

We downgrade our stance for tobacco sector to NEUTRAL following the announcement of excise tax hike numbers by the government.

We are of the view that tobacco sector outlook turns highly challenging as government intends to raise excise tax for tobacco products at a fairly high level that may jeopardize tobacco players' performance next year, in terms of potential declining volume, falling bottom-line earnings and shrinking margins. Despite tobacco stocks such as HMSP and GGRM already trading below its average PER, yet the higher-than-anticipated hike may result in persisting negative sentiment on the overall industry, therefore we expect significant correction on both stocks may continue in the near to medium term. **As a result, we lower our recommendation for both HMSP and GGRM to NEUTRAL with new FY20F target price of IDR 2,820 and IDR 62,800.**

Higher-than-expected excise tax hike in 2020. Government via Minister of Finance, Sri Mulyani, stated that excise tax and minimum retail price for tobacco products will be elevated by average 23% and 35% respectively. These new tariffs will be later on regulated through Ministry of Finance decree estimated published on Oct/Nov-19, and take place effectively on 1 January 2020. On MoF's note, the decision is intended to cut cigarette consumption, control the industry and preserve government income. The 23% increase in excise tax is much higher than the adjusted total excise tax increases of 11% in 2020 state budget, in which we assume that government is currently seeing a significant industry volume decline up to 10% YoY next year. Note that this number also beat the 16% YoY hike back in 2016, surpassing market's expectation of ~15-18% hence will result in persisting negative sentiment for the overall tobacco industry.

Cigarette volume may be at risk. We are of the view that the unprecedented 23% YoY excise tax hike will burden the industry and tobacco players, with industry volume expected to fall worse than 2019's, at ~10% in 2020. Let alone that the industry has been experiencing soft volume in recent years. We also note the risk from potential diminishing consumer purchasing power next year due to the likelihood of utilities tariffs hike, rising universal healthcare (*BPJS Kesehatan*) premium as well as lower social aids noting government focus more on healthcare and education, that may inhibit cigarette consumption in 2020.

Potential significant earnings fall shadowing tobacco players in 2020. Historically, tobacco players deal with excise tax hike by fully passing them on consumers, however given the sluggish volume and tight competition in the industry, we believe only partly of the excise will be able to be passed on to consumers this time. The evidence is more value for money cigarette products (product mix) and less aggressive pricing strategy from big players such as HMSP and GGRM, which eventually retain their margins even when there was no excise hike in 2019. Therefore, our assumption is that tobacco players will only partly pass the excise hike in the goal for market share, which brings up the potential risk of bottom-line earnings fall significantly in 2020. Our base assumptions are 15% ASP hike with volume decline ranging between 5% – 8% YoY.

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We lower our call to NEUTRAL for PT HM Sampoerna Tbk (HMSP) with FY20F target price of IDR 2,820 (from IDR 3,640). Our TP provides limited upside of 0.7% from current price, pegged to 27x target PE (-1.5SD from its 5-yr historical PE). Our new recommendation on HMSP and PE derating follows the unexpected 23% YoY excise tax hike in 2020 that we believe will be negative towards industry volume and HMSP's 2020 performance. Plugging in the excise tax hike, we currently forecast HMSP's bottom-line earnings to drop by 19% YoY in FY20F assuming 15% ASP hike and volume to slump by 8% YoY. Upside risks to our call include better-than-expected volume growth and higher ASP hike.

Higher-than-expected excise tax hike in 2020. Government decided to raise excise tax by average 23% YoY and minimum retail price for cigarettes by 35% YoY in 2020, which will lift up cigarette price much higher next year. The 23% YoY excise tax hike will provide persisting negative sentiment on the overall industry and we foresee industry volume growth to experience significant decline at 10% for FY20.

Our assumptions and forecasts. In 2020, we assume HMSP will perform ASP adjustment of 15% YoY hike while volume will drop by 8% YoY. In recent years, HMSP has been struggling with volume growth and market share loss which we believe was due to its premium products profile. Its flagship product, A Mild, has continued to book negative growth over the years as consumers shift to cheaper products. As cigarette price will increase significantly along with potential diminishing consumer purchasing power next year, HMSP may potentially see another significant volume drop next year. Our projection shows HMSP's revenue to grow by 5.3% YoY for FY20F, mainly supported by ASP increases. GPM forecasted to drop 360bps to 21.5% (vs 25% in FY19E) mainly on higher excise tax. In addition, shrinking margins will be on higher portion of lower margin products and the delay of A Mild recovery. Note that HMSP is currently focusing to fill their products gap with more value for money cigarettes. Bottom-line earnings are estimated at IDR 12,2tn (-19% YoY), leading NPM to 10.5% (vs 13.6% in FY19E).

Valuation. Based on our new EPS projection, HMSP is traded at 26.8x FY20F PE. Despite HMSP's valuation is at historically low, the concern on challenging industry and potential earnings disruption in 2020 may keep on pressuring HMSP's share performance. We currently advise investors to WAIT and SEE for HMSP.

Highlights (IDR Bn)	2017	2018	2019E	2020F	2021F
Revenue	99,091	106,742	110,222	116,058	125,842
% growth	3.8%	7.7%	3.3%	5.3%	8.4%
Gross Profit	24,216	25,491	27,540	24,807	26,287
Net Profit	12,671	13,538	15,025	12,173	12,525
% growth	-0.7%	6.8%	11.0%	-19.0%	2.9%
Gross Margin (%)	24.4%	23.9%	25.0%	21.4%	20.9%
Net Margin (%)	12.8%	12.7%	13.6%	10.5%	10.0%
Return on Equity (%)	37.1%	39.0%	41.7%	34.4%	36.7%
Return on Assets (%)	29.6%	30.2%	32.4%	27.2%	28.4%
EPS (IDR)	109	116	129	105	108

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Sector	Tobacco
Bloomberg Ticker	HMSP IJ
Market Cap. (IDR tn)	325.7
Share Out./Float (mn)	116,318/8,723
Current Price	2,800
End-of-FY20 Target Price	2,820
Upside (%)	0.7%

Share Price Performance

52W High (01/07/19)	4,080
52W Low (09/02/19)	2,570
52W Beta	1.2
YTD Change (%)	-24.5%

Relative Valuations

Trailing P/E	23.0x
Forward P/E	26.8x
P/BV	11.4x
EV/EBITDA	16.7x

Income Statement (IDR Bn)	2017	2018	2019E	2020F	2021F
Revenue	99,091	106,742	110,222	116,058	125,842
Cost of Good Sold	(74,876)	(81,251)	(82,682)	(91,251)	(99,555)
Gross Profit	24,216	25,491	27,540	24,807	26,287
Operating Expenses	(8,104)	(8,609)	(8,918)	(9,796)	(10,658)
Opex to Sales (%)	-8.2%	-8.1%	-8.1%	-8.4%	-8.5%
Other Income (Expenses)	(8)	106	-	-	-
EBIT	16,104	16,988	18,622	15,011	15,630
EBITDA	16,989	17,962	19,309	15,751	16,402
Net Financing Income (Expenses)	791	973	1,312	1,139	987
EBT	16,895	17,961	19,934	16,150	16,617
Tax Expenses	(4,224)	(4,423)	(4,909)	(3,977)	(4,092)
Net Income	12,671	13,538	15,025	12,173	12,525
EPS (IDR)	109	116	129	105	108

Balance Sheet (IDR Bn)	2017	2018	2019E	2020F	2021F
Cash & Equivalents	7,502	15,516	14,291	11,674	10,912
Trade Receivables	3,781	3,815	3,338	3,514	3,811
Inventories	18,023	15,183	15,678	16,508	17,900
Other Current Assets	4,874	3,317	4,681	4,043	4,547
Total Current Assets	34,180	37,831	37,988	35,739	37,170
Fixed Assets	6,891	7,288	6,840	6,778	6,492
Other Non Current Assets	2,070	1,483	1,222	1,078	1,042
Total Assets	43,141	46,602	46,050	43,595	44,704
Short Term Debt	-	-	-	-	-
Trade Payables	3,666	3,450	3,840	4,338	4,760
Taxes Payable	1,868	1,688	1,873	1,518	1,561
Other Current Liabilities	949	3,656	996	1,017	1,039
Total Current Liabilities	6,483	8,794	6,709	6,873	7,361
Other Non Current Liabilities	2,545	2,450	2,573	2,791	3,048
Total Liabilities	9,028	11,244	9,282	9,664	10,409
Share & APIC	20,914	21,011	21,011	21,011	21,011
Retained Earnings	12,582	13,731	15,140	12,304	12,667
Others	617	616	616	616	616
Total Equity	34,113	35,358	36,768	33,931	34,295
Total Liabilities & Equity	43,141	46,602	46,050	43,595	44,704

Source: Company Data, Sinarmas Investment Research

Cash Flow (IDR Bn)	2017	2018	2019E	2020F	2021F
Net Income	12,671	13,538	15,025	12,173	12,525
Dep. & Amortization	886	974	687	740	772
Chg. In NWC	1,967	6,675	(3,467)	(205)	(1,704)
CF from Operating	15,523	21,187	12,246	12,708	11,593
Capital Expenditure	(881)	(1,372)	(239)	(678)	(486)
Chg. in LT Assets	(105)	587	261	144	35
Others	640	(95)	123	218	257
CF from Investing	(345)	(879)	145	(315)	(194)
Chg. in Share & APIC	(18)	97	-	-	-
Chg. in Debt	-	-	-	-	-
Dividends Paid	(12,714)	(12,390)	(13,616)	(15,010)	(12,161)
Others	(1)	(0)	-	-	-
CF from Financing	(12,733)	(12,293)	(13,616)	(15,010)	(12,161)
Chg. in Cash	2,446	8,015	(1,225)	(2,617)	(762)
Beginning Cash	5,056	7,502	15,516	14,291	11,674
Ending Cash	7,502	15,516	14,291	11,674	10,912

Financial Ratio & Key Assumptions	2017	2018	2019E	2020F	2021F
Profitability					
Gross Margin	24.4%	23.9%	25.0%	21.4%	20.9%
Operating Margin	16.3%	15.9%	16.9%	12.9%	12.4%
EBITDA Margin	17.1%	16.8%	17.5%	13.6%	13.0%
Net Margin	12.8%	12.7%	13.6%	10.5%	10.0%
Liquidity					
Current Ratio (x)	5.3	4.3	5.7	5.2	5.0
Quick Ratio (x)	1.7	2.2	2.6	2.2	2.0
Solvency					
Debt to Equity (x)	0.0	0.0	0.0	0.0	0.0
Interest Cov. (x)	na	na	na	0.0	0.0
Valuation					
Price to Earnings (x)	25.9	24.2	21.8	26.9	26.2
Price to Book (x)	9.2	9.3	8.9	9.7	9.6
Key assumptions					
Volume (Bn Sticks)	101.3	101.4	101.3	92.8	93.3
% growth	-4.0%	0.1%	-0.1%	-8.4%	0.5%
Blended ASP Est.	967	1,044	1,078	1,239	1,339
% growth	8.1%	7.9%	3.3%	15.0%	8.0%

Source: Company Data, Sinarmas Investment Research

We lower our recommendation for PT Gudang Garam Tbk (GGRM) to NEUTRAL with FY20F target price of IDR 62,800 (from IDR 92,800). Our TP provides downside risk of 8.7% from current price, pegged to 17x target PE (-1SD from its 5-yrs historical PE). Our new call on GGRM and lower PE are basically on the higher-than-expected excise tax hike in 2020 that makes the industry become more challenging and may ruin GGRM's performance next year. We are now seeing potential bottom-line earnings fall by 24% YoY next year as we only put in a 15% ASP hike (lower than 23% excise tax hike) coupled with 5% volume decline for GGRM. Upside risks to our call include better-than-expected volume growth and higher ASP hike.

Higher-than-expected excise tax hike in 2020. Government decided to raise excise tax by average 23% YoY and minimum retail price for cigarettes by 35% YoY in 2020, which will lift up cigarette price much higher next year. The 23% YoY excise tax hike will provide persisting negative sentiment on the overall industry and we foresee industry volume growth to experience significant decline at 10% for FY20.

Our assumptions and forecasts. In 2020, we assume GGRM will adjust ASP by 15% YoY hike while volume will decline by 5% YoY. Our assumption for volume is better than industry's following GGRM's strong brand equity, reflected by GGRM's ability to record robust volume growth and grab significant market share in recent years outperforming the industry. Most GGRM's consumers who buy per stick will be more resilient towards price increases as well. To add, as the cigarette down trading behavior continues, we expect some portion to shift to GGRM's products for its affordable price compared to its peers. As a result, we estimate revenue to grow at 9% YoY in FY20F supported by ASP hike. On profitability side, we see GPM to shrink significantly by 340bps to 16.4% as we are not expecting GGRM to fully pass on the excise tax this time, in order to maintain market share. Net income comes out at IDR 7,1tn (-24.1% YoY), translates to NPM at 6% (vs 8.6% in FY19E).

Valuation. Based on our new EPS projection, GGRM is traded at 18.6x FY20F PE which is quite demanding noticing the tough industry environment and lower profitability profile in 2020. We currently advise investors to WAIT and SEE for GGRM.

Highlights (IDR Bn)	2017	2018	2019E	2020F	2021F
Revenue	83,306	95,708	108,837	118,611	129,624
% growth	9.2%	14.9%	13.7%	9.0%	9.3%
Gross Profit	18,222	18,644	21,505	19,495	20,871
Net Profit	7,754	7,792	9,366	7,110	7,451
% growth	16.1%	0.5%	20.2%	-24.1%	4.8%
Gross Margin (%)	21.9%	19.5%	19.8%	16.4%	16.1%
Net Margin (%)	9.3%	8.1%	8.6%	6.0%	5.7%
Return on Equity (%)	19.0%	17.8%	19.8%	14.1%	14.1%
Return on Assets (%)	12.0%	11.5%	13.0%	9.2%	9.1%
EPS (IDR)	4,030	4,050	4,868	3,695	3,872

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Sector	Tobacco
Bloomberg Ticker	GGRM IJ
Market Cap. (IDR tn)	132.4
Share Out./Float (mn)	1,924/457
Current Price	68,800
End-of-FY20 Target Price	62,800
Upside (%)	-8.7%

Share Price Performance

52W High (03/04/19)	100,975
52W Low (09/03/19)	65,500
52W Beta	0.9
YTD Change (%)	-17.7%

Relative Valuations

Trailing P/E	15.5x
Forward P/E	18.6x
P/BV	3.0x
EV/EBITDA	9.3x

Income Statement (IDR Bn)	2017	2018	2019E	2020F	2021F
Revenue	83,306	95,708	108,837	118,611	129,624
Cost of Good Sold	(65,084)	(77,063)	(87,333)	(99,116)	(108,752)
Gross Profit	18,222	18,644	21,505	19,495	20,871
Operating Expenses	(7,103)	(7,551)	(8,494)	(9,414)	(10,278)
Opex to Sales (%)	-8.5%	-7.9%	-7.8%	-7.9%	-7.9%
Other Income (Expenses)	119	64	170	137	130
EBIT	11,237	11,157	13,181	10,218	10,724
EBITDA	13,187	13,358	15,351	12,333	12,784
Interest Expenses	(801)	(678)	(692)	(739)	(789)
EBT	10,437	10,479	12,488	9,480	9,935
Tax Expenses	(2,681)	(2,686)	(3,122)	(2,370)	(2,484)
Net Income	7,755	7,793	9,366	7,110	7,451
EPS (IDR)	4,030	4,050	4,868	3,695	3,872

Balance Sheet (IDR Bn)	2017	2018	2019E	2020F	2021F
Cash & Equivalents	2,329	2,034	2,078	1,498	1,206
Trade Receivables	2,229	1,726	2,619	2,722	2,811
Inventories	37,920	38,560	43,025	47,909	51,506
Other Current Assets	1,286	2,965	2,018	2,568	3,075
Total Current Assets	43,764	45,285	49,740	54,698	58,598
Fixed Assets	21,409	22,759	23,838	23,723	23,663
Other Non Current Assets	1,587	1,054	1,338	1,674	1,617
Total Assets	66,760	69,097	74,916	80,096	83,879
Short Term Debt	20,600	17,322	17,822	19,822	20,322
Trade Payables	1,214	1,130	1,280	1,453	1,594
Taxes Payable	308	135	156	237	248
Other Current Liabilities	797	3,552	3,888	4,594	5,105
Total Current Liabilities	22,611	22,004	22,990	25,869	27,021
Other Non Current Liabilities	1,961	1,960	2,429	2,623	2,805
Total Liabilities	24,572	23,964	25,419	28,492	29,826
Share & APIC	1,016	1,016	1,016	1,016	1,016
Retained Earnings	41,187	44,151	48,515	50,622	53,070
Others	(15)	(33)	(33)	(33)	(33)
Total Equity	42,188	45,133	49,497	51,604	54,052
Total Liabilities & Equity	66,760	69,097	74,916	80,096	83,879

Source: Company Data, Sinarmas Investment Research

Cash Flow (IDR Bn)	2017	2018	2019E	2020F	2021F
Net Income	7,754	7,792	9,366	7,110	7,451
Dep. & Amortization	1,872	2,190	2,170	2,115	2,060
Chg. In NWC	(972)	855	(3,925)	(4,659)	(3,540)
CF from Operating	8,654	10,837	7,612	4,565	5,971
Capital Expenditure	(3,231)	(4,037)	(3,250)	(2,000)	(2,000)
Chg. in LT Assets	(1,067)	533	(284)	(337)	58
Others	388	481	-	-	-
CF from Investing	(3,910)	(3,024)	(3,534)	(2,337)	(1,942)
Chg. in Share & APIC	-	-	-	-	-
Chg. in Debt	847	(3,278)	500	2,000	500
Dividends Paid	(5,003)	(5,003)	(5,003)	(5,003)	(5,003)
Others	145	172	469	194	182
CF from Financing	(4,010)	(8,108)	(4,034)	(2,809)	(4,321)
Chg. in Cash	734	(295)	44	(580)	(292)
Beginning Cash	1,595	2,329	2,034	2,078	1,498
Ending Cash	2,329	2,034	2,078	1,498	1,206

Financial Ratio & Key Assumptions	2017	2018	2019E	2020F	2021F
Profitability					
Gross Margin	21.9%	19.5%	19.8%	16.4%	16.1%
Operating Margin	13.5%	11.7%	12.1%	8.6%	8.3%
EBITDA Margin	15.8%	14.0%	14.1%	10.4%	9.9%
Net Margin	9.3%	8.1%	8.6%	6.0%	5.7%
Liquidity					
Current Ratio (x)	1.9	2.1	2.2	2.1	2.2
Quick Ratio (x)	0.2	0.2	0.2	0.2	0.1
Solvency					
Debt to Equity (x)	0.5	0.4	0.4	0.4	0.4
Debt to Assets (x)	0.3	0.3	0.2	0.2	0.2
Interest Cov. (x)	14.0	16.5	19.0	13.8	13.6
Valuation					
Price to Earnings (x)	15.6	15.5	12.9	17.0	16.2
Price to Book (x)	2.9	2.7	2.4	2.3	2.2
Key assumptions					
Volume (Bn Sticks)	78.7	85.2	93.9	89.1	90.4
% growth	2.0%	8.3%	10.2%	-5.1%	1.5%
Blended ASP Est.	1,044	1,103	1,141	1,312	1,414
% growth	7.2%	5.6%	3.4%	15.0%	7.8%

Source: Company Data, Sinarmas Investment Research

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