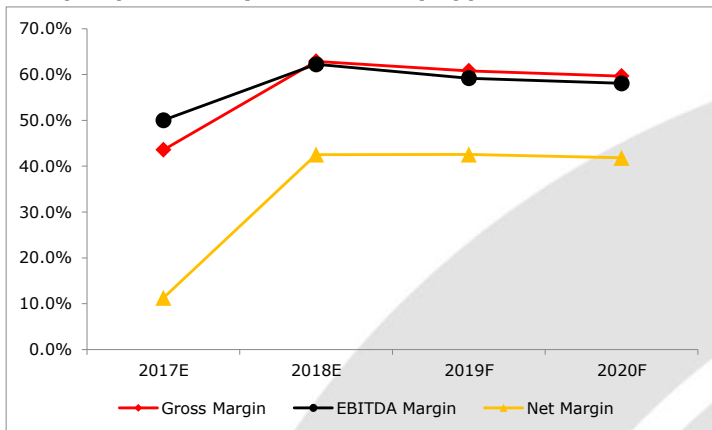
Source: Sinarmas Investment Research

Resulting in significant financial performance increases



Source: Company Data, Sinarmas Investment Research

Jump in profitability as tax holiday applied

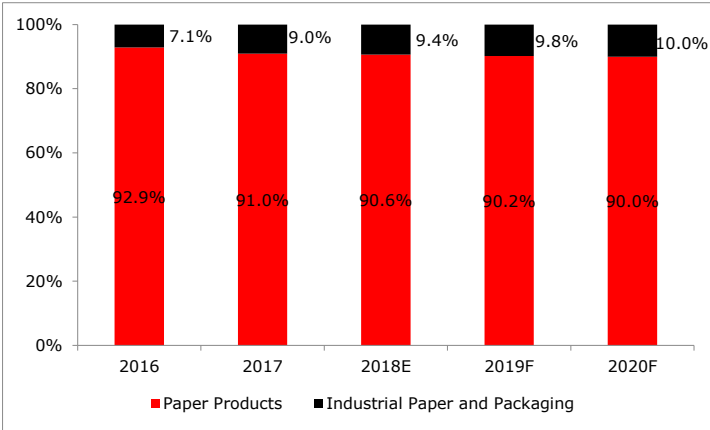


Source: Company Data, Sinarmas Investment Research

TKIM's shift to industrial brown paper. The triumph of white paper products is currently disrupted by the digitalization era. Nowadays, people are switching to digital media, exemplified by their preference to read e-paper and even taking notes on their gadgets. This is in-line with the projection that paper demand is currently facing flat growth and will potentially decline in the near future. Paying attention to this issue, TKIM will stop focusing on its paper production, and plans to convert some of them into industrial brown paper production line. This is done to take advantage of e-commerce boom as well as to capture the growing demand of packaging products, note that it is used as a layer on a carton box.

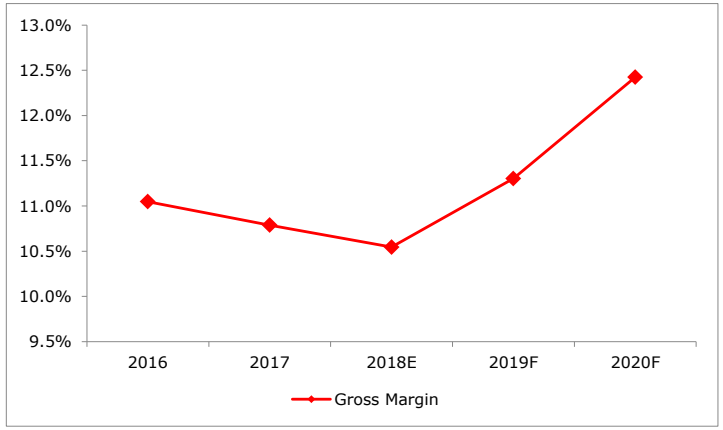
Management reveals that this strategy will be done gradually until 2019, with 1 line already converted in 2017. Compared to white paper, industrial brown paper possesses lower selling price though enjoys much bigger profitability. To note, white paper usually produces EBITDA of USD 30/ton, whilst industrial brown paper's could reach USD 100/ton on the back of cheaper raw materials (produced from mixed and waste paper). Despite industrial brown paper production is still very limited currently, it could be a booster for TKIM's profitability in the upcoming years.

Industrial paper & packaging sales to increase



Source: Company Data, Sinarmas Investment Research

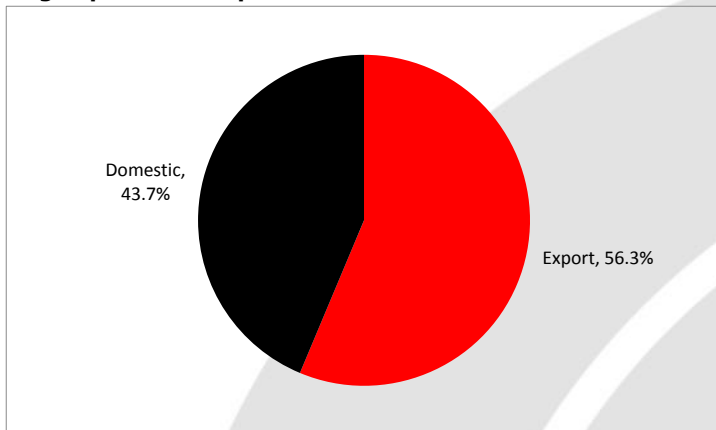
Gross margin to improve due to the conversion strategy



Source: Company Data, Sinarmas Investment Research

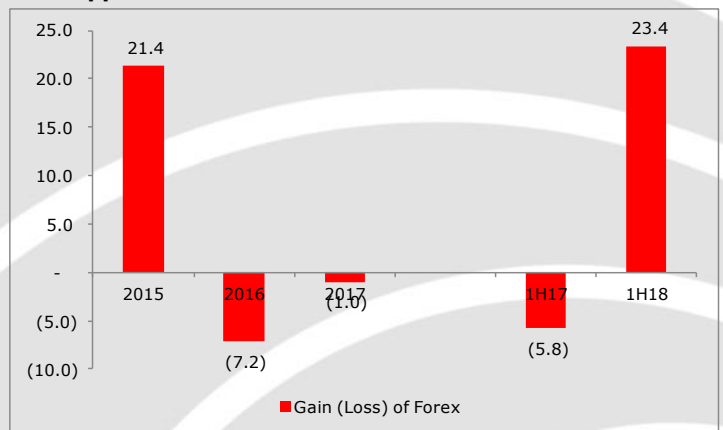
Beneficiary of USD appreciation. With around 60% of its sales going to the export market, TKIM is a beneficiary of USD appreciation. This is mainly as the company sells their products in USD, meanwhile some of its costs (labor costs, marketing costs etc.) are Rupiah denominated. Therefore, when USD appreciates, there will be potential record of gain on forex. Referring to TKIM's 1H18 results, it had recorded a USD 23.4mn gain of forex, which was due to 7.85% YTD USD appreciation.

Big exposure in export market



Source: Company Data, Sinarmas Investment Research

USD appreciation benefits TKIM

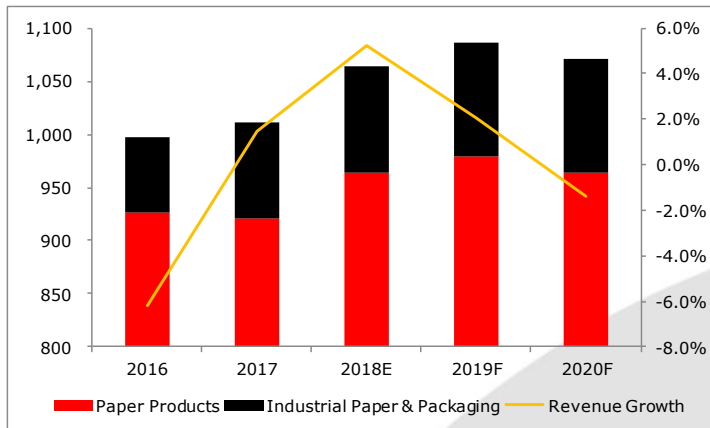


Source: Company Data, Sinarmas Investment Research

Financial Outlook

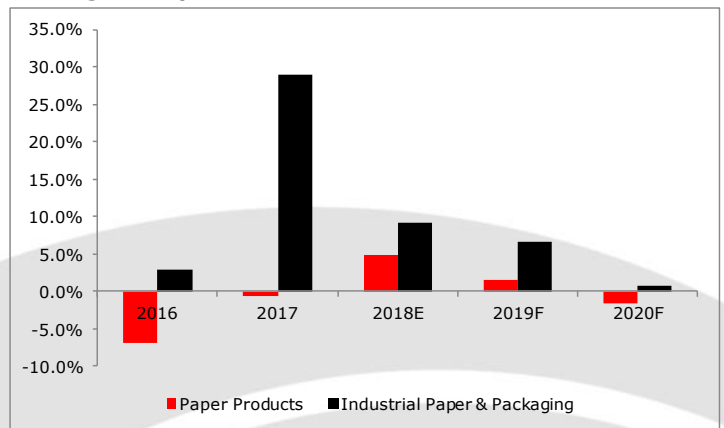
Moderate top-line growth. As of 1H18, TKIM recorded its revenue at USD 548.3mn, increased by 4.4% YoY. Growing revenue was mainly contributed by industrial paper, packaging, and others (+31.6% YoY), while paper products only grew by 2.3% YoY. We believe this confirms the demand trend that moves towards packaging and industrial paper rather than white paper. Export sales remains dominant, accounting for 58% from total sales in that period. We forecast TKIM's FY18E revenue to reach USD 1.06bn (+5.2% YoY). Meanwhile in the upcoming years, we estimate revenue to remain stable due to lower paper sales volume with conservative ASP growth for paper products. To add, industrial brown paper is also priced lower, hence as the company gradually convert some of its white paper production into industrial brown paper, we expect blended ASP to wane in the upcoming years.

TKIM's revenue and growth



Source: Company Data, Sinarmas Investment Research

Sales growth per division

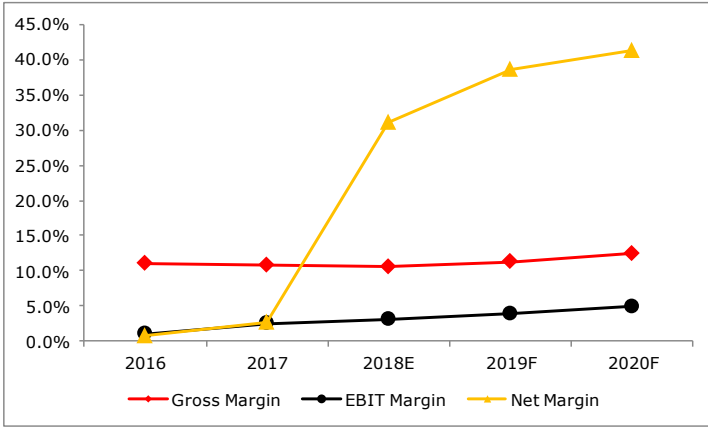


Source: Company Data, Sinarmas Investment Research

Mounting profitability as larger contribution from OKI kicks in. As of 1H18, TKIM's gross and EBIT margins were recorded stable at 10.3% and 3.5% respectively. Note that EBIT margin was supported by lower operating expenses, as opex to sales ratio was posted at 6.8% (vs 7% in 1H17). Net income had jumped incredibly to USD 147.6mn (net margin of 26.9%), thanks to USD 126.8mn income from OKI (85.7% from TKIM's 1H18 net income). Another thing that support TKIM's bottom line was USD 23.4mn gain of forex on USD appreciation in 2Q18. We estimates TKIM's FY18E net income will reach USD 330.6mn, with NPM stands at 31.1%. In the following years, OKI will remain as the backbone for TKIM's net income, hence we estimate income from OKI to achieve USD 407.2mn and USD 419.3mn in FY19F/20F. For TKIM alone, we expect to see gradual margin improvement in the upcoming years generated by increasing portion of industrial brown paper sales. FY19F/20F gross and EBIT margins are forecasted to improve to 11.3%/12.4% and 3.9%/4.9% respectively.

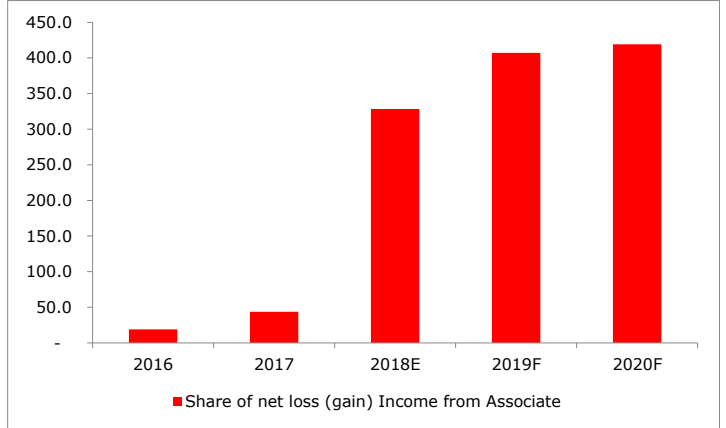
Increasing net income will translate to jump in its profitability ratios as well. ROE should jump to 25%/24.4% in FY18E/FY19F, vs 2.8% in FY17. In line, ROA will increase to 11.5%/12.7% in FY18E/FY19F, vs 1.1% in FY17.

TKIM profitability



Source: Company Data, Sinarmas Investment Research

Increasing contribution from OKI mills

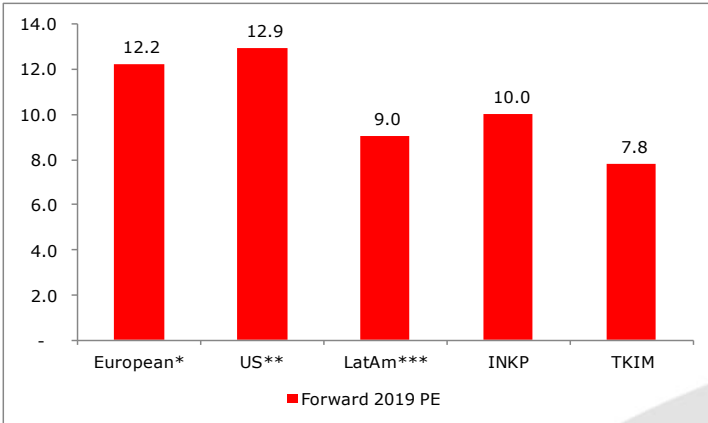


Source: Company Data, Sinarmas Investment Research

Valuation and Peers Comparison

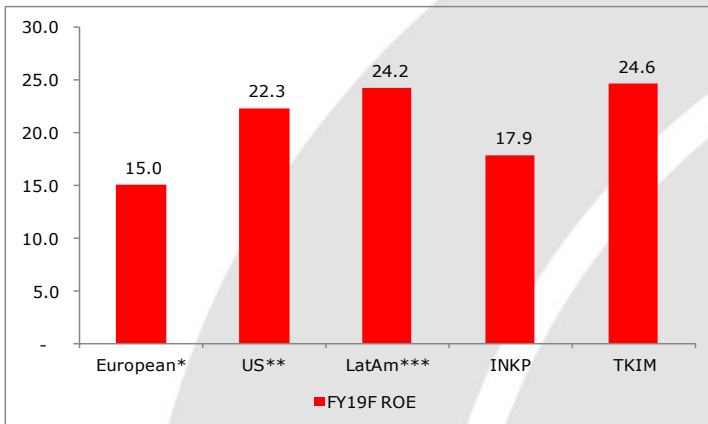
Valuation remains attractive. Despite its sparkling share performance YTD, we believe TKIM remains attractive from valuation perspective. At current market price of IDR 14,775, TKIM's is traded at 7.8x forward PE, still discounted from its global peers (European, US and LatAM producers). Another thing to note, OKI mills, associate company of TKIM, has one of the lowest cash cost due to state-of-the-art technology and is vertically integrated. Hence, better profitability compared to other players. **Pegged to 12x FY19F PE, our 52-week target price stands at IDR 23,250 which represents potential upside of 57.4%.**

Pulp and Paper industry valuation (x)



Source: Bloomberg, Sinarmas Investment Research

Pulp and Paper industry valuation (x)



Source: Bloomberg, Sinarmas Investment Research

* European industry includes UPM, Stora Enso, Ence, Navigator and Altri

** US industry includes Domtar Corp, IP, Mercer, and RFP

*** LatAm industry includes Fibria, Klabin, and CMPC

Income Statement (USD Mn)	2016	2017	2018E	2019F	2020F
Revenue	997	1,012	1,064	1,086	1,071
% growth	-6.2%	1.5%	5.2%	2.0%	-1.4%
COGS	(887)	(903)	(952)	(963)	(938)
% growth	-6.8%	1.8%	5.5%	1.2%	-2.7%
Gross Profit	110	109	112	123	133
% growth	-0.4%	-0.9%	2.8%	9.4%	8.4%
Operating Expenses	(99)	(83)	(79)	(80)	(80)
Opex to Sales (%)	-10.0%	-8.2%	-7.4%	-7.4%	-7.5%
EBIT	11	26	33	43	53
% growth	-16.0%	138.4%	28.2%	27.2%	23.9%
EBITDA	99	109	117	121	132
% growth	-3.0%	9.9%	6.8%	4.0%	9.2%
Income from Associated Company	19	44	329	407	419
Others	(29)	(34)	(32)	(32)	(32)
EBT	1	36	330	418	441
% growth	-107.6%	3929.7%	828.0%	26.8%	5.4%
Tax Benefit (Exp)	7	(8)	(0)	(3)	(5)
Net Income	8	27	330	415	435
% growth	427.1%	256.9%	1106.5%	26.1%	4.8%
EPS (USD)	0.003	0.009	0.106	0.133	0.140

Balance Sheet (USD Mn)	2016	2017	2018E	2019F	2020F
Cash & Equivalents	112	125	150	148	106
Trade Receivables	74	120	97	96	98
Inventories	251	234	276	276	269
Other Current Assets	161	227	193	205	212
Total CA	599	705	716	725	685
Fixed Assets	1,164	1,100	1,047	1,014	968
Other Non CA	728	776	1,117	1,528	1,944
Total Assets	2,491	2,581	2,879	3,267	3,597
Short Term Debt	281	405	466	507	501
Trade Payables	97	58	69	83	76
Other CL	30	27	29	30	29
Total CL	407	490	565	621	606
Long Term Debt	1,095	1,029	929	877	826
Other Non CL	52	65	62	63	64
Total Liabilities	1,554	1,584	1,556	1,561	1,497
Share & APIC	681	714	714	714	714
Retained Earnings	254	280	607	990	1,383
Others	(2)	(2)	(2)	(2)	(2)
Total Equity	933	992	1,319	1,701	2,095
Total Liabilities & Equity	2,491	2,581	2,879	3,267	3,597

Cash Flow (USD Mn)	2016	2017	2018E	2019F	2020F
Net Income	8	27	330	415	435
Dep. & Amortization	88	83	83	79	80
Chg. In NWC	291	(134)	27	4	(10)
CF from Operating	387	(24)	440	499	505
Capital Expenditure	(7)	(19)	(30)	(46)	(34)
Chg. in LT Assets	(119)	(47)	(341)	(412)	(415)
Chg. in LT Liabs	(11)	13	(2)	1	1
CF from Investing	(138)	(53)	(373)	(457)	(448)
Chg. in Share & APIC	0	33	0	0	0
Chg. in Debt	(161)	58	(39)	(11)	(57)
Dividends Paid	(1)	(1)	(3)	(33)	(42)
Others	(26)	0	0	0	0
CF from Financing	(188)	90	(42)	(44)	(98)
Chg. in Cash	61	13	25	(2)	(42)
Beginning Cash	50	112	125	150	148
Ending Cash	112	125	150	148	106

Financial Ratios & Key Assumptions	2016	2017	2018E	2019F	2020F
Profitability					
Gross Margin	11.0%	10.8%	10.5%	11.3%	12.4%
Operating Margin	1.1%	2.6%	3.1%	3.9%	4.9%
EBITDA Margin	10.0%	10.8%	11.0%	11.2%	12.4%
Net Margin	0.8%	2.7%	31.0%	38.2%	40.6%
Liquidity					
Current Ratio (x)	1.5	1.4	1.3	1.2	1.1
Solvency					
Debt to Equity (x)	1.5	1.4	1.1	0.8	0.6
Debt to Assets (x)	0.6	0.6	0.5	0.4	0.4
Valuation					
Price to Earnings (x)	610.2	183.6	15.9	12.1	11.5
Price to Book (x)	5.0	5.1	4.0	3.0	2.4
Key Assumptions					
Utilization rate	64.6%	64.2%	64.7%	64.4%	65.1%
Sales Vol Growth					
Paper	-3.6%	-4.4%	-1.5%	-2.8%	-0.3%
Stationery	-3.5%	6.7%	1.8%	1.1%	2.7%
Industrial paper & Packaging	-1.9%	45.1%	12.2%	11.1%	7.2%
Pulp price (USD/ton)	517	662	750	800	825

SINARMAS SEKURITAS INVESTMENT RATINGS GUIDE

BUY: Share price may rise by more than 15% over the next 12 months.

ADD: Share price may range between 10% to 15% over the next 12 months.

NEUTRAL: Share price may range between -10% to +10% over the next 12 months.

REDUCE: Share price may range between -10% to -15% over the next 12 months.

SELL: Share price may fall by more than 15% over the next 12 months.

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