COMPANY UPDATE

PT UNITED TRACTORS Tbk

27 July 2012

PT UNITED TRACTORS Tbk

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UNDERWEIGHT

We reduced our call on UNTR to UNDERWEIGHT on the backdrop of continuation of extremely gloomy outlook in the coal markets, intensified competition in the heavy equipment sector coupled with decreased investment by mining companies and lower-than-expected margin from mining contracting as weather has just improved in second half of May.

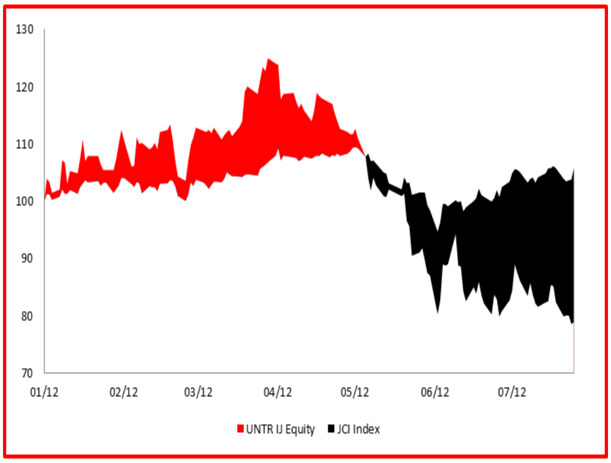
Construction Machinery

The firm managed to sell 4,231 units of Komatsu heavy equipment which is slightly below 50% of its revised new target of 8,500 units or 51.5% of our previous target of 8,215 units and down 2.4% yoy. The firm cites: (1) ongoing slumps in the coal markets and mineral exports taxes imposed on Nickel causing demands for heavy equipment (for expansion) to fall; (2) intensifying competition from other heavy equipment firms as the global partners reallocate assets from China to other countries including Indonesia. This blew Komatsu's market share to 44% and the firm has taken proactive actions, as cited in our previous reports, to circumvent this issue and the initial results will be reflected in the 3Q12. 2Q2012 post-elimination gross profit margin of 23.2% exceeded our estimate of 17.0% which is due to increased portion of higher-margin Parts & Services division (+29.5% yoy) and the fact that the firm has increased its ASP early this year. Key concerns include: (1) Pricing war among other distributors intensified which will force UNTR to eventually reverse its price increase or even lower it to defend its market share despite the potential complications affecting the secondary market (used equipment market). Caterpillar (CAT US) and Hitachi Construction Machinery (6305 JP) have stated that China's demands for construction/heavy equipment will remain weak and will allocate resources to other parts of APAC including Indonesia[1], implying potential supply overflow in the coming half of 2012); (2) Further deterioration in the global economies and mining industry, especially intensification of EU crisis escalating to Greece leaving EMU or Spain and/or Italy requesting Sovereign bailout *a la "Troika"*, will prompt many companies to delay expansion to preserve cash as buffer for the next storms; (3) the firm's Corporate Secretary has issued warning that company *"may lower sales target as maintaining last year's sales number won't be easy"* and should the condition deteriorates further, we should expect more earning cut.

Stock Data

Sector	Heavy Equipment
Price (27 July 2012)	IDR 20,850
Target Price 2012	**IDR 20,400**
12-month Rating	UNDERWEIGHT
Prior	BUY (TP IDR 27,100)
Ticker	UNTR.IJ (BBG); UNTR.JK (RIC)
Market Cap	IDR81.6 tn
Shares Outstanding	3,730 mn
Free Float	1,511 mn

UNTR Performance against JCI Index



Source: Bloomberg

Profitabiity	5-year average	2010	2011	2012F	2013F	2014F
Gross Margin%	19.4%	18.2%	18.5%	17.7%	17.2%	18.2%
EBIT Margin%	14.8%	13.8%	13.8%	13.1%	12.9%	13.7%
EBITDA Margin%	21.0%	21.7%	20.1%	19.3%	18.9%	17.7%
EV/EBITDA x				7.6	7.1	6.4
P/E x				12.8	12.0	9.4
Net Dividend Yield				3.1%	3.3%	4.2%

Source: Bloomberg, Company data, Sinarmas Sekuritas Research

[1]: Komatsu Ltd (6301 JP) reported a 36% decline yoy on its excavators sales to China in June 2012 (source: Bloomberg)

To reflect these risks, we reduced our Komatsu 2012 sales volume to 7,869 (1H12 sales: 54% of our revised target) units from our previous 8,215 units and we estimate that the firm will reverse its ASP increase in the coming quarters to defend its market share as the competition intensified in the medium/small-sized heavy equipment. Increased in infrastructure investment and expansion by agriculture companies will offset the fall in heavy equipment demand but even then, we feel that the heavy equipment industry is way too dependent on mining sector (with mining made up of more than 60% of heavy equipment sales).

Mining Contracting

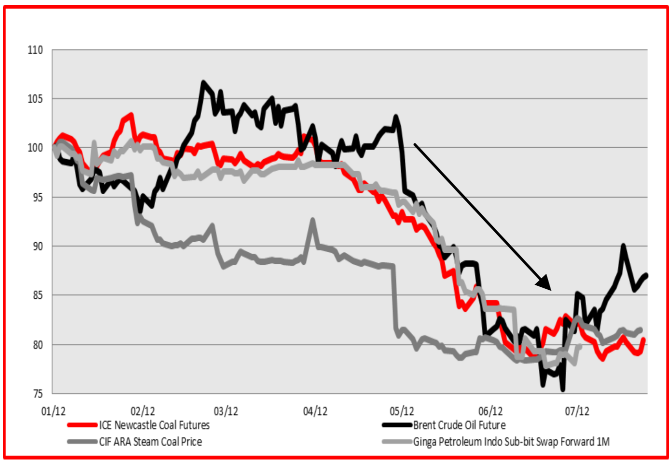
Unfavorable weather conditions in the 1Q2012 and one and a half month of 2Q2012 significantly depressed the gross margin of this division but, according to the firm, the weather has improved significantly and this allowed PAMA to operate at lower cost to meet its target. Post-elimination 2Q2012 margin fell to 17.3% (vs our estimate of 22.0%; up from 14.0% in 1Q2012) and we expect that with improving weather conditions, the firm should be able to register higher margin in the coming quarter and higher production and OB removal volumes. Total coal production increased to 45.1 mn tons (+12% yoy; 45.8% of 2012 target of 98 mn tons) while OB removal increased to 415.2 mn bcm (+13.3% yoy; 46.4% of out 2012 target of 894 mn bcm). These are slightly below our estimate which can be accounted for the seasonality of weather. However, with declining coal prices, we are concerned that mining companies will just want to meet the minimum volumes pre-specified at the contract in order to minimize losses incurred from operating above the cash cost. Furthermore, with 2 consecutive quarters of margin below our estimates, we revise 2012 gross margins downwards to 17.5% from our previous 18.5%.

Mining Division

Bloodbath in the coal markets has pushed its 2Q12 margin to 6.3% (post-elimination) vs our estimate of 14%. The declining coal prices and temporary breakdown in correlation between crude oil and coal prices have been cited to cause this margin compression. With the global markets turmoil denting investor's confidence and slowing down Chinese economy, we expect this trend to persist unless: (1) colder than expected winter in 2H2012 driving up demands for energy; (2) Tensions in the middle east intensified escalating to the closure of Strait of Hormuz; (3) Better-than-expected Chinese economy growth as the results of strategic stimulus pumped into its economy triggering demands for energy; (4) EU achieved some form of feasible resolutions that do not trigger any market events. Despite these possible upside potentials, in near terms, we remain cautious and revise its 2012 gross margin downwards to 8.3% to account for the margin compression as the spread between coal ASP and cash cost narrows. With this scenario in place, we estimate that the mining division will barely break-even or even operating on net loss.

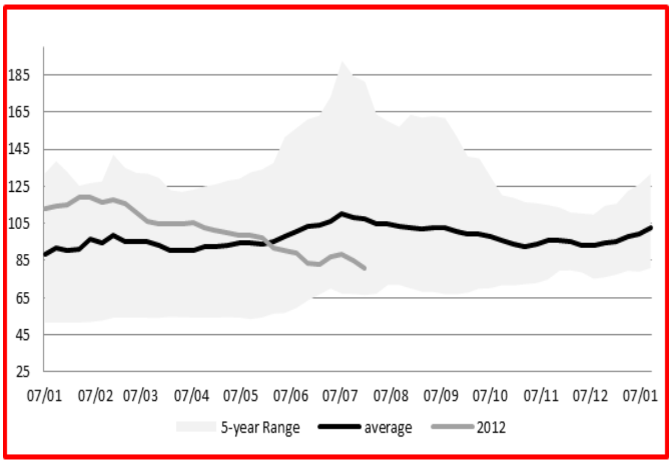
With the coal prices continue to be under pressure, we expect that the firm will seize the opportunity to acquire distressed mines at cheap/current valuation to boost its reserves for future operations and reduce its dependencies on heavy equipment sales (which is more leveraged to the coal/macroeconomic cycles).

Chart 1: Various coal prices and Brent Crude oil



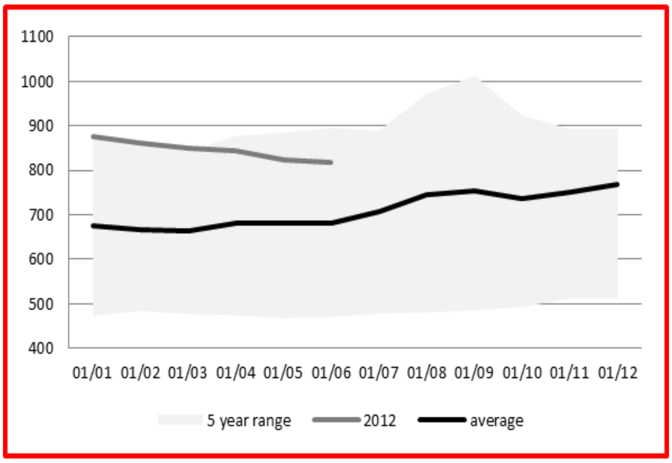
Source: Bloomberg; GP: Ginga Petroleum (Energy broker based in Singapore).
Normalized at 3/1/2012 = 100

Chart 2: McCloskey Newcastle Steam Coal Spot Price-FOB Newcastle (USD/ton)



Source: McCloskey (accessed via Bloomberg)

Chart 3: McCloskey/Xinhua Infolink's Steam Coal Price—FOB Qinhuangdao (CNY/ton)



Source: McCloskey (accessed via Bloomberg)

Valuations

We derived the price target via Discounted Cash Flow valuation methodologies with via discrete growth rate till 2025 and the after the firm will grow at the rate of 3% per annum. We assumed WACC to be 15.4% and our target price of IDR 20,400 indicates relatively low upside potential with 2012P/E of 12.8× and hence we reduce our recommendation to UNDERWEIGHT. We expect more turbulence and more selling pressure as the depressed coal markets continue to persist and implementation of mineral tax has come to effect.

Table 1: Revised Assumptions Summary

	2009	2010	2011	6M2012	6M2012 as % of 2012F	2012F	2013F	2014F
Construction Machinery								
Komatsu Volumes	3,111	5,404	8,467	4,231	54%	7,869	8,026	8,428
yoy growth rate	*-28%*	*74%*	*57%*	*-2%*		*-7%*	*2%*	*5%*
ASP per unit (IDR mn)	2,373	2,436	2,208	2,330		2,448	2,545	2,606
yoy growth rate	*9%*	*3%*	*-9%*	*12%*		*11%*	*4%*	*2%*
Parts & Services (IDR mn)	3,597,000	4,108,000	5,145,569	3,053,000	49%	6,210,130	7,846,288	9,807,859
yoy growth rate	*23%*	*14%*	*25%*	*30%*		*21%*	*26%*	*25%*
Mining Contracting								
Overburden Removed	598	651	790	415	47%	885	995	1,144
yoy growth rate	*35%*	*9%*	*21%*	*13%*		*12%*	*12%*	*15%*
Coal mined	68	78	87	45.10	46%	97	111	127
yoy growth rate	*15%*	*15%*	*11%*	*12%*		*12%*	*14%*	*15%*
Implied Strip Ratio	8.8	8.3	9.1	9.21		9.1	9.0	9.0
Mining								
Coal Production volume	2,397,000	2,842,000	4,488,000	3,046,000	49%	6,178,500	10,069,488	13,090,335
yoy growth rate	*-35%*	*19%*	*58%*	*38%*		*38%*	*63%*	*30%*
ASP (IDR/ton)	1,185,889	1,098,021	1,210,867	1,155,285		999,209	910,769	960,041
yoy growth rate	*0%*	*-7%*	*10%*	*-6%*		*-17%*	*-9%*	*5%*

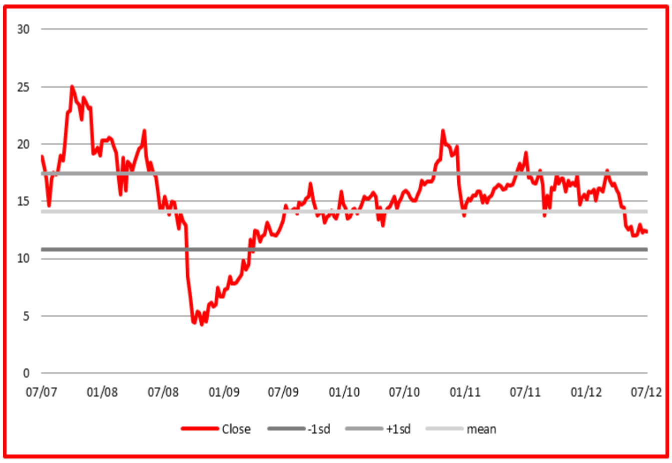
Source: Company data, Sinarmas Sekuritas Research

Table 2: Income Statement Summary

	2009	2010	2011	1H2012	1H2012 as % of 2012F	2012F	2013F	2014F
Revenues	29,241,883	37,323,872	55,052,562	30,610,414	50.3%	60,840,408	66,599,635	78,709,244
Cost of Revenue	(22,570,824)	(30,528,174)	(44,859,041)	(25,076,355)	50.1%	(50,049,621)	(55,164,590)	(64,379,490)
Gross Profit	6,671,059	6,795,698	10,193,521	5,534,059	51.3%	10,790,787	11,435,045	14,329,754
SG&A	(1,404,587)	(1,633,177)	(2,578,423)	(1,451,286)	51.7%	(2,808,978)	(2,864,212)	(3,552,526)
EBIT	5,266,472	5,162,521	7,615,098	4,082,773	51.2%	7,981,809	8,570,834	10,777,228
Other non-operating income	266,534	38,939	208,282	(109,376)		42,588	39,960	47,226
interest, net	(88,768)	(140,200)	(38,803)	913		(52,989)	(122,823)	(44,761)
Profit before tax	5,444,238	5,061,260	7,784,577	3,974,310	49.9%	7,971,408	8,487,971	10,779,693
Taxation	(1,594,543)	(1,186,745)	(1,885,071)	(893,550)		(1,992,852)	(2,121,993)	(2,694,923)
Profit after tax	3,849,695	3,874,515	5,899,506	3,080,760	51.5%	5,978,556	6,365,978	8,084,770
Minorities	(32,154)	(1,584)	1,402	6,336		0	0	0
Net Profit	3,817,541	3,872,931	5,900,908	3,087,096	51.6%	5,978,556	6,365,978	8,084,770
Gross Margin	22.8%	18.2%	18.5%	18.1%		17.7%	17.2%	18.2%
EBITDA margin	24.4%	21.7%	20.1%	20.1%		19.3%	18.9%	17.7%
EBIT Margin	18.0%	13.8%	13.8%	13.3%		13.1%	12.9%	13.7%
NOPAT Margin	13.2%	10.4%	10.7%	10.1%		9.8%	9.6%	10.3%
Net Margin	13.1%	10.4%	10.7%	10.1%		9.8%	9.6%	10.3%
Revenue Growth	4.8%	27.6%	47.5%	9.1%		10.5%	9.5%	18.2%
EBITDA Growth	29.3%	13.9%	36.1%	26.3%		6.4%	6.9%	10.8%
EBIT Growth	26.6%	-2.0%	47.5%	22.1%		4.8%	7.4%	25.7%
Net Profit Growth	43.5%	1.5%	52.4%	21.5%		1.3%	6.5%	27.0%

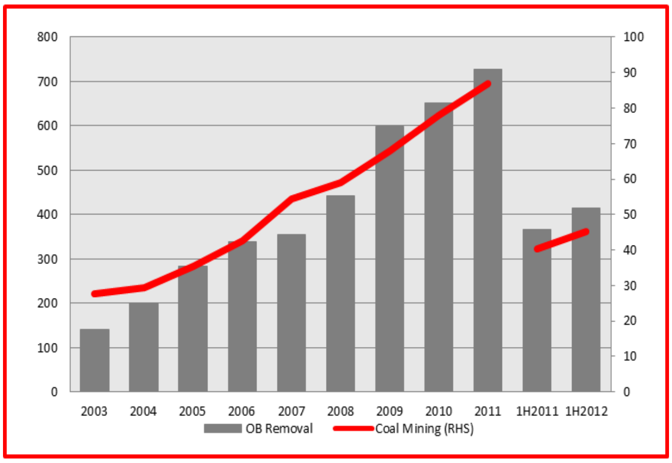
Source: Company data, Sinarmas Sekuritas Research

Chart 4: Forward or Best P/E is trading at lowest valuation since 2009 but the firm is highly leveraged to coal cycle which positions it at extremely risky position especially with depressed coal markets



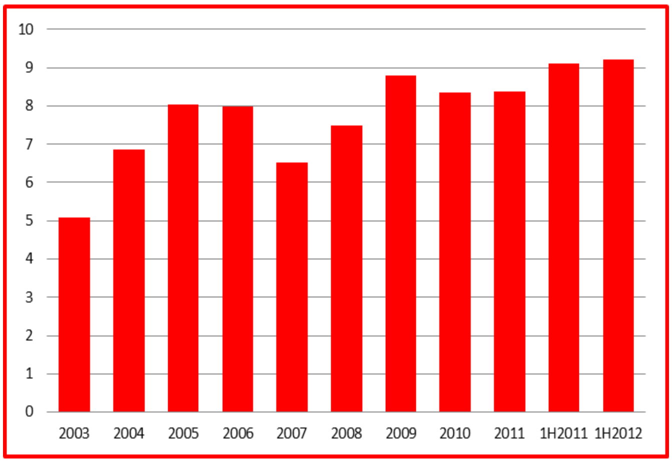
Source: Bloomberg

Chart 5: Mining Contracting OB Removal (in mn bcm) and Coal mining (in mn tons)



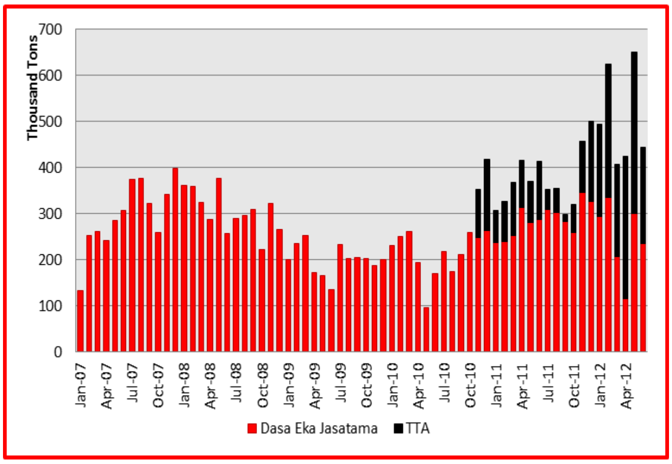
Source: Company data

Chart 6: Stripping ratio



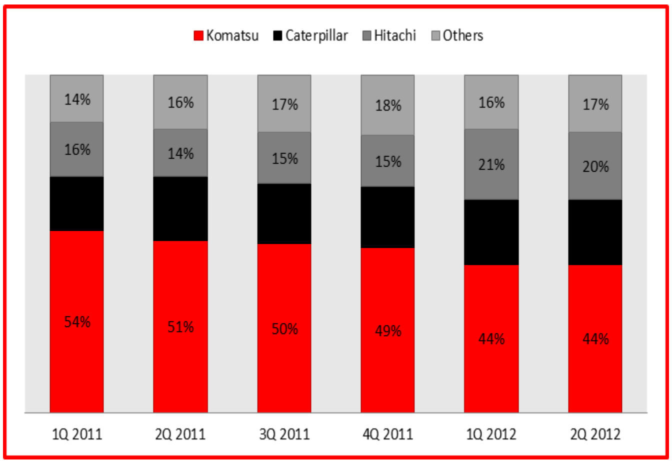
Source: Company data, Sinarmas Sekuritas Research

Chart 7: Mining Division monthly coal mined



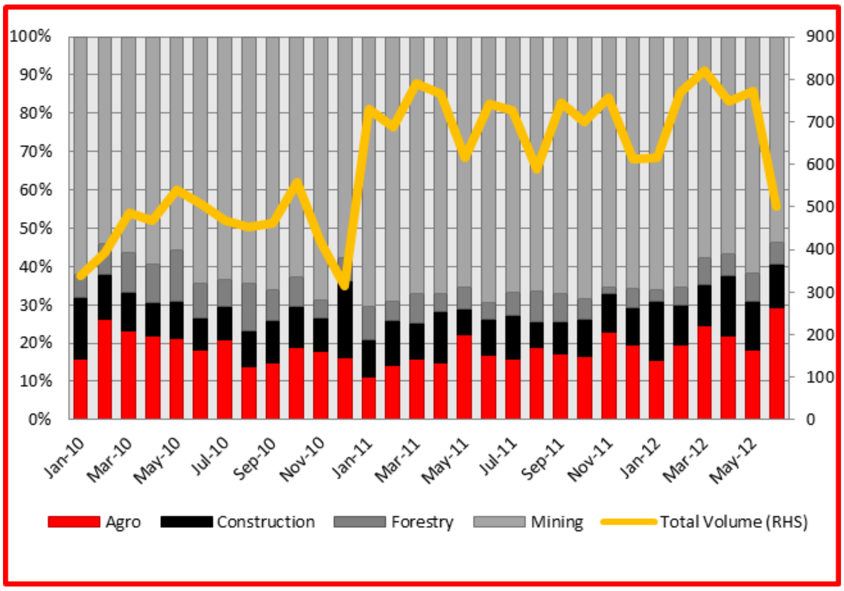
Source: Company data, Sinarmas Sekuritas Research

Chart 8: Komatsu market share stagnating at 44%



Source: Company data, Sinarmas Sekuritas Research

Chart 9: Komatsu breakdown with June performance particularly worrying



Source: Company data, Sinarmas Sekuritas Research

Fiscal Year End					
Income Statement (IDR mn)	2010	2011	2012E	2013F	2014F
Sales Revenue	37,323,872	55,052,562	60,840,408	66,599,635	78,709,244
Gross Profit	6,795,698	10,193,521	10,790,787	11,435,045	14,329,754
Operating Income	5,162,521	7,615,098	7,981,809	8,570,834	10,777,228
Depreciation & Amortization	2,952,125	3,428,272	3,772,105	3,995,978	3,148,370
EBITDA	**8,114,646**	**11,043,370**	**11,753,914**	**12,566,812**	**13,925,598**
Other non-operating income	38,939	208,282	42,588	39,960	47,226
Net Interest Income (expense)	-140,200	-38,803	-52,989	-122,823	-44,761
Profit before tax	5,061,260	7,784,577	7,971,408	8,487,971	10,779,693
Tax expenses	-1,186,745	-1,885,071	-1,992,852	-2,121,993	-2,694,923
Profit after tax	3,874,515	5,899,506	5,978,556	6,365,978	8,084,770
Minority Interests	-1,584	1,402	0	0	0
Net Profit	**3,872,931**	**5,900,908**	**5,978,556**	**6,365,978**	**8,084,770**
Cash Flow (IDR mn)					
Operating Cash Flow	2,423,881	9,947,819	11,583,940	6,461,555	13,122,735
Capex	3,357,689	5,258,071	6,250,000	5,626,136	6,076,227
Free Cash Flow	-933,808	4,689,748	5,333,940	835,419	7,046,508
Dividends Received from Investments	23,550	17,939	0	0	0
Dividends Paid	-1,629,228	-1,697,214	-2,391,422	-2,546,391	-3,233,908
Debt Issuance (redemption)	1,539,128	-1,493,506	2,359,769	833,841	1,106,136
Share Capital increase	0	6023188	0	0	0
Net debt (cash)	3,879,249	-3,065,384	-5,720,313	-4,269,551	-8,436,443
Balance Sheet (IDR mn)					
Cash & cash equivalents	1,343,220	7,135,386	11,981,640	11,125,465	16,086,162
Account Receivables	5,349,688	9,969,714	6,930,399	11,569,499	10,294,180
Inventories	6,931,631	7,129,459	7,820,253	8,619,467	10,059,295
Other Current assets	1,908,223	1,391,019	1,519,134	1,655,010	1,988,270
Net fixed assets	13,261,374	19,395,857	17,617,665	19,247,823	22,175,680
Other non-current assets	906,778	1,418,627	4,148,710	3,709,084	3,416,613
Total Assets	29,700,914	46,440,062	50,017,802	55,926,349	64,020,200
Short term Liabilities	9,919,225	14,930,069	14,532,542	16,123,467	18,513,297
Long term Liabilities	3,616,283	4,006,045	4,376,950	4,856,886	5,691,034
Total Liabilities	13,535,508	18,936,114	18,909,492	20,980,353	24,204,331
Shareholders' Equity	16,136,338	26,320,449	29,924,811	33,762,496	38,632,370
Minority Interest	29,068	1,183,499	1,183,499	1,183,499	1,183,499
Total Equity & Liabilities	29,700,914	46,440,062	50,017,802	55,926,349	64,020,200
Key Ratio					
Revenue Growth (%)	27.64%	47.50%	10.51%	9.47%	18.18%
EPS Growth (%)	1.45%	42.30%	-3.24%	6.48%	27.00%
EBITDA Margin (%)	21.74%	20.06%	19.32%	18.87%	17.69%
Payout Ratio (%)	37.87%	40.00%	40.00%	40.00%	40.00%
ROE (%)	24.00%	22.42%	19.98%	18.86%	20.93%
Quick Ratio (x)	0.87	1.24	1.41	1.51	1.53
Debt/Equity (%)	35.20%	17.87%	23.60%	23.39%	23.30%

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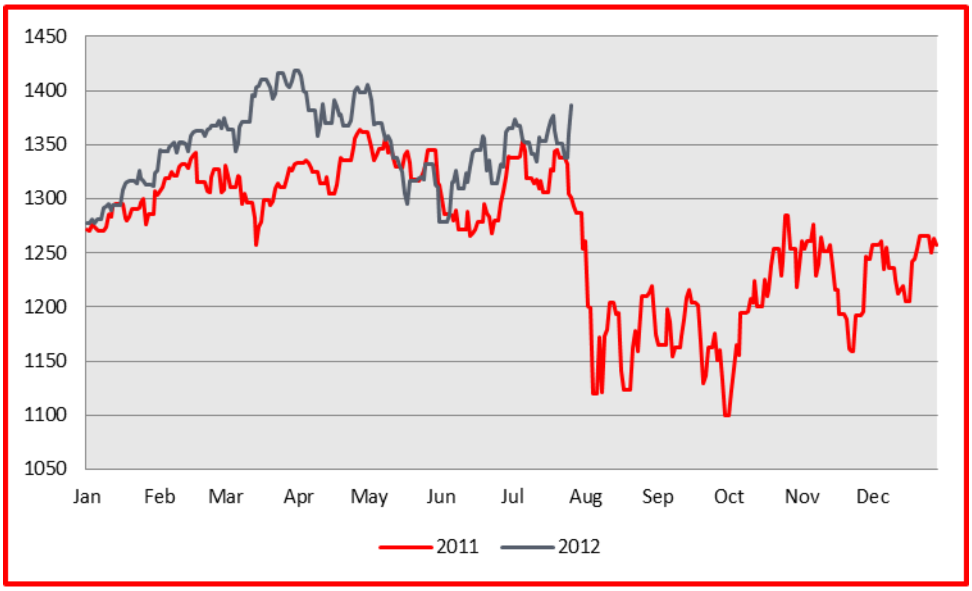
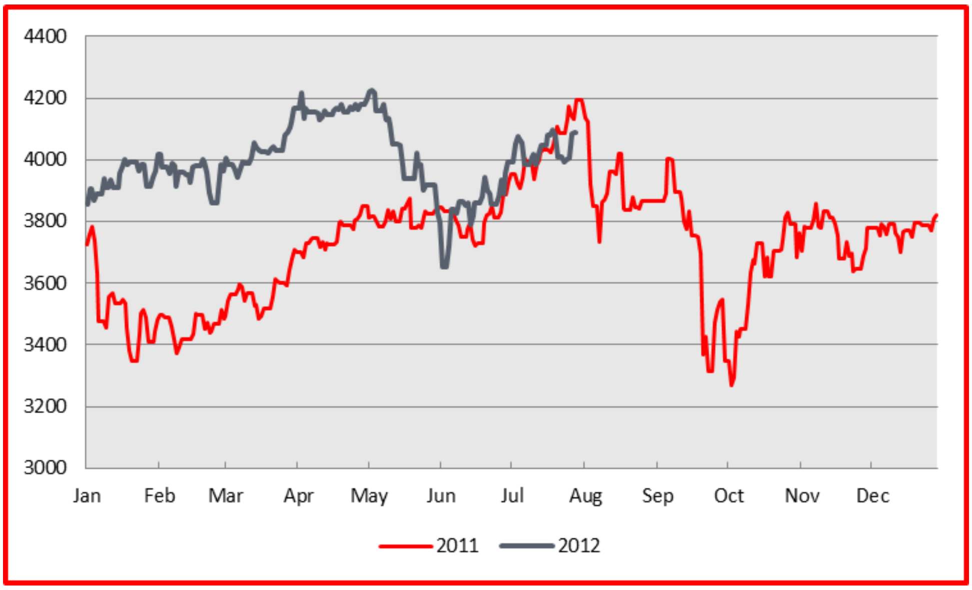
Appendix

Chart 10: S&P500 Index—Is 2012 reminiscent of 2011?



Source: Bloomberg, adapted from SG Cross Asset Research

Chart 11: If it is, the worse is yet to come, JCI Index will not be spared.



Source: Bloomberg

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