

# Nippon Indosari Corpindo

ROTI IJ / ROTI.JK

Report Initiation | BCAS Virtue | Consumer Sector

## BUY

11 August 2017

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Theoretical Ex-Rights Price: IDR1,160

Target Price: IDR1,400

Upside potential: 20.7%

## The maestro of baking

### ROTI, the bread market leader in Indonesia

With the spread of health information, more Asians have adopted a Western diet and eat more wheat-based food, especially bread, in place of rice. Bread products are viewed as a low-cost alternative to rice, convenient and available everywhere. ROTI, the market leader in the Indonesian bread industry with 'Sari Roti' Brand with around 90% market share, offers affordable and healthy bread products to middle- and low-income individuals and families while taking advantage of a consumption rate in Indonesia – starting from a low base. Additionally, ROTI offers the most product varieties in the market, compared to its competitors; ROTI Brand products are sold in supermarkets and minimarkets, as well as through general trade. The latter gives ROTI a supreme advantage over its close competitors, because ROTI will definitely feel less impact from a proposed bill to limit convenience store expansion. Finally, being a company with a vision in mass producing, ROTI has better product distribution than boutique bakeries, whose sales are limited in or around shopping malls. Helped by a depressed global wheat price and increasing demand for bread products, ROTI now perceives the opportunity to remain profitable and grow its already-dominant market share.

### Continual innovations and expansion

Cementing its position as the first mover, ROTI continuously innovates and expands its business. Today ROTI has launched more than 50 SKUs and looks to launch more in the near future. In domestic market, ROTI operates 10 factories, in Sumatra, Java and Sulawesi. Additionally, ROTI formed a joint venture with Monde Nissin in 2016 to create Sarimonde Foods Corporation, to market Walter Bread, a premium Filipino brand for health-conscious consumers, as well as ROTI's own Sari Roti in the Philippines. With ROTI's factories close to optimum capacity (~80%) end-2017 and market expansion in mind, ROTI plans to add 7-8 factories with double production lines for each white bread and sweet bread variety in the next five years, in Sumatra, Java, Kalimantan and the Philippines, to satisfy the demand for Sari Roti in the respective areas.

### ROTI's rights issue: initiate with BUY, TP IDR1,400

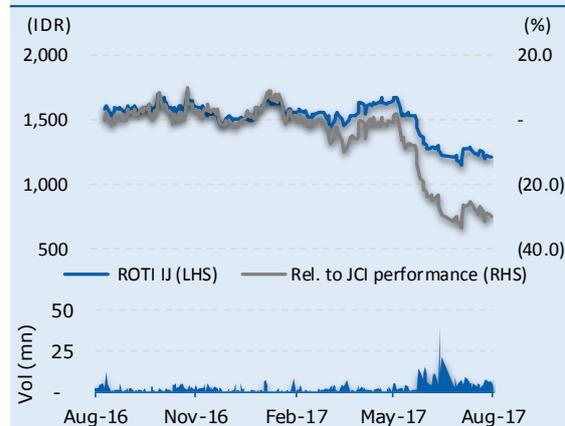
To fund factory expansion, ROTI needs additional capital for more production capacity, projecting up to 7m pieces/day by end-2021. With factory construction completed in 2018, we believe ROTI should see an increase in revenue as early as 2019. Our valuation suggests that theoretical ex-rights price of IDR1,160 provides a buying opportunity, and we recommend BUY with TP of IDR1,400 post-rights issue, a 20.7% upside using 26x (discounted from mean level) to 2018F EPS. Risks include: inability to lock down favorable wheat flour price, unexpected factory expansion issues and stiffer competition in the industry.

### Exhibit 1. Financial Summary

YE to 31 Dec (IDR bn)	2015	2016	2017F	2018F	2019F
Revenue	2,175	2,522	2,736	3,043	3,435
EBIT	416	383	268	411	494
Net Profit	271	280	188	332	396
BCAS/Consensus (%)	-	-	72.9	95.6	80.2
EPS (IDR)	53	55	35	53	64
EPS Growth (%)	43.4	3.4	(36.4)	52.0	19.4
PE (x)	22.8	22.1	34.7	22.8	19.1
BVPS (x)	235	285	485	464	517
PB (x)	5.2	4.3	2.5	2.6	2.4
DPS (IDR)	6	11	14	7	11
Dividend Yield (%)	0.5	0.9	1.1	0.6	0.9
ROE (%)	25.2	21.3	9.3	12.1	13.0

Source: Company, BCA Sekuritas estimate, \*Closing price as of 11 August 2017

### 12M PRICE PERFORMANCE



Source: Bloomberg

### STOCK PERFORMANCE

	YTD	1M	3M	12M
Absolute	-23.8%	2.1%	-27.2%	-22.8%
JCI Return	10.0%	0.2%	2.2%	7.1%
Relative	-33.7%	1.9%	-29.4%	-29.8%

Source: Bloomberg

### MARKET DATA

12M price range (IDR)	:	1,150 - 1,725
12M PE range (x)	:	26.5 - 48.0
Outstanding shares (mn)	:	5,062
Market cap (IDRbn)/(USDmn)	:	6,175 / 463
Avg daily turn. (IDRbn/USDmn)	:	38.5 / 2.9

Source: Bloomberg

### SHAREHOLDERS

Indoritel makmur International	:	31.5%
Pasco Shikishima Corp	:	8.5%
Bonlight Investment Ltd	:	25.1%
Others (each below 5%)	:	34.9%

Source: Bloomberg

**Exhibit 2. Financial Summary**

<b>Income Statement</b>					
<b>Year-end 31 Dec (IDRbn)</b>	<b>2015</b>	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
<b>Revenue</b>	<b>2,175</b>	<b>2,522</b>	<b>2,736</b>	<b>3,043</b>	<b>3,435</b>
Cost of revenue	1,020	1,221	1,402	1,502	1,672
<b>Gross profit</b>	<b>1,155</b>	<b>1,301</b>	<b>1,334</b>	<b>1,541</b>	<b>1,763</b>
<b>EBITDA</b>	<b>523</b>	<b>478</b>	<b>365</b>	<b>516</b>	<b>609</b>
Depreciation	107	95	97	104	114
<b>EBIT</b>	<b>416</b>	<b>383</b>	<b>268</b>	<b>411</b>	<b>494</b>
Net interest income (expenses)	(72)	(74)	(27)	22	23
Forex gain (loss)	(0)	7	-	-	-
Other incomes (expenses)	35	56	13	15	18
<b>Pre-tax profit</b>	<b>378</b>	<b>369</b>	<b>254</b>	<b>448</b>	<b>535</b>
Taxes	108	90	66	117	139
Minority Interests	-	-	-	-	-
<b>Net Income</b>	<b>271</b>	<b>280</b>	<b>188</b>	<b>332</b>	<b>396</b>
<b>EPS (Rp)</b>	<b>53</b>	<b>55</b>	<b>35</b>	<b>53</b>	<b>64</b>

**Revenue is expected to reach IDR3tn in 2018, responding to recovery of sales.**

<b>Balance Sheets</b>					
<b>Year-end 31 Dec (IDRbn)</b>	<b>2015</b>	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
Cash and cash equivalents	515	611	1,689	1,302	937
Account receivables	251	284	304	338	382
Inventories	43	51	55	57	61
LT Investments & LT Receivables	-	-	-	-	-
Fixed assets	1,842	1,868	1,918	2,132	2,822
Other assets	55	106	137	152	172
<b>Total assets</b>	<b>2,706</b>	<b>2,920</b>	<b>4,102</b>	<b>3,981</b>	<b>4,373</b>
Short term Liabilities	-	-	-	-	-
Other short term liabilities	396	321	389	440	471
Long term liabilities	994	996	996	493	491
Other long term liabilities	127	160	125	168	199
<b>Total liabilities</b>	<b>1,518</b>	<b>1,477</b>	<b>1,510</b>	<b>1,101</b>	<b>1,162</b>
Minority Interests	-	43	43	43	43
Equity	1,189	1,399	2,549	2,837	3,168
<b>Total liabilities &amp; equity</b>	<b>2,706</b>	<b>2,920</b>	<b>4,102</b>	<b>3,981</b>	<b>4,373</b>

**Rights issue proceeds will increase ROTI's cash level by end-2017...**

<b>Cash Flows Statement</b>					
<b>Year-end 31 Dec (IDRbn)</b>	<b>2015</b>	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
Net income	271	280	188	332	396
Depreciations and Amortization	107	95	97	104	114
Change in working capital	241	(13)	105	107	79
<b>Operating cash flow</b>	<b>618</b>	<b>362</b>	<b>390</b>	<b>543</b>	<b>590</b>
Capex	(248)	(116)	(125)	(330)	(798)
Others	(29)	(56)	(34)	(16)	(23)
<b>Investing cash flow</b>	<b>(278)</b>	<b>(172)</b>	<b>(158)</b>	<b>(346)</b>	<b>(821)</b>
Dividend Paid	(28)	(54)	(73)	(43)	(66)
Net change in debt	159	2	(0)	(503)	(1)
Others	(119)	(42)	920	(37)	(67)
<b>Financing cash flow</b>	<b>12</b>	<b>(94)</b>	<b>846</b>	<b>(583)</b>	<b>(134)</b>
Change in cash	353	96	1,078	(386)	(365)
Beginning in cash flow	163	515	611	1,689	1,302
<b>Ending in cash flow</b>	<b>515</b>	<b>611</b>	<b>1,689</b>	<b>1,302</b>	<b>937</b>

**... and will be used for factory expansion.**

<b>Key Ratios</b>	<b>2015</b>	<b>2016</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
Gross Margin (%)	53.1	51.6	48.8	50.6	51.3
EBITDA Margin (%)	24.0	18.9	13.3	16.9	17.7
EBIT Margin (%)	19.1	15.2	9.8	13.5	14.4
Pretax margin (%)	17.4	14.6	9.3	14.7	15.6
Net Margin (%)	12.4	11.1	6.9	10.9	11.5
ROAE (%)	25.2	21.3	9.3	12.1	13.0
ROAA (%)	11.2	9.9	5.4	8.2	9.5
Current ratio (x)	2.1	3.0	5.3	3.9	3.0
Acid ratio (x)	1.9	2.8	5.1	3.7	2.8
Gearing (%)	89.4	74.2	41.0	19.9	18.3
Net Gearing (%)	46.1	31.9	n.c.	n.c.	n.c.
AR turnover (days)	38	38	39	38	38
Inventory turnover (days)	15	14	14	13	13
AP turnover (days)	50	49	46	46	46

**Flattish margins in 2018F but improved margins in 2019F are anticipated, with higher production output.**

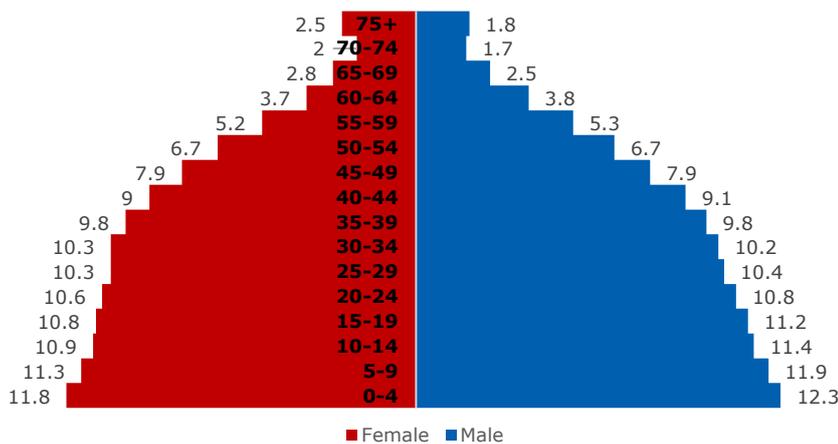
Source: Company, BCA Sekuritas estimate

### A shift in culture

Dietary habits in most Asian countries have changed considerably in recent years. While most Asians still eat more rice than the global average, many consumers have adopted a Western diet by switching to bread as a daily staple, another meal option for breakfast or throughout the day. According to a Rabobank study, the demand for wheat in Southeast Asia will increase 4.5% annually to satisfy market demand for wheat-based food products. In this fast-paced world, bread products are considered cheap and convenient to be consumed everywhere and at any time between meals. We think that this should bode well for the young Indonesian demographic. The younger generation now prefers convenience over other attributes in an item, and bread products offer them a very convenient and practical meal. Indonesia has been known as the largest-growing economy in Southeast Asia. Unarguably, one of the motors of Indonesian growth is consumption, which is boasted by both population growth and stronger purchasing power. This is shown by increasing GDP consumption in recent years. We believe that the strong growth of both small ticket and big ticket items highlights strong consumerism in Indonesia.

A few aspects of being convenient are affordability, easy for a go-to meal, and availability. As such, we believe that ROTI, as a first mover in the Indonesian market, has conquered all three aspects mentioned above. ROTI has an extensive distribution network, with ASP of IDR7,000 for sweet bread and 15,000 for white bread – targeting middle-class consumers, and having a strong brand image as well as extensive products. Stemming from a low consumption rate as well as a shift in eating habits, ROTI is set to be a strong consumer stock that continues to offer growth and value.

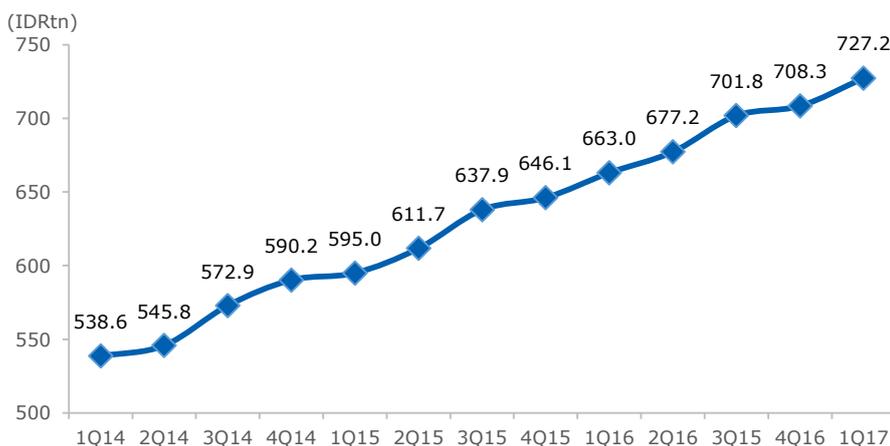
### Exhibit 3. Demographics breakdown



**Indonesia's population consists of young consumers...**

Source: BPS, BCA Sekuritas

### Exhibit 4. Indonesian GDP consumption



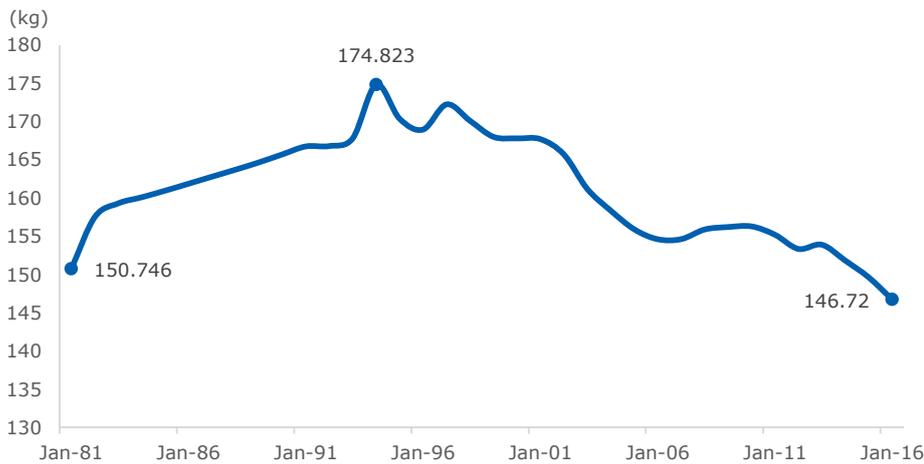
**...with relatively aggressive shopping patterns.**

Source: BPS, BCA Sekuritas

**Bread consumption in Indonesia**

In line with changing lifestyles and growing consumption, as we have mentioned before, many Indonesians have also switched their preferences from rice as daily staple to bread. In fact, the level of rice consumption in Indonesia has been decreasing steadily since 2014. We believe that part of the carbohydrate consumption has switched elsewhere. As we try to gauge where tastes have moved, we highlight the expenditure in Indonesia towards several carbohydrate-rich items. Aside from rice, which has been the staple, instant noodles are also a popular daily dietary item in Indonesia. But, as we can see from the chart (Exhibit 6), bread holds the highest growth expenditure, compared to instant noodles and rice. We also believe that most the growth in bread expenditure comes from volume, as ASP increases have been subtle – a similar trend that is shared among rice and instant noodles as well. Thus, assuming that ASP increase for all 3 items share similar growth, we think that bread volume demonstrates the largest growth potential among the three carbohydrate products.

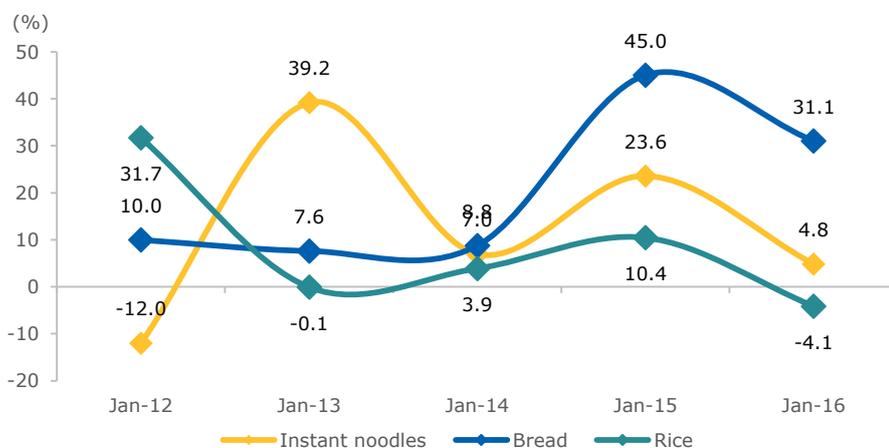
**Exhibit 5. Domestic rice consumption per capita**



**Current Indonesian rice consumption is the lowest since 1980.**

Source: Bloomberg, BCA Sekuritas

**Exhibit 6. Expenditure growth of instant noodle, bread and rice**



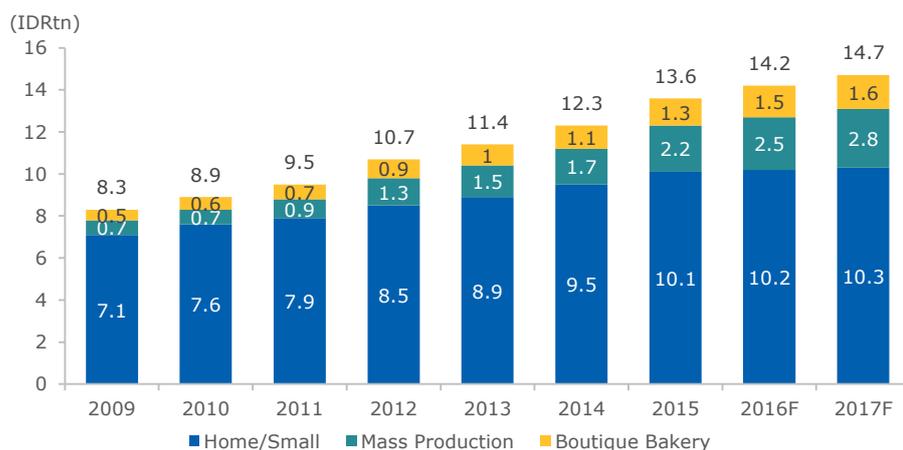
**Expenditures on bread have eclipsed expenditures on instant noodles and rice.**

Source: BPS, BCA Sekuritas

Although we think that it is unlikely for bread to completely change the landscape and replace rice as the most sought-after source of carbohydrates in Indonesia, we believe potential market for bread is huge. This is reflected by the 2011-17F Indonesian bread industry CAGR of 7.6%.

We discern three categories in the Indonesian bread industry, generally speaking: the boutique bakery, the mass production facility and home/small scale production. Referring back to the growing population, we believe that the key growth driver will lie with mass production. Boutique bakery outlets are too segmented and only cater to middle-upper income consumer class, while home/small scale production will encounter production volume and distribution coverage area limitations, inhibiting them from pursuing strong growth ahead. As such, boutique bakeries only form 11% of the total bread market, and despite the growing trend, we do not think that it will grow more than 4% going forward, and mass production will enjoy faster growth and higher revenue. We believe that the new names popping up in the mass production market serve as a testament to our thesis that this segment is the key driver. Yamazaki's MyRoti, Sharon Bread's Paroti, Gardenia's Prime Bread are a few new brands that have entered the battle. ROTI has been the market leader and first mover in this segment, cornering a 90% market share as of 1H17. While we are convinced that ROTI will come out as the champion of the Indonesian bread industry, we will try to assess its potential growth on supporting sides as well.

### Exhibit 7. Bread market size

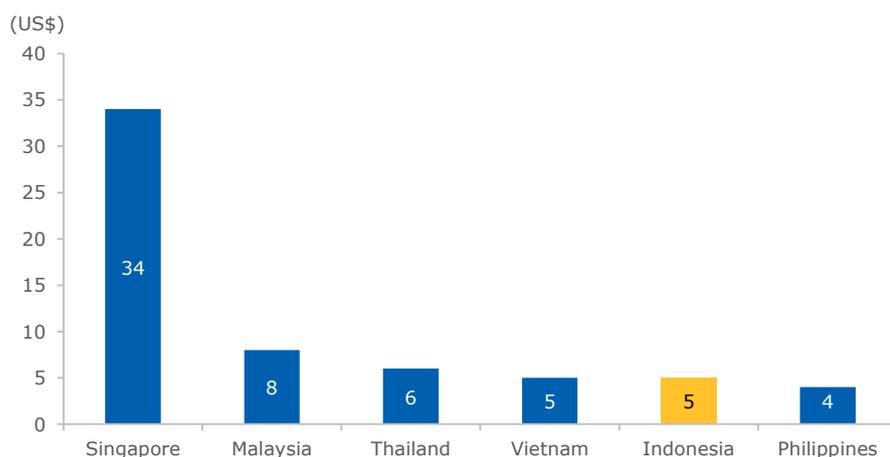


**The market share for home/small scale production in Indonesia is expected to shrink, to make way for mass production and boutique bakeries.**

Source: Frost & Sullivan, BCA Sekuritas

Consumption rate is also one of the key indicators for the growing trend of bread consumption. We have witnessed a growing trend in consumption for several food items, most notably in milk, meat, egg and wheat products, including bread. It is worth noting that bread consumption in Indonesia is the lowest among countries in the region, where there is more than ample room for growth. Our calculation suggests that a USD100 increase in Indonesian GDP per capita will increase 3% per capita revenue in bread market.

### Exhibit 8. Per capita revenue in bread market in select countries, 2014



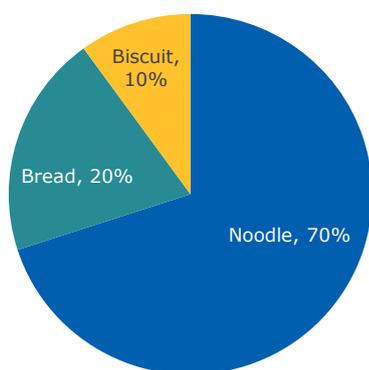
**Bread consumption in Indonesia is still the lowest among neighboring countries.**

Source: Frost & Sullivan, BCA Sekuritas

**How does the price of wheat affect ROTI?**

While we think that the rate of consumption will increase, the issue is whether the industry can keep up with production. One of the cornerstones for Indonesian bread industry growth is the parallel growth of its raw material production. According to APTINDO (Asosiasi Produsen Tepung Terigu Indonesia), as of 2016 there were 31 flour mills with a total installed capacity of 11.4 million tons. The total installed capacity of Indonesian flour mills is projected to reach approximately 14.2 million tons by 2025. With mills’ running capacity of at just 70 percent in 2016, the wheat flour-based food industry in Indonesia still has plenty of room to grow and is projected to grow by five percent in 2017. Aside from having plenty of raw material, we believe that growth in the flour industry will also spur expansion of other flour-based products. This in turn should serve as the catalyst for another switch in eating habits. We also believe that wheat-flour based products should be more acceptable in Indonesia, led by the custom of noodle consumption, which should familiarize Indonesian consumers with wheat.

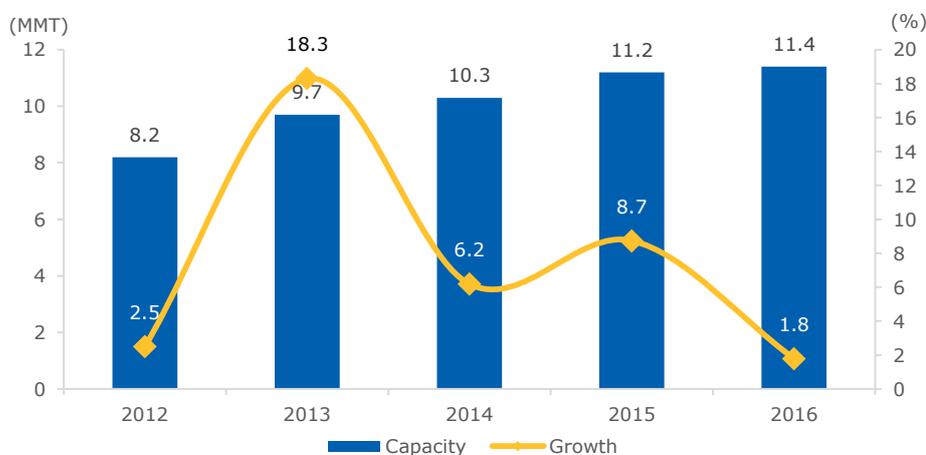
**Exhibit 9. Wheat flour usage by industry, 2017**



**The wheat flour consumption in bread industry still has plenty of room to grow.**

Source: USDA, BCA Sekuritas

**Exhibit 10. Wheat facilities’ capacity in Indonesia**



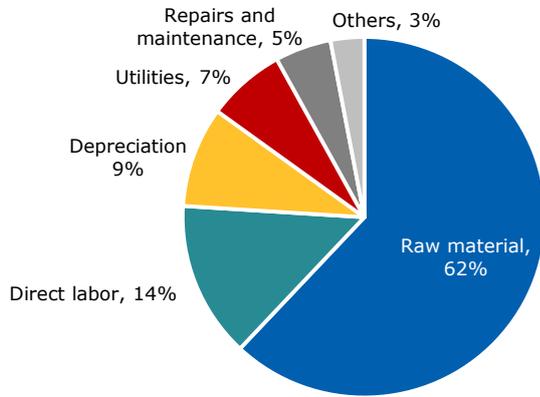
**Demand for wheat flour has been increasing to satisfy rapidly-expanding wheat-based food production.**

Source: APTINDO, BCA Sekuritas

Given that flour mills’ capacity is increasing, we believe that this will serve as a sense of security for the bread industry to grow in Indonesia as well. With an uninterrupted source of raw material secured, we see no hindrance in production growth potential.

As Indonesia does not grow wheat and relies on wheat imports, ROTI COGS is helped tremendously by soft global wheat prices: the monthly global price has nearly halved over the past four years. Furthermore, global wheat prices are expected to stay low in the foreseeable future, following bumper crops. Thus, we do not see any short term jolt in wheat price which could disrupt ROTI margins.

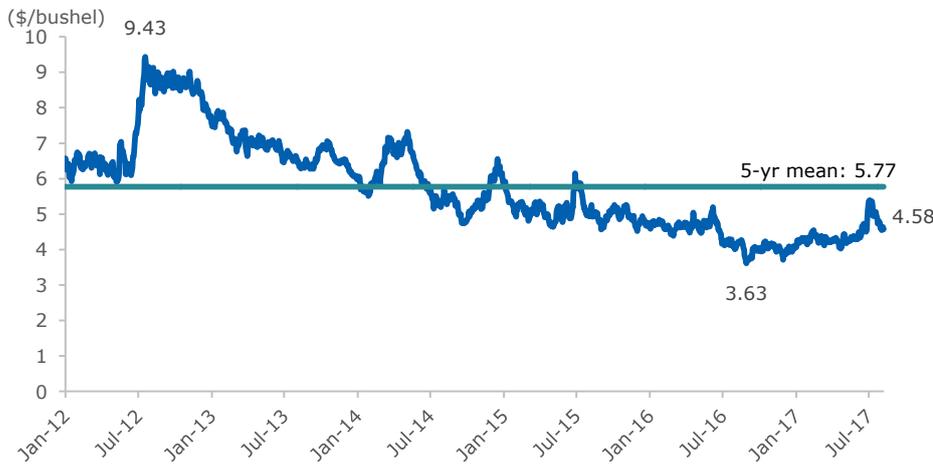
**Exhibit 11. ROTI's COGS**



**Wheat comprises 40% of raw material of COGS, while raw material contributes 62% of total COGS.**

Source: Bloomberg, BCA Sekuritas

**Exhibit 12. Historical monthly global price of wheat**



**Global price of wheat is currently below a 5-year mean.**

Source: Bloomberg, BCA Sekuritas

**Exhibit 13. Wheat price sensitivity to ROTI income**

(IDRbn)	Base case			Avg. wheat prices -10%			% changes		
	2017F	2018F	2019F	2017F	2018F	2019F	2017F	2018F	2019F
COGS	1402	1502	1672	1402	1413	1574	0.0%	-5.9%	-5.8%
Gross profit	1334	1541	1763	1334	1630	1861	0.0%	5.8%	5.5%
Operating profit	268	411	494	268	515	608	0.0%	25.2%	23.0%
Net profit	188	332	396	188	410	484	0.0%	23.6%	22.1%

**A 10-percent downturn in global wheat price will potentially decrease COGS by 6%.**

Source: BCA Sekuritas

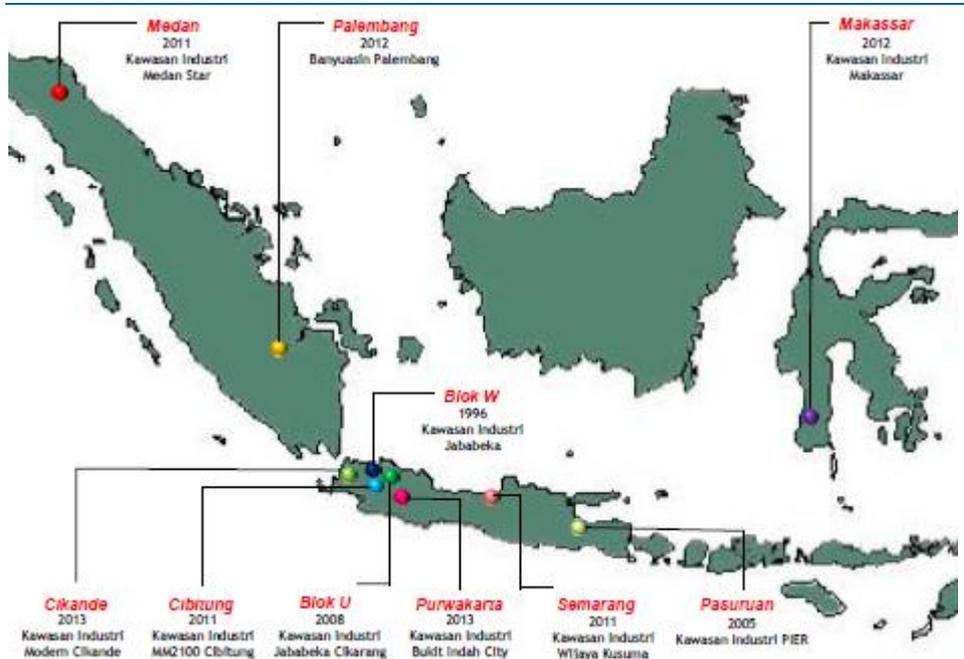
Although global wheat price is a helpful indicator to ascertain raw material expenses, ROTI contracts its wheat flour every 6 months. Recently management has confirmed flattish wheat flour price in 2H17 compared to 1H17. This would translate to -4% YoY wheat flour price in 2H17. In other words, the volatility of global wheat prices should not directly affect ROTI's raw material expenses. The USDA expects the 2017/18 season-average global wheat price to hover at \$4.40 to \$5.20 per bushel, lower than 5-year mean at \$5.78 per bushel. Note that given 1% increase in wheat price, net profit will be affected 2.3% YoY.

Furthermore, given continuous soft wheat prices, we are expecting another favorable wheat contract for ROTI in 1H18. Wheat forms 40% of raw material, while the next sizeable component is packaging which contributes 8% of raw material. Other components, like sugar and flavoring, do not contribute significantly to COGS. With oil prices expected to remain below USD55/barrel, we believe packaging costs will be manageable.

### ROTI's positioning vis-à-vis competitors

With ROTI's revenue steadily increasing, we try to assess its advantages; it is ahead in the market, and exhibits strong branding (the Company has been spending roughly 5% in advertising expenses yearly); it operates 10 bread factories across Indonesia. Indonesian consumers are quite loyal to brands that they know, a sticky preference. Having an early presence in the Indonesian market helps ROTI create a deep-rooted brand image. Another advantage of ROTI is its diverse production sites and extensive distribution network. Being an archipelago, one of the key problems for corporate growth is logistics. With bread products having a short shelf life, we see how ROTI has embarked in the right direction by having production plants in different places. In 2012, ROTI built a new plant in Sulawesi to serve demand in the eastern part of the archipelago, already contributing net sales of IDR91bn in 2016. While we note that most of the plants are located in Java and Sumatra, we believe that the strongest growth will continue to emerge from these islands.

### Exhibit 14. Sari Roti factories

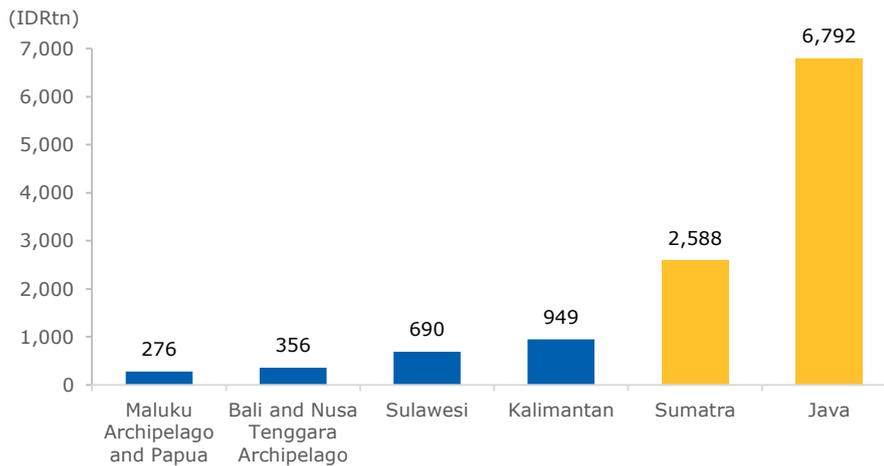


Source: Company, BCA Sekuritas

**ROTI looks to add more factories to satisfy product demand...**

We also believe that improvement in infrastructure and logistics, in gigantic efforts promoted by the government, should benefit ROTI. As we mentioned before, the strongest growth will still come from the western part of Indonesia. With the government opening the path of the eastern front, we believe ROTI can use improved infrastructure to further expand its presence in the market there and possibly embark on investing in additional plants. The experience so far will also help ROTI with logistics for items with a short shelf life. We think that this is one of the key advantages of ROTI that cannot be replicated by its competitors in the near term.

### Exhibit 15. Gross Regional Domestic Product by islands, 2015



**... especially in the western part of Indonesia, as Java and Sumatra still dominate GRDP.**

Source: BPS, BCA Sekuritas

ROTI has established itself as the bread producer with the most product line varieties in the market. As of June 2017, ROTI already had 65 different product products available, while planning to add 45 new SKUs and retire old SKUs that are no longer profitable. This is by far the largest portfolio of bread products offered by a single producer in Indonesia. Delving deeper into the products, ROTI offers white bread which ranges from premium (double soft) to health conscious (whole wheat bread). Similarly, ROTI's sweet bread covers a number of products, from a single item (pillow bread) to multiples (tear-and-share bread), catering to the needs of Indonesian consumers. It is worth mentioning that ROTI also offers cake product lines, although sales of white and sweet bread are far more significant. Nonetheless, it portrays ROTI's eagerness in providing more selections to consumers. With a more dynamic change in preference, the extensive portfolio should be an advantage for ROTI against other competitors.

### Exhibit 16. Some ROTI white bread products



**ROTI offers various white bread products...**

Source: Company, BCA Sekuritas

### Exhibit 17. Some ROTI sweet bread and cake products



*... as well as sweet bread and cake products with the price range from IDR7,000 to IDR15,000 per package.*

Source: Company, BCA Sekuritas

### ROTI as the market leader

Aside from the extensive range of products, ROTI products are affordable to middle and low-income individuals and families, targeting consumer class B, C, and D. Average selling price of Sari Roti white bread is around IDR15,000 per package, and the average selling price of Sari Roti sweet bread is around IDR7,000. As we mentioned before, ROTI do not annually increase their ASP, as they intend to keep their products affordable while maintaining quality. Being the market leader, ROTI can command a higher ASP compared to other producers. But, if ROTI did not increase their ASP, then competitors would have little room to adjust their ASPs as well, while on the volume front, ROTI has the upper hand compared to its peers.

**Exhibit 18. Price comparison of several mass-produced bread brands**

Variety		Brand	Price (IDR)	Net Weight (gr)	IDR/gr
Wheat bread		<b>Sari Roti</b>	<b>18,000</b>	<b>350</b>	<b>51.4</b>
Wheat bread		Yamazaki's MyRoti	15,000	400	37.5
Wheat bread		Indomaret's Mr. Bread	14,000	280	50.0
White bread		<b>Sari Roti</b>	<b>12,000</b>	<b>370</b>	<b>32.4</b>
White bread		Yamazaki's MyRoti	11,500	380	30.3
White bread		Indomaret's Mr. Bread	11,500	350	<b>32.9</b>
White bread		Sharon's Paroti	11,000	350	31.4
Tear-and-share		<b>Sari Roti</b>	<b>15,000</b>	<b>226</b>	<b>66.4</b>
Tear-and-share		Sharon's Paroti	15,000	200	<b>75.0</b>
Tear-and-share		Yamazaki's MyRoti	13,500	235	57.4
Tear-and-share		Indomaret's Mr. Bread	10,000	240	41.7
Sweet bread		<b>Sari Roti</b>	<b>6,000</b>	<b>72</b>	<b>83.3</b>
Sweet bread		Yamazaki's MyRoti	3,000	58	51.7
Sweet bread		Gardenia's Prime Bread	3,000	50	60.0
Sandwich		<b>Sari Roti</b>	<b>4,500</b>	<b>49</b>	<b>91.8</b>
Sandwich		Yamazaki's MyRoti	4,500	96	46.9

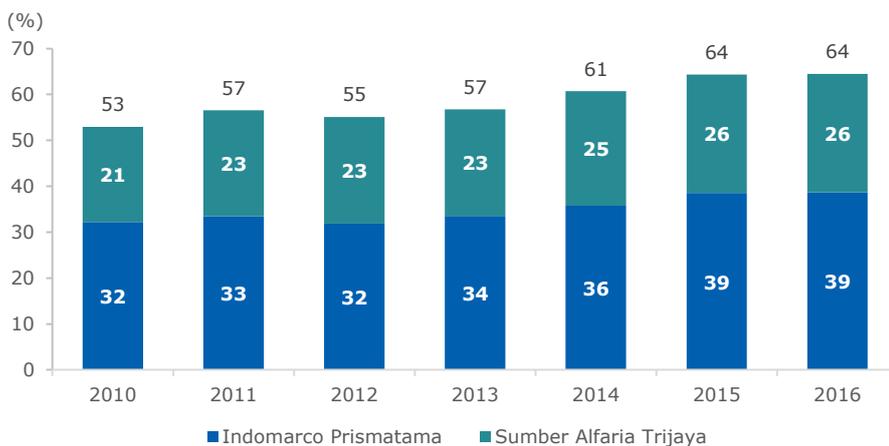
**Despite being the priciest in each variety (justified by its quality), ROTI's products sometimes provide the best value for money.**

Source: BCA Sekuritas

In addition to affordable prices, ROTI offers a variety of selections in the market. As of mid-2017, ROTI has launched more than 50 products. Using advanced mass production techniques since 1995 and employing technical support from Japan-based Shikishima Baking Company, ROTI has demonstrated how it can maintain the taste and freshness in its products across the country. In order to serve consumers with the best product, ROTI products have a short shelf life of 5 days, implementing an efficient distribution network. Additionally, ROTI continues to develop healthy products that contain Omega 3 fatty acids, DHA, dietary fiber and high calcium.

Another strong point for ROTI is its availability. ROTI products can be found everywhere, whether in general trade or in modern trade stores (supermarkets and convenience stores) across Indonesia. Riding on the booming convenience store growth, ROTI products can be found in almost every large convenience store. Two of the largest mini-market chains, Indomaret (PT Indomarco Prismaatama) and Alfamart (PT Sumber Alfaria Trijaya) readily stock ROTI breads. We have seen growth in sales through modern outlets steadily increasing through the years, along with the growth in modern outlets.

**Exhibit 19. Portion of sales by Indomaret and Alfamart to total sales**



**Sales by Indomaret and Alfamart contribute almost two-thirds of total sales.**

Source: Company, BCA Sekuritas

Despite recent news about proposed limitations on opening new convenience store, we do not think that this issue will pose any problem for ROTI, given that the Company has started to ramp up its general trade (GT) channel. We believe that GT will provide ROTI more consumers in rural areas, and improvement of recruitment in GT outlets, like distributors (mom-and-pop stores) and agents (tricycles, box motors and bicycles), would also help in mitigating spikes in return rate. ROTI is targeting GT to form 26% of total sales by end-2017 (2016: 24%). We believe that this proportion will be maintain in 2018-19F, as the growth in modern trade (MT) will continue to outpace GT. While there may be some concern that higher GT proportion would translate to more sales on the lower ASP range, we believe that volume plays a more critical role in growth – proven by the Company not having to increase ASP annually.

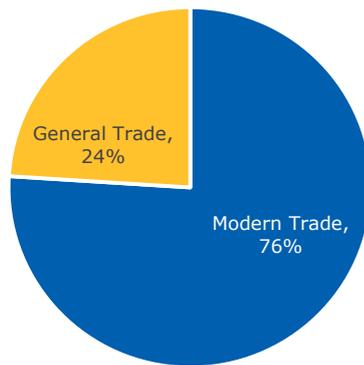
**Exhibit 20. List of ROTI outlets, Jun-17**

Outlet	Number of Stores
Indomaret	13,259
Alfamart	11,478
Alfamidi	1,271
Others (< 500 stores per outlet)	1,291

Source: Company, BCA Sekuritas

**Minimarkets, as ROTI's MT channel, are expected to be added every year...**

**Exhibit 21. Distribution channel mix, 1H17**



*... which is portrayed by MT contribution to the distribution channel mix.*

Source: Company, BCA Sekuritas

With us believing that the growth in bread industry will lie in mass production, we try to gauge ROTI's competitors in this industry. Given the distinguished brand of Sari Roti, ROTI's products are generally placed on the top shelves or at eye level to attract buyers, compared to other less-known bread brands. We believe that this gives ROTI a strong advantage in gaining more market share and revenue.

**Exhibit 22. Shelf space competition with other brands**



*ROTI products dominate shelf space in most supermarkets and minimarkets.*

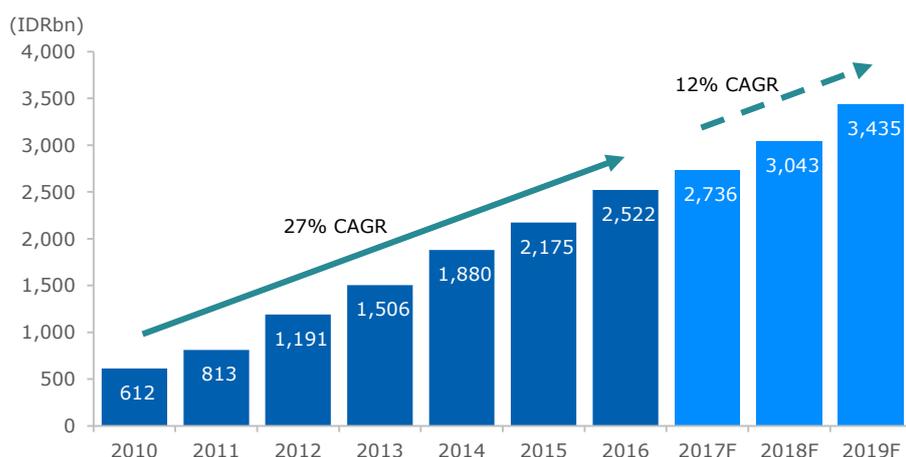
Source: BCA Sekuritas

Many parties have raised their concerns about ROTI's competitors. While it is true that there are new companies that have tried to get their feet wet in the industry (due to promising growth in bread market), we believe that ROTI is still far ahead of the competition. The two foreign ROTI competitors in the industry are Yamazaki and Gardenia. Yamazaki's MyRoti is only sold in Jakarta MT market, while Gardenia's Prime Bread and Indomaret's Mr. Bread are only sold in Indomaret. Both Prime Bread and Mr. Bread are not expected to be marketed in Alfamart and GT space. Being the dominant bread brand in Indonesia, ROTI will continue to supply their breads to MT outlets, while bearing the risk of higher sales return, which the Company continues to improve to manage its product stocking in MT. ROTI has taken the bitter pill in 1H17, in which their sales return increased to 21% (historically 12-14%). But, we are looking at the move from a longer time perspective, in which ROTI would be able to maintain its dominance. The high sales return in 1Q17 is also partly due to the remaining negative sentiment arising from the Dec-16 demonstration, but this is a one-off

event and force majeure that ROTI could not have anticipated. The 2Q17 sales return remained high, but this would be in line with historical sales return near Lebaran. However, seen from another light, the Company has experienced noticeable improvement in sales return after 1H17, a sign that the issue may have subsided.

While 1H17 is soft, we have seen strong growth in revenue, with 2010 to 2016 CAGR of 27%. Furthermore, we believe growth in 2017F-2019F will remain sustainable at 12% CAGR. ROTI also did not implement ASP increase on an annual basis, which will prompt growth stemming from volume. Going forward, we still see that volume growth will remain robust, supported by a young demographic – which has adjusted some eating culture as well as a number of new products which will entice a larger consumer profile. The new SKUs should also help in keeping volume buoyant and given the underperforming sales return in 1H17, an improvement in sales return would be a comeback for ROTI revenue.

### Exhibit 23. ROTI's revenue in the last 10 years



**ROTI is projected to keep posting high revenue, year by year.**

Source: Company, BCA Sekuritas [estimate]

To generate more revenue, ROTI opts to increase production output. Historically, ROTI has rarely increased ASP of its products. Stable and affordable product prices have been one of the key deciding factors that made ROTI into the Company it is today. The last ASP changes were an 8% increase in Apr-17 and a 10% increase in Oct-14. The latter affected 50% of total SKUs. In the past, ROTI has been gradually increasing the capacity of bread production by adding more production lines every year. Today ROTI produces 4.5mn pieces of bread daily nearing the optimum utilization rate in the region of 75-80% end-2017. Thus ROTI will require factory expansion soon.

### Exhibit 24. ROTI's production capacity per day



**ROTI's production capacity has flattened out and will be at optimum level by end-2017.**

Sources: Company, BCA Sekuritas [estimate]

### ROTI's calculated costs

On the cost side, we have mentioned wheat in the earlier part of this report. On the opex front, we believe that mass market has the upper hand compared to other segments. While boutique bakeries are also on the rise, we believe that this segment caters to a niche market, given its scope of availability (i.e.: in shopping malls) and affordability. Another strong point for mass production, and especially for ROTI, is that the Company has the flexibility to sell its products using general trade and modern trade methods, while boutique bakeries are generally found in shopping malls and are limited by their requirement for permanent shops, limited distribution area and higher opex. This gives ROTI an advantage in having lighter operating costs for its distribution channels. On the opposite spectrum, ROTI has the advantage of branding and wider distribution coverage when compared to home/small scale production. We also note that ROTI has been promoting directly near or in supermarkets using a stall, and providing jams to spread upon their breads bought by customers. This could serve as another outlet to expand its distribution, without the need of a permanent location.

### Exhibit 25. ROTI's direct promotion in supermarkets

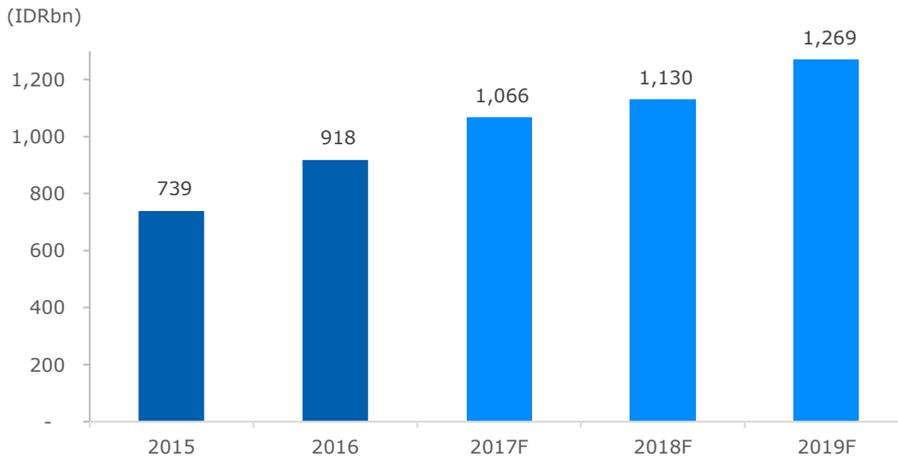


**ROTI's direct promotion entices customers and drives ROTI sales.**

Source: Internet

In order to cope with larger scale of operation and to operate more efficiently and effectively, ROTI has conducted restructuring by adding vital positions. Previously, ROTI only had a Managing Director to handle operations, but in Jan-16 ROTI split the responsibility of the Managing Director and hired a CFO, COO and Chief of HRGA. ROTI also hired senior VPs to enhance their sales team, for each MT and GT channel. Each channel senior VP leads a group of sales teams specialized by regions: West Java, Central Java, East Java, and Outer Islands. All of these contributed to higher employee salary costs in opex.

### Exhibit 26. ROTI's opex

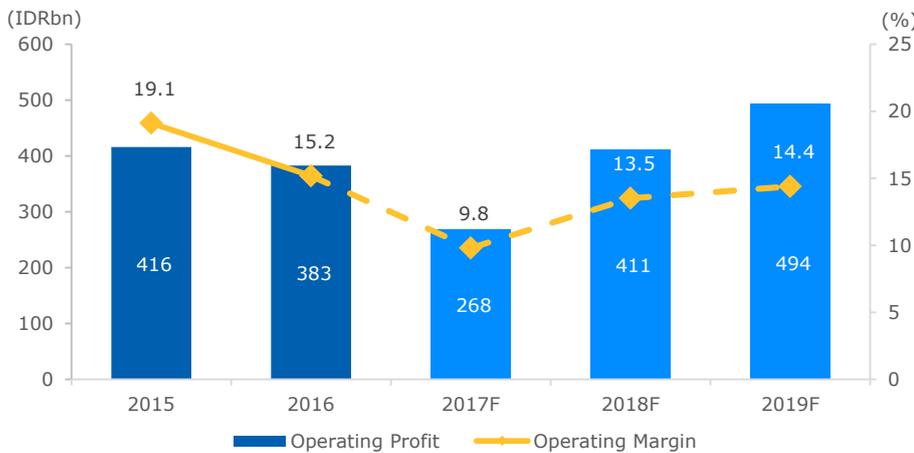


**High opex in 2016 (+24.2% YoY) was due to restructuring.**

Source: Company, BCA Sekuritas [estimate]

Additionally, in 2Q17 ROTI rationalized its distribution channels in GT by renegotiating new terms with existing distributors, launching new training programs and implementing massive direct selling techniques. All of these will add up to higher opex. Again, we believe that this is a bitter pill that ROTI has to take in its effort to grow further. We estimate 2017F EBIT margins of 10%, lower than previous years, mainly caused by the additional workforce.

### Exhibit 27. ROTI's operating profit and operating margin



**Lower EBIT margins in 2017F are expected, due to distribution channel rationalization.**

Source: Company, BCA Sekuritas [estimate]

### Expansion to the Philippines

While the growth story in Indonesia is still fulsome, ROTI has also started to step out, looking to move into Southeast Asian territory. In addition to factories in Indonesia, ROTI has formed a joint venture with a Philippine-based wheat-based food product manufacturer, Monde Nissin, to create Sarimonde Foods Corporation, which is owned 55% by ROTI and headquartered in the Philippines. ROTI will be in charge of production while Monde Nissin will distribute the products. A bit of background on Monde Nissin: with 75% instant noodle market share in the country, Monde Nissin is the largest instant noodle producer in the Philippines, distributing its products through both MT and GT channels (300,000 sari-sari stores/*warung* in the country). We think that having logistics and distribution expertise will help to market ROTI's Philippines' products. In addition, the Philippines boasts 60% of its population under 30 years of age, similar to the Indonesian young demographic. With GDP per capita of USD2,951, we believe that the country consumption profile may be similar to Indonesia, which will serve as ROTI's strong point. Bread market in the Philippines is segmented, as the largest bread producer is Gardenia Bakeries, which only controls 10% of the Filipino bread market share.

In 2016 the Monde Nissin-ROTI joint venture acquired Walter Bread, a premium healthy bread brand, to appeal to health-conscious Filipinos. The brand includes Walter Sugar Free Wheat Pan de Sal, Walter High Fiber Weight Control Bread, Walter Whole Wheat Raisin Bread and other innovative, first-in-the-market products, such as Walter Sugar-Free Wheat Bread and Walter Double Fiber Wheat Bread. ROTI is currently building a plant to replace old Walter Bread production lines and to build single capacity white and sweet bread production lines, with capacity of 31mn pieces of bread per year, expected to commence new production for Walter Bread and Sari Roti-styled white and sweet breads in Oct-17 and 1Q18, respectively. The variety of Sari Roti breads will be adapted to Filipinos' taste. As such, we think that we can start to see a more significant contribution from Philippines starting in 4Q17.

Given the segmented market, this would be an opportunity for ROTI to gain some market share, especially with ROTI having an established product (Walter Bread) and extensive distribution network.

While we believe that domestic sales will remain as the main contributor to revenue, we believe that the venture to the Philippines will help ROTI in gaining expertise in healthy type breads, as well as exposing them to foreign market experience. Given the growing trend to health-conscious living in Indonesia's up and coming generation, we think that healthy bread may be well-received in Indonesia.

#### Exhibit 28. Walter Bread products



**Walter Bread products currently sold in the Philippines.**

Source: Company, BCA Sekuritas

#### The rights issue

By end-2017, ROTI will reach optimum production capacity, at around 80%. Therefore, to increase bread production output, ROTI plans to build 7-8 factories, with each costing around USD18-20mn, including land, three of which have been purchased, in East Java, Central Java and South Sumatra in 4Q16 and 1Q17. Factory construction in East Java will start in 2018 followed by construction in Central Java, South Sumatra and Kalimantan. Aside from Indonesian expansion, two new factories will also be built in 2020 and 2021 in the Philippines. At end-2021 ROTI expects to be producing more than 7mn pieces of bread daily, a 65% increase from 2017 production level.

Building these 7-8 factories requires around USD300mn, a tremendous amount of capex. Debt financing was explored as an option to raise capex. However, ROTI currently has 2 outstanding bonds worth IDR1tn. Had ROTI refinanced the debt, the Company would breach the covenant ratio in 2018. Consequently, ROTI is planning to raise capex for factory expansion by conducting a rights issue in 2H17 in addition to using cash from operation. We estimate the rights issue will reap USD75-100mn (IDR1-1.3tn, using USDIDR13,500) with all rights issue proceed will be used for the expansion plan covering the next 5 years.

### Valuing ROTI

Given 1H17 lukewarm results, we are expecting tepid 2017F revenue of IDR2.7tn. However, as we have mentioned before, beginning 2017 is influenced by negative sentiment arising from the Dec-16 demonstration that adversely impacted sales. Thus, we are expecting a rosier 2018F, in which revenue should reach IDR3tn, (+11.2% YoY).

### Exhibit 29. ROTI's income statement

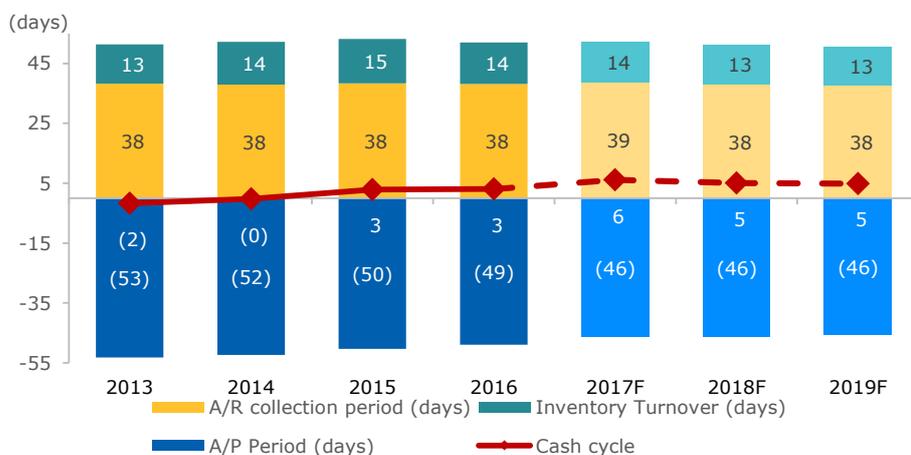
	2015	2016	2017F	2018F	2019F
Revenue	2,175	2,522	2,736	3,043	3,435
Gross Profit	1,155	1,301	1,334	1,541	1,763
EBIT	416	383	268	411	494
Net Profit	271	280	188	332	396

Source: Company, BCA Sekuritas [estimate]

**Lower net profit is expected end-2017, but better net income is ahead with restored sales return level.**

One of the most admirable aspects of ROTI's balance sheet is their cash management. This is shown by the cash cycle, which always hovers near zero, despite increasing production volume and adding new product variants year by year. On the liquidity front, acid ratio has continued to stay above 1, indicating healthy liquid asset level. Likewise, current ratio and quick ratio are all above 1 for the same reason. And finally, the gearing ratio stays below 1, indicating less risky financing, despite the fact of being in expansion mode. We are confident that ROTI will continue the trend in coming years.

### Exhibit 30. ROTI's cash conversion cycle



Source: Company, BCA Sekuritas [estimate]

**ROTI has constantly exhibited a healthy cash cycle.**

### Exhibit 31. ROTI's acid ratio



Source: Company, BCA Sekuritas [estimate]

**ROTI's acid ratio displays a healthy liquid asset level.**

### Initiate with BUY; TP IDR1,400

ROTI plans to conduct a rights issue by releasing 1.15bn new shares with estimated total proceeds of USD75-100mn. We are using PE multiple to derive our TP, as ROTI's profitability should be reflected in its share price. Using conservative PE multiple of 26x – discounted from its 5-year mean with 2018F EPS, we arrive to our TP of IDR1,400 post-rights issue, a 20.7% potential upside from theoretical ex-rights price of IDR1,160. The stock is currently trading at below the mean level; we believe that this is unwarranted, as ROTI continues to book strong net income growth of 105% in 2013-18F. We think that the recent weakness in share price is due to: 1) soft 1H17 results; 2) some unclarified intentions about rights issue.

### Exhibit 32. Rights price assumption comparison

Num. of new shares (bn)	Assumed rights price (IDR)	Expected proceeds (IDRtn)	Dilution (%)
1.15	870 Disc. to CP: 28.7%	1.0	6.5
1.00	1,000 Disc. to CP: 18.0%	1.0	5.8
0.95	1,050 Disc. to CP: 13.9%	1.0	5.5
0.90	1,111 Disc. to CP: 8.9%	1.0	5.3
0.85	1,176 Disc. to CP: 3.6%	1.0	5.0

Source: BCA Sekuritas [estimate]

**Potential dilution estimate of 5%-6.5% to existing public shareholders.**

### Exhibit 33. ROTI's forward PE band



Source: Bloomberg, BCA Sekuritas

**ROTI is currently trading at below the mean level.**

### Risks to our call include, but are not limited to:

- Inability to lock down favorable wheat flour price
- Rise on USD/IDR exchange rate as wheat is still imported to Indonesia
- Bottlenecks in distribution channels
- Unexpected obstacles during factory expansion
- Stronger competition in bread industry

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