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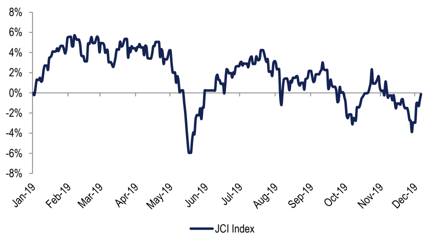
Indonesia Strategy

Strategy Update | 06 December 2019

JCI Performance

	3M	6M	12M
Absolute	-1.9%	-0.4%	1.2%



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What has caused the sell off?

- JCI dropped 4% in Nov (-2% YTD) and this marks two second consecutive years of negative equity return (vs. c.6% p.a. bond return).
- Based on our analysis and discussion with investors, we think these are the main causes: 1) weak growth, 2) tepid earnings and 3) sentiment.
- Improving sentiment (especially domestic), along with upside in growth and earnings underpin our unchanged JCI FY20 target of 6,900.

Another sell-off in Nov due to several factors

JCI dropped by another 4% in Nov, which brought overall YTD return to -2%, this marks 2nd consecutive year of negative equity return vs. +6% p.a. bond returns during the same period. Based on our analysis and discussion with several investors (both local and foreign), we believe these are the main causes for JCI underperformance: 1) weak economic growth (especially on nominal GDP side), 2) tepid earnings outlook and 3) sentiment (domestic factors like political and/or intervention noises along with external noises).

Sluggish nominal growth in 3Q, all-time low since 1999

Despite decent real GDP (5% in 3Q19), to our surprise nominal GDP was only at 5.9% in 3Q19, the lowest ever since 1999 (all-time low of 5%). This suggests a very weak ASP on the producer side which may due to slowing demand. This also resulted in lacklustre earnings growth (FY19F of 5%).

Other than in 2014, single digit earnings growth always resulted in JCI underperformance

Historically JCI always posted negative return during period of single digit earnings growth except for 2014 (rally was caused by the election euphoria). 9M19 earnings growth of 8% and FY19 expectation of 5% clearly wasn't attractive enough to compensate risk-adjusted return of holding equity as opposed to holding bonds.

Weak sentiment amidst domestic and external noises

Domestic noises such as political (uncertainty during presidential election and cabinet reshuffle) and intervention (lowering gas price/lending rate) has been major pushback for most of the investors. This was exacerbated by external noises such as trade war and riot in Hong Kong.

What may change next year?

We think generally next year will be a better year as: 1) domestic sentiment will not get any worse (subduing political/intervention overhang), 2) pick-up in economic growth, especially with empirical evidence in pick-up in investment from higher industrial estate sales and hopefully better government spending to offset lower consumption (from lower purchasing power) and 3) better earnings growth as we/consensus expect 10% earnings growth in FY20 (vs. 5% in FY19) which has high probability to achieve amid pick-up in banks earnings growth (post IFRS 9 implementation).

Maintain JCI target of 6,900

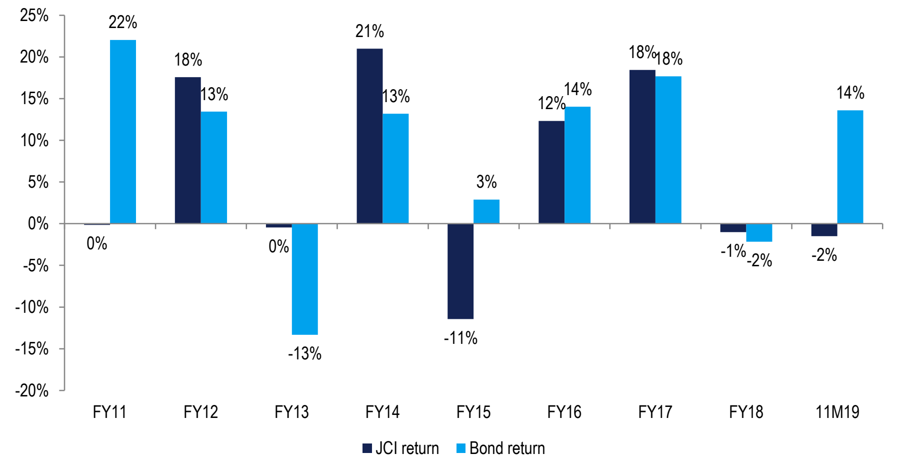
We maintain our FY20 JCI target of 6,900 (based on 2.1x P/BV – lower than its 10Y avg of 2.3x P/BV) with interest sensitive (banks/auto/tower) and selective staple (UNVR, INDF) as our picks. Risk is worse than expected earnings growth.

Another sell-off in Nov due to several factors; sluggish nominal GDP in 3Q

JCI dropped by another 4% in Nov, which brought overall YTD return to –-2%, this marks 2nd consecutive year of negative equity return vs. +6% p.a. bond returns during the same period.

Based on our analysis and discussion with several investors (both local and foreign), we believe these are the main causes for JCI underperformance: 1) weak economic growth (especially on nominal GDP side), 2) tepid earnings outlook (based on our analysis of 54 stocks under our universe, consensus only expects c.5% EPS growth in 2019) and 3) sentiment (domestic factors like political and/or intervention noises along with external noises).

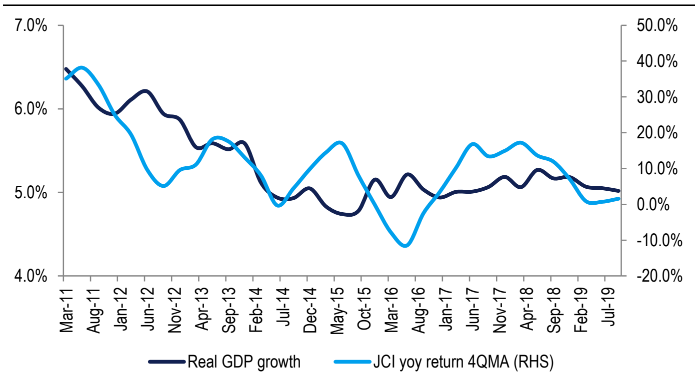
Fig. 1: JCI posted -2% return YTD, which marks the 2nd consecutive year of negative equity return vs. 6% p.a. bond returns during the same period



Sources: Company, IndoPremier

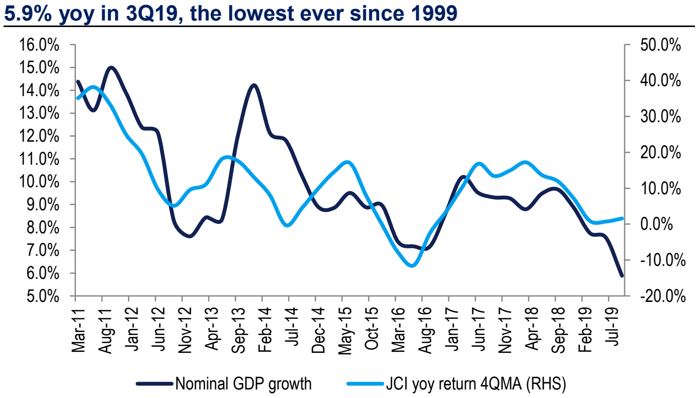
Despite decent real GDP (5% in 3Q19), to our surprise nominal GDP only grew by 5.9% yoy in 3Q19, the lowest ever since 1999 (all-time low of 5%). This suggests a very weak ASP on the producer side which may be due to slowing demand. This also resulted in lacklustre earnings growth (5% expected in FY19).

Fig. 2: Real GDP vs. JCI yoy return



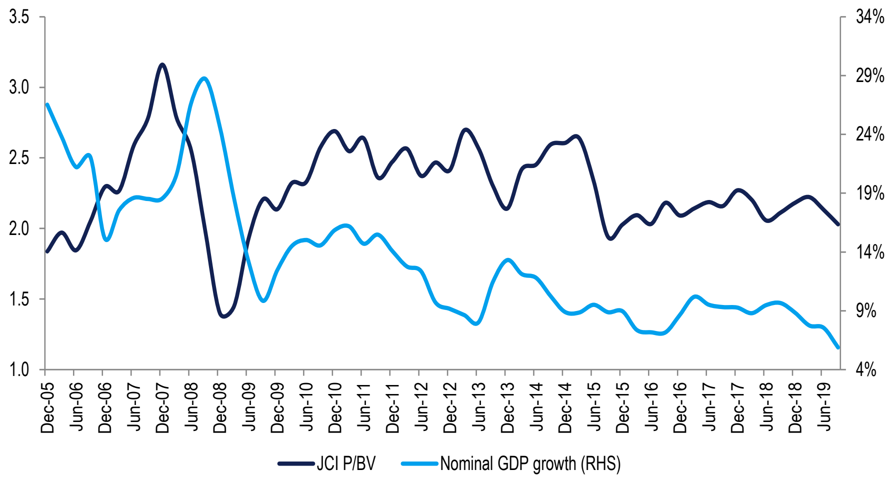
Sources: Company, IndoPremier

Fig. 3: Nominal GDP growth vs. JCI yoy return – nominal GDP grew 5.9% yoy in 3Q19, the lowest ever since 1999



Sources: Company, IndoPremier

Fig. 4: JCI P/BV growth vs. nominal GDP growth



Sources: Bloomberg, CEIC, IndoPremier

Other than 2014, single digit EPS growth always resulted in JCI underperformance

Historically JCI always posted negative return during period of single digit earnings growth except for 2014 (rally was caused by the election euphoria). 9M19 earnings growth of 8% and FY19 expectation of 5% clearly wasn't attractive enough to compensate risk-adjusted return of holding equity as opposed to holding bonds.

Subsequently, our analysis also shows very strong correlation between JCI's EPS growth and JCI return and nominal GDP growth (Fig 6-8), which further exacerbated the negative sentiment, in our view.

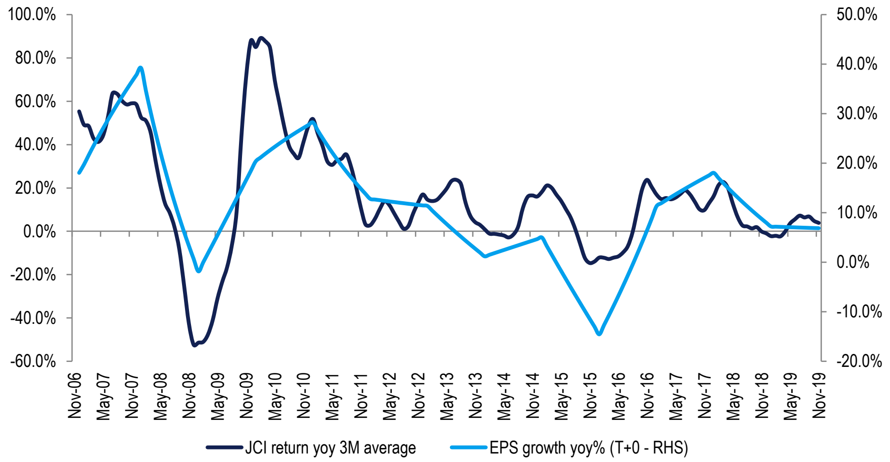
Indeed, consensus estimates on FY19 and FY20 earnings of stocks under our universe have also been downgraded by c.8% since the beginning of the year. Note that our universe comprises of 54 stocks, which accounts for c.65% of JCI's market cap. We believe has partially led to the foreign equity outflow (US$1.7bn outflow YTD), while on the other hand foreign investors seem to be more aggressive on bonds (US$12bn inflow YTD), as shown in fig 9-10.

Fig. 5: Summary of equity and bond performance from 2011-11M19

Equity	JCI return	JCI EPS yoy%	Equity foreign flow (US$ mn)	Bonds	Bond yield	Bond return	Bond foreign flow (US$ mn)	Government bond gross issuance (Rp tr)	Government gross bond issuance yoy%
FY11	0%	13%	2,956	FY11	6.0%	22%	3,235	159	16%
FY12	18%	11%	1,712	FY12	5.2%	13%	5,007	269	69%
FY13	0%	1%	(1,806)	FY13	8.5%	-13%	4,942	323	20%
FY14	21%	5%	3,766	FY14	7.8%	13%	13,308	428	32%
FY15	-11%	-15%	(1,580)	FY15	9.0%	3%	5,807	502	17%
FY16	12%	11%	1,258	FY16	8.0%	14%	8,077	652	30%
FY17	18%	18%	(1,592)	FY17	6.3%	18%	12,737	685	5%
FY18	-1%	7%	(3,656)	FY18	8.0%	-2%	3,860	799	17%
11M19	-2%	7%	(1,667)	11M19	7.1%	14%	12,388	894	15%

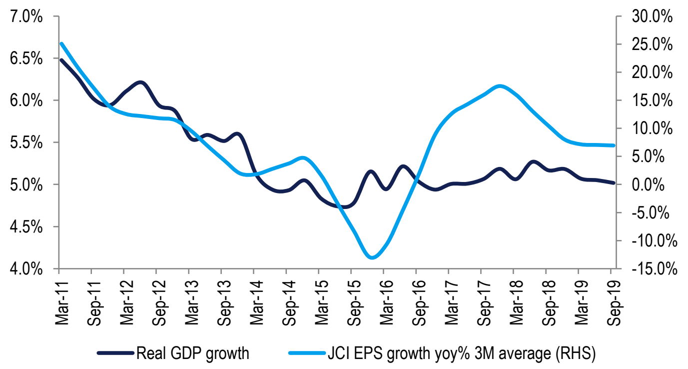
Sources: Bloomberg, CEIC, IndoPremier

Fig. 6: JCI return vs. EPS growth



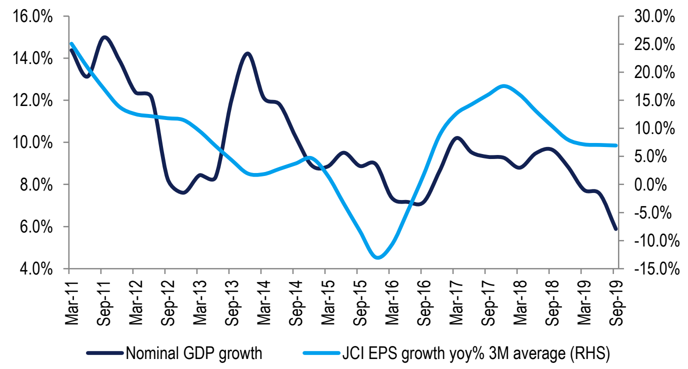
Sources: Bloomberg, CEIC, IndoPremier

Fig. 7: Real GDP growth vs. JCI's EPS growth yoy



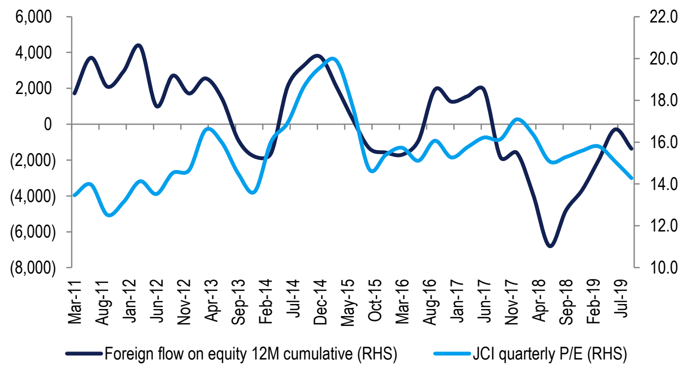
Sources: Bloomberg, CEIC, IndoPremier

Fig. 8: Nominal GDP growth vs. JCI's EPS growth yoy



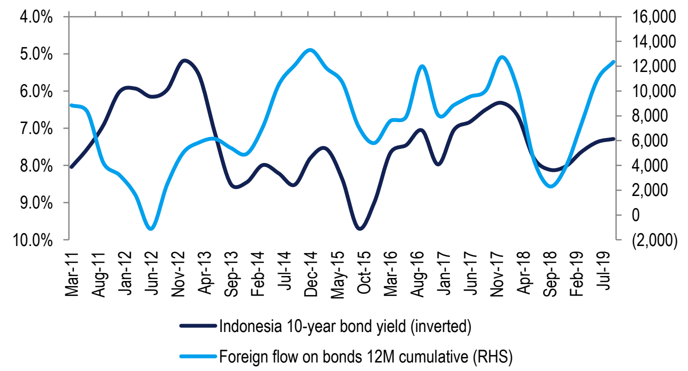
Sources: Bloomberg, CEIC, IndoPremier

Fig. 9: JCI quarterly P/E vs. cumulative foreign equity flow



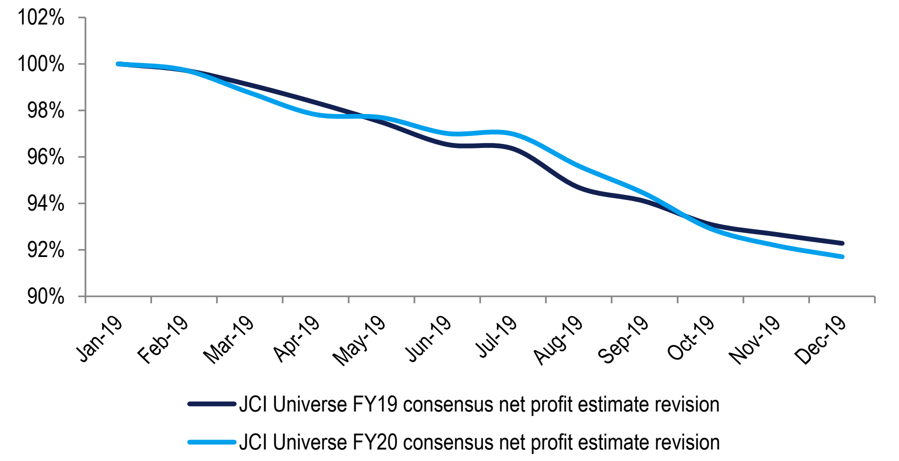
Sources: Bloomberg, CEIC, IndoPremier

Fig. 10: Indonesia 10-year bond yield vs. foreign bond flow



Sources: Bloomberg, CEIC, IndoPremier

Fig. 11: Consensus has downgraded FY19 and FY20 EPS estimate by c.8% since the beginning of the year



Sources: Company, IndoPremier

Fig. 12: FY19 consensus earnings revision by sector

FY19 cons EPS revision	Banks	Cons Staples	Retail	Telco	Coal	Others (ASII, JSMR, PGAS)	Cement	Property	Metals	CPO	Media	Towers	Contractors	JCI Universe
Jan-19	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Feb-19	100%	101%	102%	100%	98%	100%	102%	99%	96%	93%	100%	101%	97%	100%
Mar-19	100%	101%	99%	98%	96%	99%	103%	98%	98%	91%	100%	100%	91%	99%
Apr-19	100%	99%	98%	95%	97%	98%	106%	95%	99%	87%	102%	97%	88%	98%
May-19	99%	99%	95%	93%	97%	97%	98%	97%	86%	74%	106%	95%	85%	97%
Jun-19	99%	98%	94%	92%	93%	96%	95%	97%	81%	73%	108%	93%	85%	97%
Jul-19	99%	98%	93%	93%	92%	96%	93%	97%	75%	73%	109%	92%	86%	96%
Aug-19	98%	97%	92%	95%	89%	92%	87%	98%	69%	43%	111%	91%	84%	95%
Sep-19	97%	98%	93%	95%	87%	89%	83%	103%	77%	41%	111%	88%	83%	94%
Oct-19	96%	98%	93%	95%	85%	89%	82%	104%	65%	34%	111%	85%	83%	93%
Nov-19	95%	98%	90%	96%	85%	88%	83%	105%	62%	28%	110%	84%	81%	93%
Dec-19	94%	98%	90%	96%	85%	88%	82%	103%	62%	25%	109%	84%	80%	92%

Sources: Bloomberg, IndoPremier

Fig. 13: FY20 consensus earnings revision by sector

FY20 cons EPS revision	Banks	Cons Staples	Retail	Telco	Coal	Others (ASII, JSMR, PGAS)	Cement	Property	Metals	CPO	Media	Towers	Contractors	JCI Universe
Jan-19	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Feb-19	100%	101%	102%	100%	99%	100%	104%	100%	92%	95%	100%	103%	96%	100%
Mar-19	100%	101%	99%	98%	96%	97%	105%	99%	89%	93%	100%	103%	88%	99%
Apr-19	99%	99%	98%	94%	98%	95%	110%	97%	88%	90%	102%	99%	84%	98%
May-19	99%	98%	95%	98%	98%	95%	105%	98%	80%	81%	106%	97%	82%	98%
Jun-19	99%	98%	95%	97%	94%	94%	103%	98%	73%	81%	108%	95%	84%	97%
Jul-19	99%	98%	97%	98%	94%	93%	103%	99%	69%	80%	109%	93%	86%	97%
Aug-19	98%	98%	96%	99%	88%	91%	97%	98%	65%	62%	112%	92%	86%	96%
Sep-19	98%	96%	96%	100%	85%	89%	93%	99%	69%	63%	111%	88%	84%	94%
Oct-19	97%	93%	96%	99%	82%	88%	91%	98%	65%	62%	111%	86%	84%	93%
Nov-19	96%	91%	93%	100%	81%	88%	92%	98%	63%	60%	111%	86%	82%	92%
Dec-19	95%	91%	93%	99%	80%	88%	91%	98%	64%	61%	109%	86%	82%	92%

Sources: Bloomberg, IndoPremier

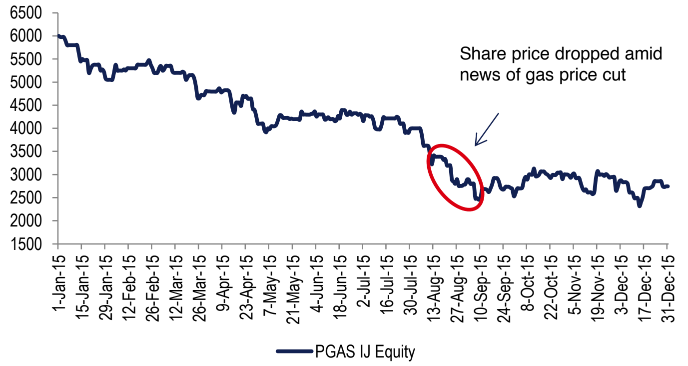
Domestic noises such as political (uncertainty during presidential election and cabinet reshuffle) and intervention (lowering gas price/lending rate) has been major pushback for most of the investors (more details on our previous report dated 6 Nov 2019). This was exacerbated by external noises such as trade war and riot in Hong Kong.

Fig. 14: Summary of previous interventions

Date	Sector affected	Intervention	Materialized	Impact
Jan-15	Cement	President Jokowi lowered cement prices of SMBR and SMGR by Rp3000/bag	Yes	SMGR and INTP share prices dropped 12-13% post announcement week-on-week
Sep-15	Gas	Government pushed for gas prices to be lowered to US$6/mmbtu	Yes	PGAS' share price dropped c.20% post announcement week-on-week
Feb-16	Banks	OJK wants to cap Indonesia banks' NIM at 4%	No	Bank sector's share price dropped c.7% within a week of the article
Jan-18	Coal	Government implemented DMO price of US$70/tonne	Yes	Coal stocks fell c.7% within a week post the announcement
Oct-19	Gas	President Jokowi wants lower gas prices	N/A	PGAS's share price dropped 24% within 2 days of the announcement
Nov-19	Banks	President Jokowi wants to lower lending rates	N/A	Banks's share price today down 1-3% today after the news broke

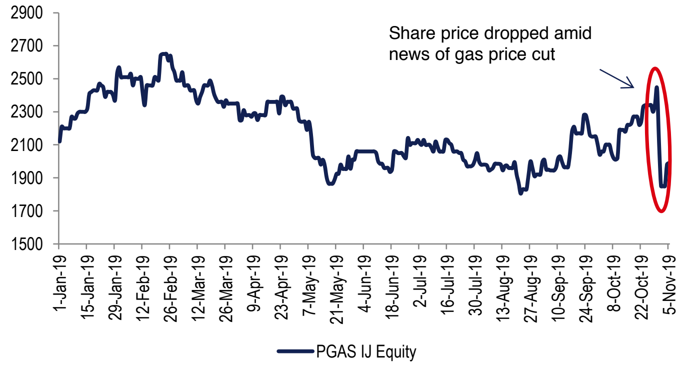
Sources: IndoPremier

Fig. 15: Gas prices to be cut to US$6/mmbtu in Sep15, and share price corrected by 20% within a week



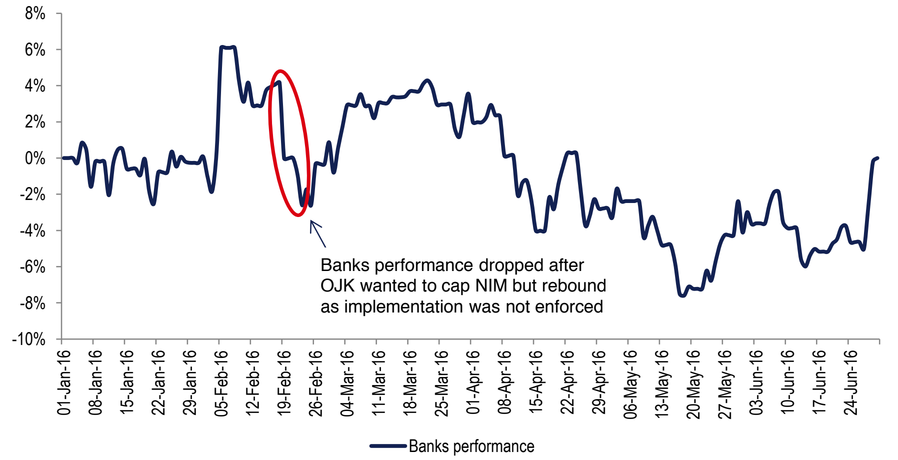
Sources: Bloomberg, IndoPremier

Fig. 16: Share prices fell 24% within 2 days after news of gas prices cut



Sources: Bloomberg, IndoPremier

Fig. 17: Banks dropped 7% week after OJK cited that they want to cap bank's NIM at 4% in mid Feb16



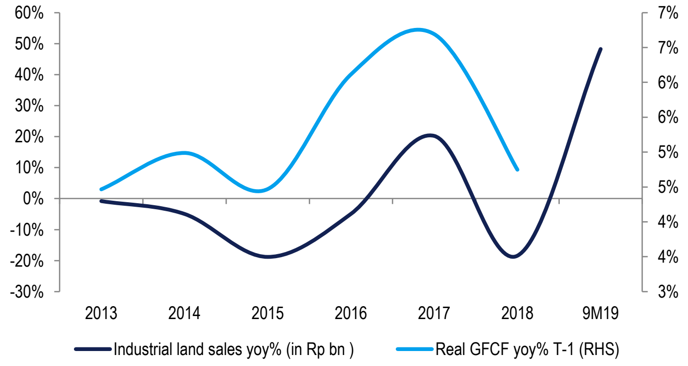
Sources: Bloomberg, IndoPremier

What may change next year?

We think generally next year will be a better year as:

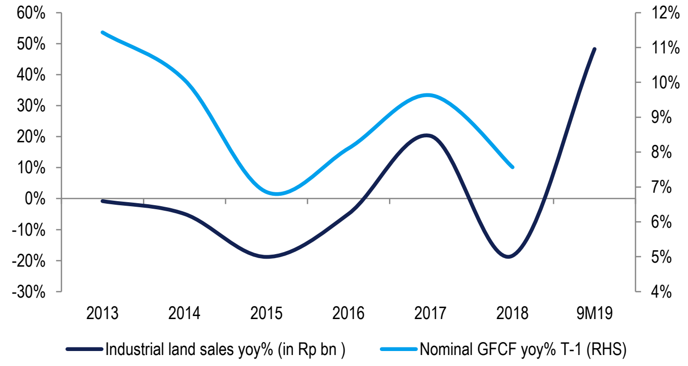
1) Domestic sentiment will not get any worse (subduing political/intervention overhang),
2) Pick-up in economic growth (we expect Indonesia's real GDP growth to improve to 5.1-5.3% in 2020 from 5-5.1% in 2019), especially with empirical evidence in pick-up in investment from higher industrial estate sales and hopefully better government spending to offset lower consumption (from lower purchasing power), and
3) Better earnings growth as we/consensus expect 10% earnings growth in FY20 (vs. 5% in FY19) which has high probability to achieve amid pick-up in banks earnings growth (post IFRS 9 implementation).

Fig. 18: Industrial land sales growth vs. real GFCF – industrial land sales seems to be a reliable leading indicator for investments



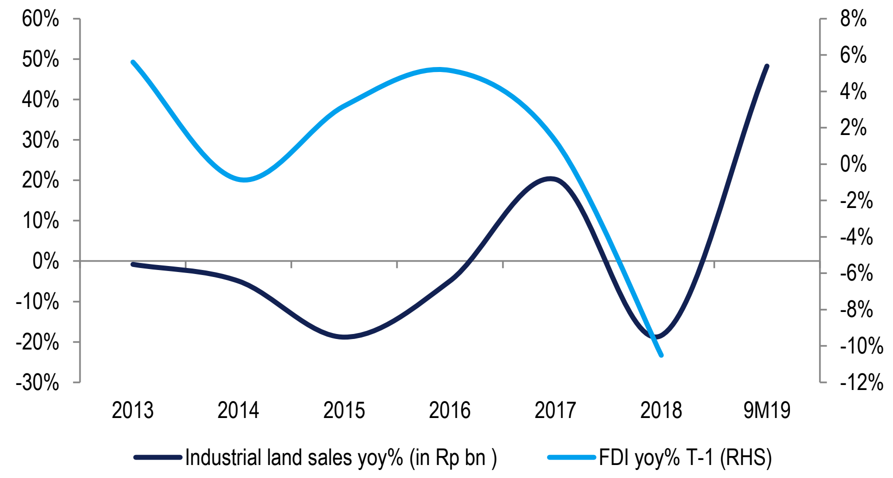
Sources: Company, IndoPremier

Fig. 19: Industrial land sales growth vs. nominal GFCF – industrial land sales seems to be a reliable leading indicator for investments



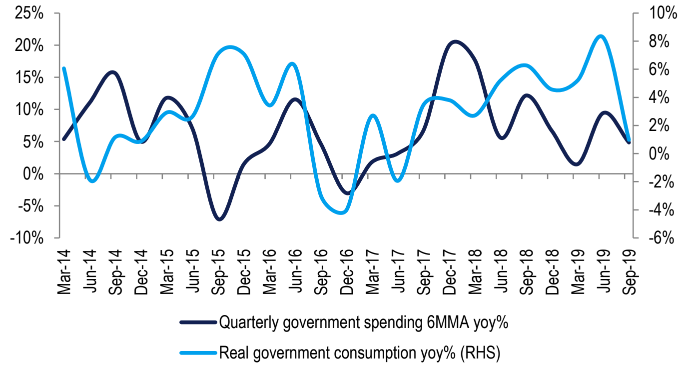
Sources: Company, IndoPremier

Fig. 20: Industrial land sales yoy% vs. FDI – FDI seems to lag industrial land sales as well



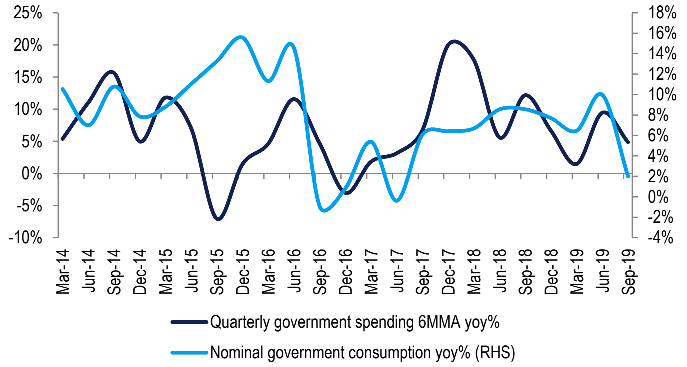
Sources: Company, CEIC, IndoPremier

Fig. 21: Government spending realization vs. real government consumption – a better government spending in 2020 might help offset potentially lower consumption



Sources: CEIC, IndoPremier

Fig. 22: Government spending realization vs. nominal government consumption



Sources: CEIC, IndoPremier

Fig. 23: We/consensus expect a pick-up in 2020 earnings growth, which seems highly likely achievable amid a pick-up in banks' earnings growth

				yoy%	yoy%
Net profit (Rp bn - IPOT forecast for covered stocks)	**2018**	**2019**	**2020**	**18-19**	**19-20**
Banks	114,857	121,747	138,264	6%	14%
Consumer Staples	48,932	50,562	52,094	3%	3%
Retail	3,385	4,352	4,767	29%	10%
Telco	12,213	21,267	22,976	74%	8%
Coal	25,830	23,138	21,994	-10%	-5%
Big caps (ASII, JSMR, PGAS)	28,220	26,785	30,418	-5%	14%
Cement	4,225	3,563	5,177	-16%	45%
Property	6,504	7,744	7,866	19%	2%
Metals	1,736	1,665	2,684	-4%	61%
CPO	1,770	589	1,601	-67%	172%
Media	3,016	3,465	3,793	15%	9%
Towers	2,905	3,114	3,692	7%	19%
Contractors	7,839	7,240	7,950	-8%	10%
JCI Universe	**261,432**	**275,233**	**303,275**	**5%**	**10%**

Blue indicates sectors that we have initiated coverage on

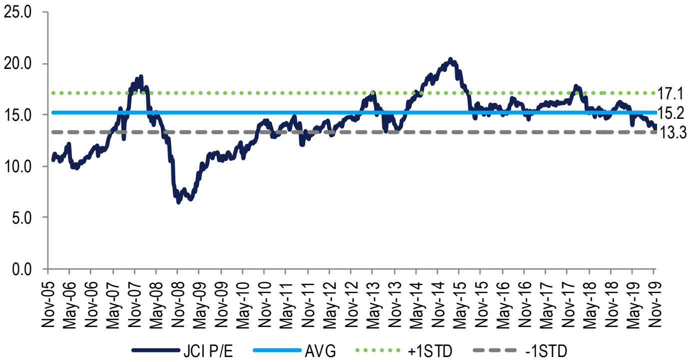
				yoy%	yoy%
Net profit (Rp bn - Consensus numbers)	**2018**	**2019**	**2020**	**18-19**	**19-20**
Banks	114,857	122,804	139,246	7%	13%
Consumer Staples	48,932	50,484	51,564	3%	2%
Retail	3,385	4,170	4,651	23%	12%
Telco	12,213	20,334	23,735	66%	17%
Coal	25,830	23,771	22,758	-8%	-4%
Big caps (ASII, JSMR, PGAS)	28,220	27,283	29,909	-3%	10%
Cement	4,225	3,563	5,177	-16%	45%
Property	6,504	7,744	7,865	19%	2%
Metals	1,736	1,665	2,684	-4%	61%
CPO	1,770	589	1,601	-67%	172%
Media	3,016	3,465	3,793	15%	9%
Towers	2,881	3,175	3,530	10%	11%
Contractors	7,839	7,240	7,950	-8%	10%
JCI Universe	**261,408**	**276,277**	**304,465**	**6%**	**10%**

Sources: Bloomberg, Company, IndoPremier

Maintain JCI target of 6,900

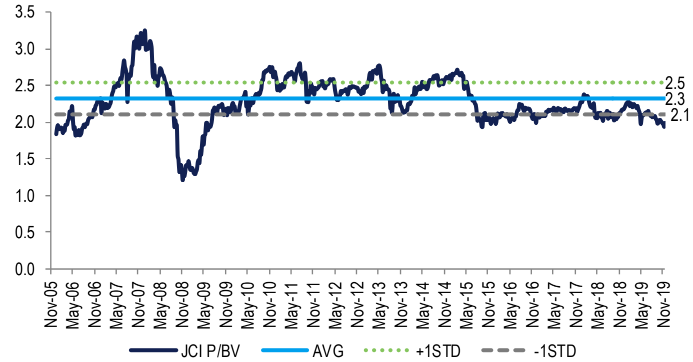
We maintain our 2020 JCI target of 6,900 (based on a target multiple of 2.1x P/BV – lower than its 10Y avg of 2.3x P/BV) with interest sensitive (banks/auto/tower) and selective staples (UNVR, INDF) as our top picks. Risk is worse than expected earnings growth.

Fig. 24: JCI's forward P/E – now trading at 13.9x 2020 P/E vs. 10-year average of 15.2x P/E



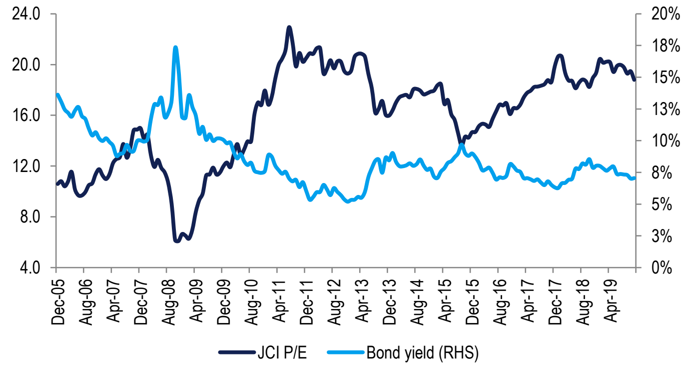
Sources: Bloomberg, IndoPremier

Fig. 25: JCI's forward P/BV – now trading at 2x 2020 P/BV vs. 10-year average of 2.3x P/BV



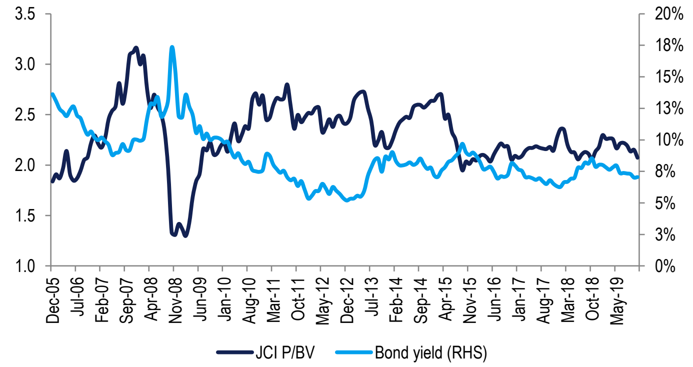
Sources: Bloomberg, IndoPremier

Fig. 26: JCI P/E vs. bond yield – negative correlation between JCI's valuations vs. bond yield



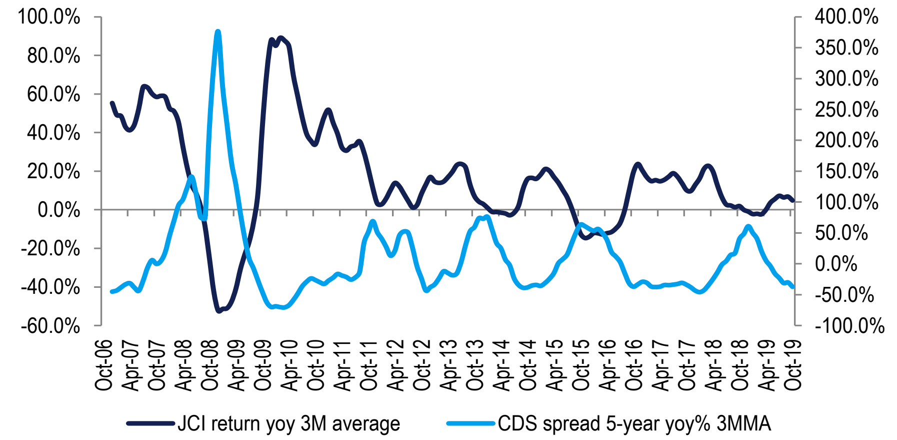
Sources: Bloomberg, IndoPremier

Fig. 27: JCI P/BV vs. bond yield



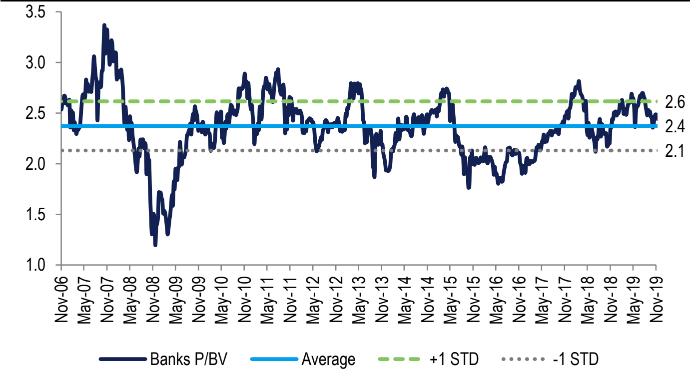
Sources: Bloomberg, IndoPremier

Fig. 28: Strong negative correlation between CDS spread vs. JCI's return – CDS spread has remained benign YTD



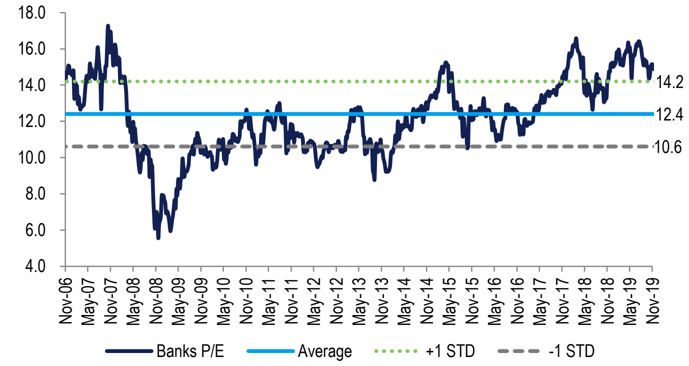
Sources: Bloomberg, IndoPremier

Fig. 29: Banks' forward P/BV – now trading at 2.4x 2020F P/BV vs. 10-year average of 2.4x P/BV



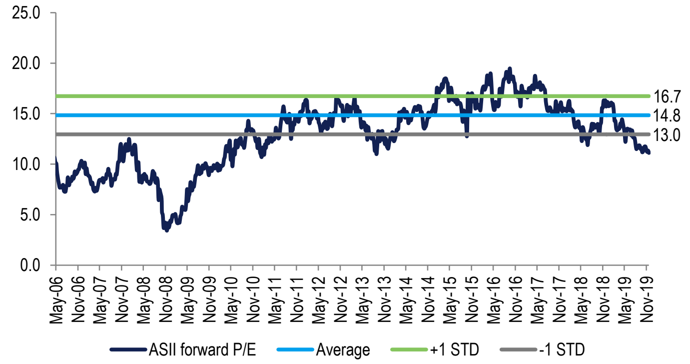
Sources: Bloomberg, Company, IndoPremier

Fig. 30: Bank's forward P/E – now trading at 14.7x 2020F P/E vs. 10-year average of 12.4x P/E



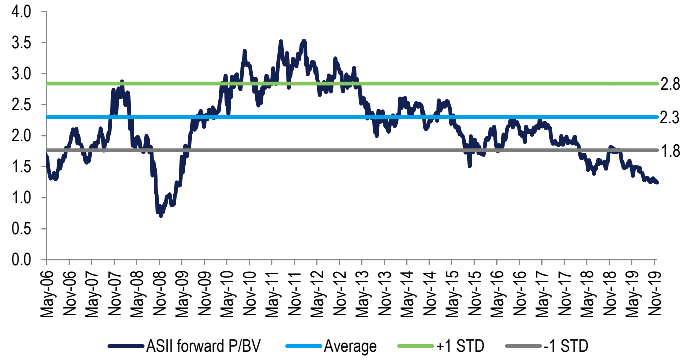
Sources: Bloomberg, Company, IndoPremier

Fig. 31: ASII's forward P/E – now trading at 11.1x 2020 P/E vs. 10-year average of 15x P/E



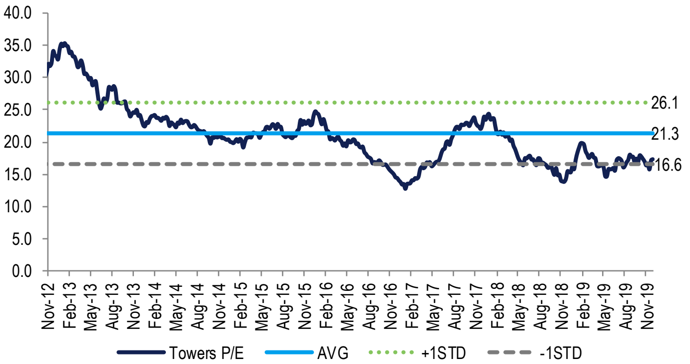
Sources: Bloomberg, Company, IndoPremier

Fig. 32: ASII's forward P/BV – now trading at 1.3x 2020 P/BV vs. 10-year average of 2.3x P/BV



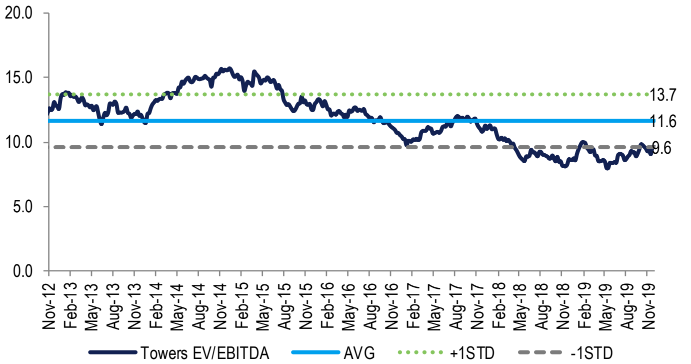
Sources: Bloomberg, Company, IndoPremier

Fig. 33: Towers's forward P/E – now trading at 17.2x 2020 P/E vs. 10-year average of 21.3x P/E



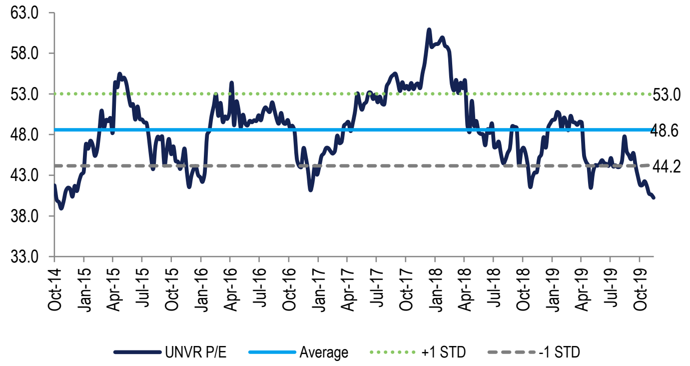
Sources: Bloomberg, Company, IndoPremier

Fig. 34: Towers's forward EV/EBITDA – now trading at 9.6x 2020 P/BV vs. 10-year average of 11.6x EV/EBITDA



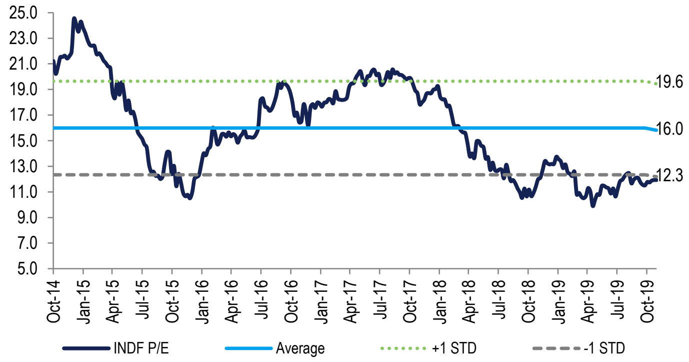
Sources: Bloomberg, Company, IndoPremier

Fig. 35: UNVR's forward P/E – now trading at 40x 2020 P/E vs. 10-year average of 48.6x P/E



Sources: Bloomberg, Company, IndoPremier

Fig. 36: INDF's forward P/E – now trading at 11.8x 2020 P/E vs. 10-year average of 16x P/E



Sources: Bloomberg, Company, IndoPremier

SECTOR RATINGS

OVERWEIGHT	:	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation
NEUTRAL	:	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation
UNDERWEIGHT	:	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation

COMPANY RATINGS

BUY	:	Expected total return of 10% or more within a 12-month period
HOLD	:	Expected total return between -10% and 10% within a 12-month period
SELL	:	Expected total return of -10% or worse within a 12-month period

ANALYSTS CERTIFICATION

The views expressed in this research report accurately reflect the analyst's personal views about any and all of the subject securities or issuers; and no part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in the report.

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