

Equity Research

Company Update

Kalbe Farma

Still banking on potentials

Growth remained subdued in most of product categories

The company reported 4.3% y-y growth in sales at IDR 20.1Tn in 2017(vs 5-year CAGR of 12%), representing 97% of our estimate. Sales were driven by volume, as company has not increased prices across product categories. KLBF's nutritional segment, which 90% is powder-milk product under brand Morinaga and Zee, recorded 9% y-y growth in sales (vs historical average of 14% p.a), outpacing powder-milk industry that recorded near 3% y-y decline in volume, contributing to 30% of KLBF's sales. Prescription business has continued to book single-digit-growth of 5% y-y (vs 5 years CAGR of 10%) to IDR 4.6Tn in 2017. Meanwhile, sales from consumers-health and distribution segments remained very weak, booking only low-single-digit growth of 0.4% y-y and 1.7% y-y, respectively in 2017 (vs 5 years CAGR of 13% and 9%, respectively). Company well-recognized product like Extra-Joss has entered saturation stage of product life cycle, thus contributing to the slowdown in KLBF's consumer-health segment. Furthermore, last year government also tightens control over drugs-distribution in the drug-store as well as FMCG retail channels, impacting sales of KLBF's over-the-counter (OTC) products.

Good efficiency measure has helped KLBF maintained its margin

Overall, the company has successfully maintained its margin performance, particularly via efficiency in operating expense. OPEX-to-sales ratio dropped to 32.7% in 2017, down from 33.2% last year, 50bps below our forecast. Unlike its peers that continuously lower prices to undercut the competition, KLBF chooses to avoid price-war while increasing direct-marketing effort to its customers via customer-engagement-events and applying good customer-relationship-management to maintain its market share. In terms of margin, GP and EBIT margins were recorded at 48.5% and 15.8% in 2017, beating our GP and EBIT margins estimate by 30/80bps, respectively, relatively in-line with KLBF's historical average. Overall, KLBF managed to book 3.5% y-y growth in earnings to IDR 2.3Tn in 2017 (vs 3 years CAGR of 6%), achieving 97% of our estimate.

Lack of short-term catalyst to support sales acceleration near-term

Overall, we believe the company has good long-term strategy through improvement in technology, distribution network, product innovations, human capital as well as upgrading manufacturing quality to be in-line with international standard. Unfortunately, we see limited growth story in the short-term as competition continues to heat up, particularly in the nutritional and consumers health, while sales contribution from prescription has consistently declined despite management's effort to increase penetration in the license and unbranded products. Based on discussion with management, KLBF's first oncology factory will be ready for commercial operation at the end of this year, but should still generate small contribution to revenue into near-term.

We expect KLBF to record IDR 22.4Tn in sales in 2018, 2% below the consensus forecast. Our forecast is based on assumption of 4% y-y growth in prescription (vs management guidance of 7%), 11% y-y growth in consumer-health (vs management guidance of 4-6%), 10% y-y growth in nutritional (vs management guidance of 10-11%) and 9% y-y growth in distribution (vs management guidance of 5-6%) for 2018. Additionally, management also plans to expand its penetration in overseas market, entering the China market, particularly through its nutrition and consumer-health under products like Hydro-coco. Management aims for 10% contribution from export in the next five years (vs 5% export contribution in 2016).

Today, management is exploring partnership with local distributors in China to help products penetration in China major cities, assembling similar strategy with Mayora (MYOR; TP 2,390), that has been the pioneer in entering the China market. We believe China market is very attractive, given China's 1.42 billion population. Kantar World panel reported that China FMCG sector has reported a recovery last year, growing by 4.3% in 2017, 70 bps faster compared to 2016, broadcasting positive signal for FMCG players.

Sucor Sekuritas

SELL

Current price 1,625
Price target 1,400
Upside (Downside) -13%

14 February 2018

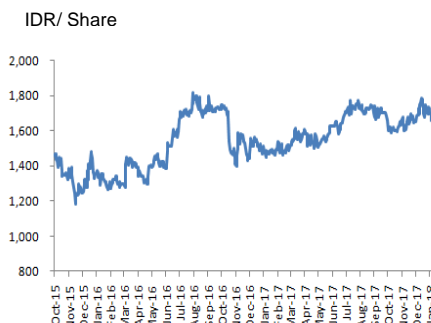
INDONESIA

STAPLES

Stock Data

Bloomberg Ticker KLBF JI
Outs. Share (Bn) 46,875.0
Mkt Cap (IDR Bn) 76,640.8
52 Week Range (IDR) 1,440-1,795
6M Avg Val (IDR Bn) 37.3
YTD Returns (%) -3.3
Beta (x) 1.3

Share Price Performance



Share Performance (%)

Month	Absolute	Relative
3m	1.3	-7.2
6m	-6.1	-16.6
12m	9.9	-9.5

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With respect to China beverages industry, energy-drink has been a growing segment in China, posting 25% growth in volume in 2015 vs 10% growth in global energy drink, according to Mintel report. Chinese Red Bull accounts for a significant market share of energy drink category of about 80% in 2016, per Mintel report. We found that there is a shift in consumer preference towards beverages, as China consumers are getting more health-conscious. Demand for energy-drinks, fruit and vegetables beverages and protein as well as milk beverages have been on the up-trends over the past few years, while demand for carbonated beverages has been deteriorating. Overall, we believe KLBF's strategy to enter the China market should serve as positive growth catalyst particularly as the company has been closely associated with nutritional products. The company also has various well-known brands like Extra-Joss and Hydro-Coco that might suit the Chinese preferences. However, we believe the impact of expansion into China market might not materialize soon to KLBF's sales growth story, particularly due to various regulations in the F&B segment requiring follow ups from exporters. Not to mention time required for setting up the distribution networks.

Shortage of bulk-drugs in China might put pressure on KLBF margins going forward

Management aims to maintain EBIT margin at 14.5-15.5% level in 2018, focusing on effective marketing effort to maintain the margin outlook, while they also expect exchange rate to be around IDR 13,750 per USD. Selling expenses-as-percentage-of-sales will be maintained at level of 25-27% p.a.

We have different view with regards to margin forecast. We expect pressure on margin, particularly due to growing shortage of bulk-drug from China. China's government has taken proactive approach in regulating environmental laws, resulting in the closing down of tens of thousands of factories across the country, including the bulk-drugs manufacturers. Management admitted that raw-material prices for drug components were already up by 10% in January this year. China itself accounts for 40% of KLBF's import. If the shortage of raw material components continues to worsen, this might increase cost production of KLBF drug products and put pressure on margin trends going forward.

In order to minimize the impact of rising raw material prices, management is actively trying to find substitution to China raw material products and plans to re-formulate the composition of some drug products. KLBF has obtained the multivendor licenses for its drugs raw-material components. However, we believe finding substitution for China product might not be easy, as China has become the world producer of bulk-drugs. Even India and US are still importing most of its drugs components from China. Furthermore, we believe the cost of raw material products outside China might be more expensive due to China scalability in producing drugs components.

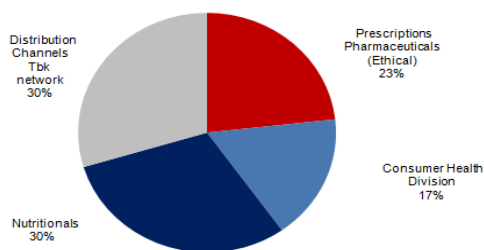
We expect KLBF's GPM to decelerate further to 47% level over 2017F-19F (vs 5 years average of 49%), as we expect sales growth to remain muted next year with potential hikes in raw material prices. Furthermore, we expect operating margins of 13.5%/13% in 2018F/19F, lower than management guidance and KLBF's 5 years average of 16%. Our forecast is 220bps-280bps lower than consensus forecast for 2018F/19F. Consequently, we expect KLBF's earnings to grow by low-single-digit-growth of average 3% p.a over 2017F-19F (vs 12% p.a historically) and ROE trends to decelerate to average 17% over 2017F-19F (vs 23% p.a historically).

Maintain with SELL—TP of IDR1,400/share

We maintain our SELL rating on KLBF, valuing the company using 12-month target PE of 28x—at 10% discount from KLBF's 5-year historical average—to derive our IDR1,400/share target price. At current share price of IDR 1,620, KLBF is currently trading at 2018F PE of 32x, at 15% premium to Indonesian consumer peers. We are expecting a de-rating on the stock on the back of unfavorable sales growth outlook in the prescription business, tight competition in the powder-milk segment, continued high-capex-cycle, deteriorating margin and ROE.

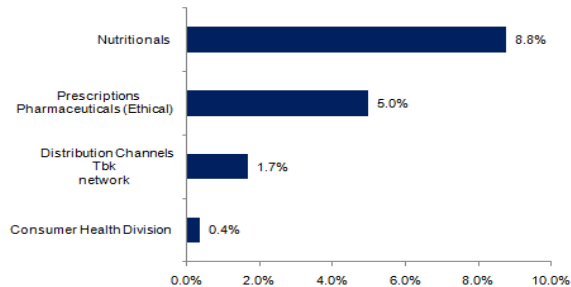
Indicative KLBF 2017 Result	2016	2017	% YoY	2017F	2018F	% YoY	% of Sucor
Total Sales (Rp Mln)	19,374	20,199	4%	20,811	22,494	8%	97%
COGS (Rp Mln)	9,886	10,403	5%	10,773	11,927	11%	97%
Gross Profit (Rp Mln)	9,488	9,796	3%	10,038	10,567	5%	98%
Margin (%)	49.0%	48.5%		48.2%	47.0%		
OPEX (Rp Mln)	6,432	6,605	3%	6,909	7,535	9%	96%
As of Sales (%)	33.2%	32.7%		33.2%	33.5%		
EBIT (Rp Mln)	3,056	3,197	5%	3,129	3,031	-3%	102%
Margin (%)	15.8%	15.8%		15.0%	13.5%		
Earnings (Rp Mln)	2,300	2,381	4%	2,435	2,395	-2%	98%
Margin (%)	11.9%	11.8%		11.7%	10.6%		

Fig 1 KLBF's sales breakdown in 2017 (%)



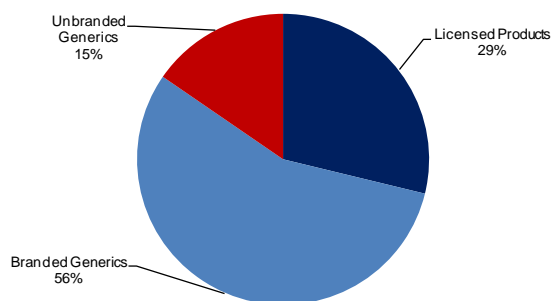
Source: Company, Sucor Sekuritas Research

Fig 2 2017 vs 2016 sales performance (% y-y growth)



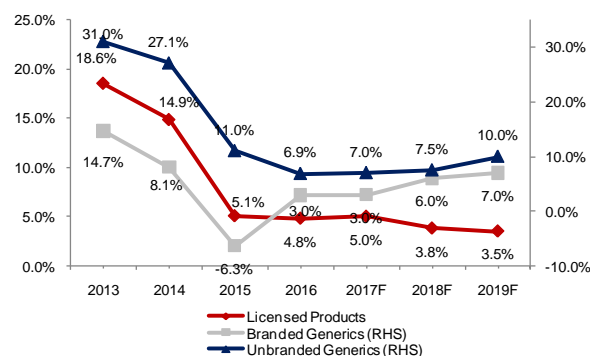
Source: Company, Sucor Sekuritas Research

Fig 3 KLBF's prescriptions breakdown in 9M17 (%)



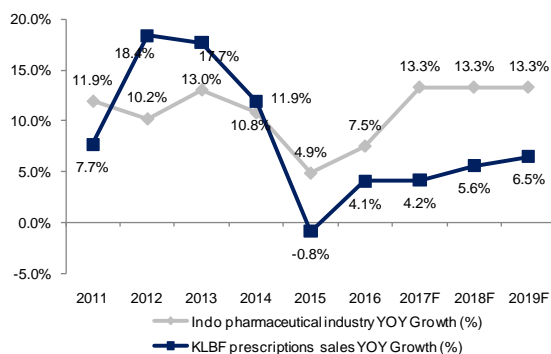
Source: Company, Sucor Sekuritas Research

Fig 4 KLBF's Prescriptions: Growth trends in sub category (%)



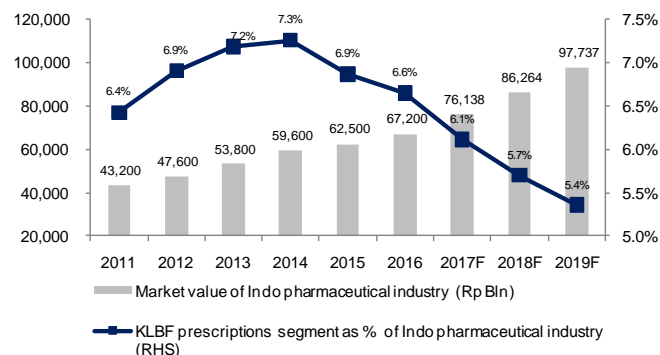
Source: Company, Sucor Sekuritas Research

Fig 5 KLBF's Prescriptions: Expecting KLBF to book slower growth than the industry



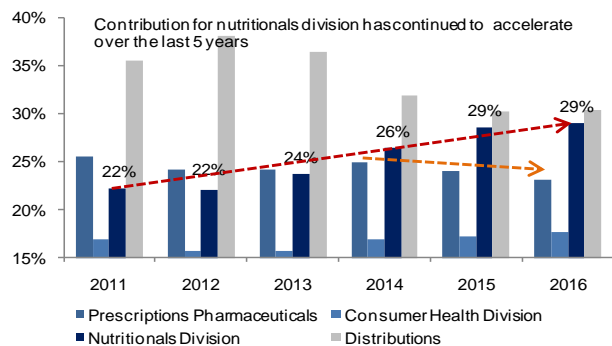
Source: Company, Sucor Sekuritas Research

Fig 6 ...as competition is intensifying



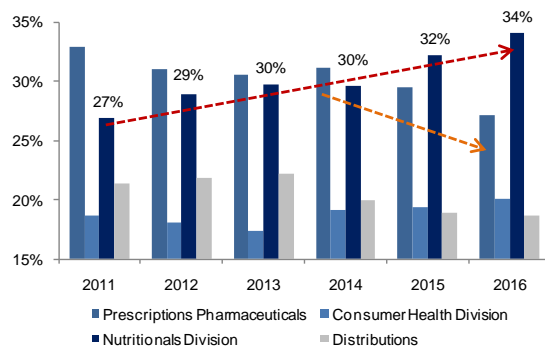
Source: Company, Sucor Sekuritas Research

Fig 7 KLB's nutritional division is registered as the second largest contributor to company's sales



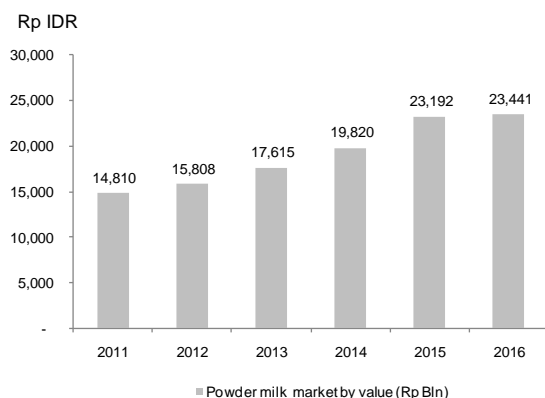
Source: Company, Sucor Sekuritas Research

Fig 8 Nutritionals division has greater contribution to gross profit



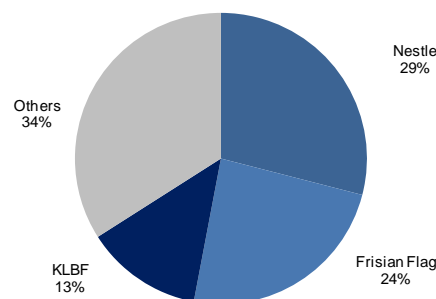
Source: Company, Sucor Sekuritas Research

Fig 9 Indonesia's powder milk market



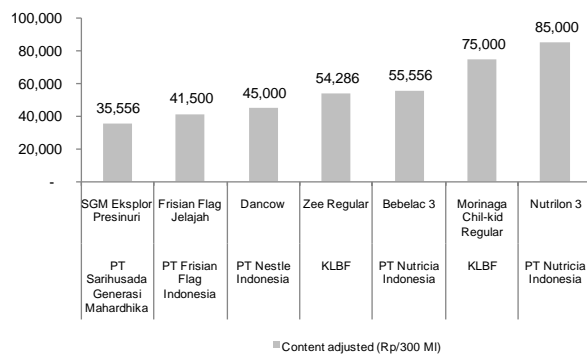
Source: Company, Sucor Sekuritas Research

Fig 10 KLB is the third largest player in the powder-milk segment



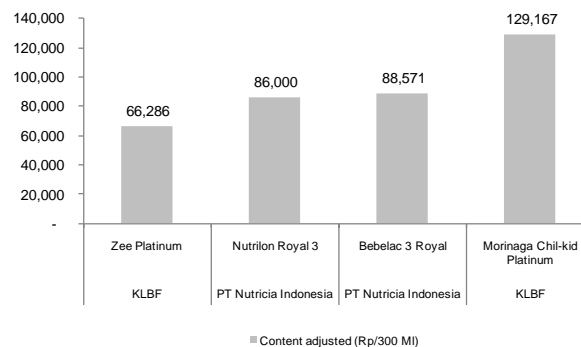
Source: Company, Sucor Sekuritas Research

Fig 11 Pricing in the powder-milk in the mass-market category



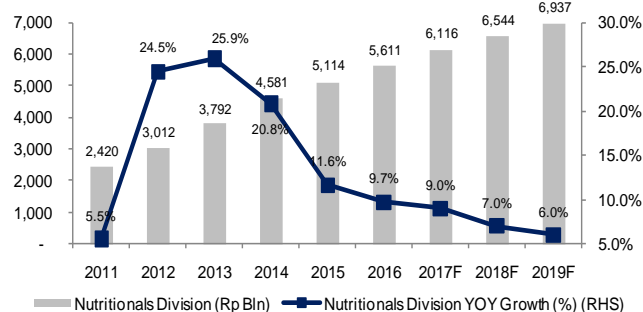
Source: Sucor Sekuritas Research

Fig 12 Pricing in the powder-milk in the premium category



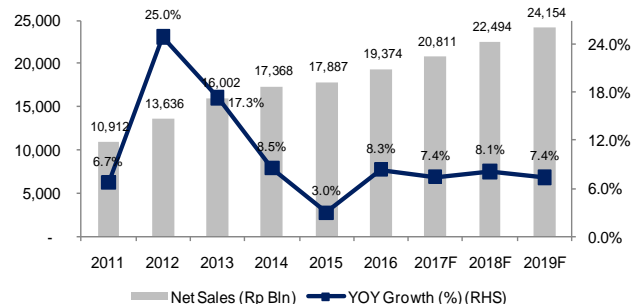
Source: Sucor Sekuritas Research

Fig 13 KLBF's nutritional division: sales trends



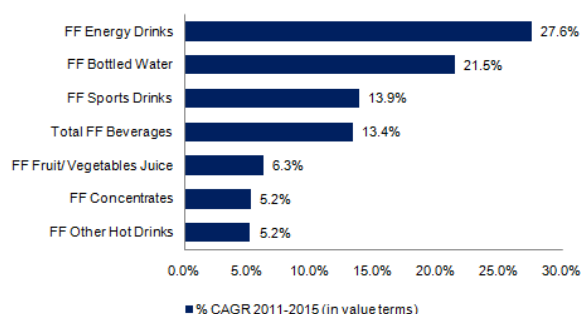
Source: Company, Sucor Sekuritas Research

Fig 14 Overall, KLBF's sales outlook to remain unfavorable



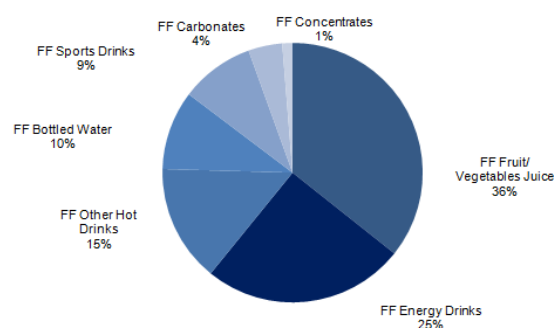
Source: Company, Sucor Sekuritas Research

Fig 15 China energy-drink category has been on the up-trend over the last four years



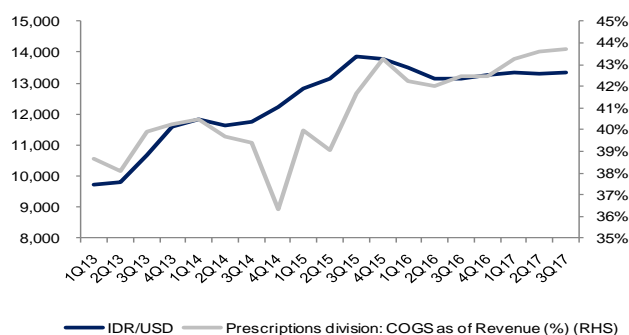
Source: Euromonitor, Sucor Sekuritas Research

Fig 16 China beverages market in 2015



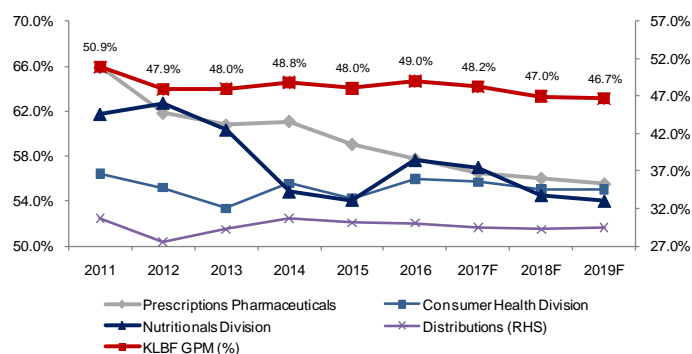
Source: Euromonitor, Sucor Sekuritas Research

Fig 17 KLBF's direct material components are tied-up to volatility of FX



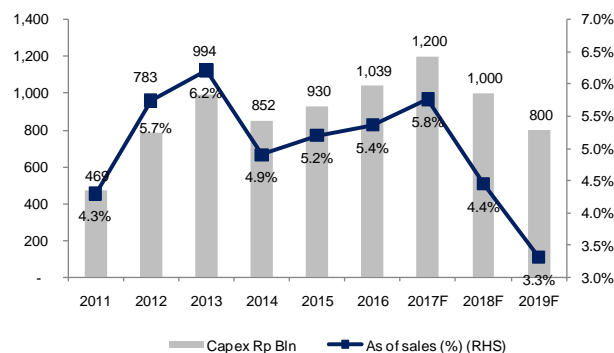
Source: Company, Sucor Sekuritas Research

Fig 18 Expecting KLBF's GPM to remain under pressure



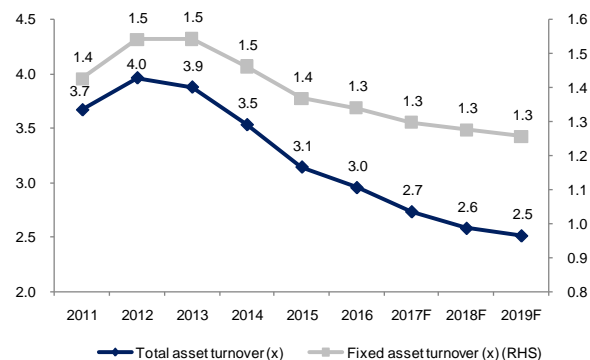
Source: Company, Sucor Sekuritas Research

Fig 19 Capex cycle spending should remain high



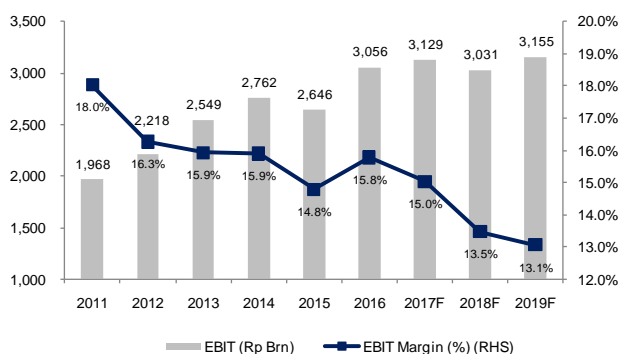
Source: Company, Sucor Sekuritas Research

Fig 20 ...resulting in lower asset turnover ratio



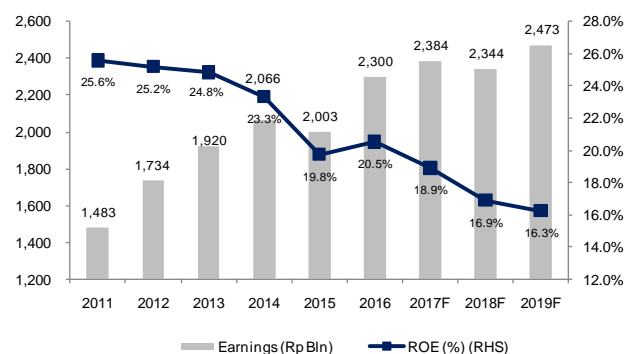
Source: Company, Sucor Sekuritas Research

Fig 21 Pressure on operating margin (%)



Source: Company, Sucor Sekuritas Research

Fig 22 ...should send ROE lower into mid-term (%)



Source: Company, Sucor Sekuritas Research

Fig 23 KLBF financial ratios

Profit and Loss Ratios	2015	2016	2017F	2018F	2019F
Sales growth (%)	3.0%	8.3%	7.4%	8.1%	7.4%
EPS growth (%)	-3.0%	14.8%	3.7%	-1.7%	5.5%
Gross margin (%)	48.0%	49.0%	48.2%	47.0%	46.7%
EBIT margin (%)	14.8%	15.8%	15.0%	13.5%	13.1%
EBITDA margin (%)	17.0%	18.0%	17.2%	15.9%	15.5%
Interest coverage (x)	126.9	124.9	225.9	279.8	359.5
Effective tax rate (%)	-23.2%	-23.2%	-25.0%	-25.0%	-25.0%
Net margin (%)	11.2%	11.9%	11.5%	10.4%	10.2%
Balance Sheet Ratios					
Net cash (debt) (IDR Bn)	2,481	2,795	3,518	3,986	4,888
Net debt/equity (%)	-22.7%	-22.4%	-25.5%	-26.4%	-29.6%
Return on assets (%)	29.3%	30.2%	14.9%	13.3%	12.9%
Return on equity (%)	19.8%	20.5%	18.9%	16.9%	16.3%
Working capital/sales (%)	-21.1%	-22.3%	-20.1%	-20.2%	-20.2%
Receivable days	50	49	46	46	46
Inventory days	120	117	122	122	122
Payable days	59	56	61	61	61
Cash cycle	110	110	106	106	106
Book (IDR/share)	235	266	294	321	352

Source: Company, Sucor Sekuritas Research

Fig 24 KLBF P&L (IDR Bn)

Profit and loss (IDR Bn)	2015	2016	2017F	2018F	2019F
Revenue	17,887	19,374	20,811	22,494	24,154
COGS	9,296	9,886	10,773	11,927	12,883
Gross profit	8,591	9,488	10,038	10,567	11,271
Operating expenses	5,781	6,240	6,667	7,249	7,775
EBIT	2,646	3,056	3,129	3,031	3,155
D&A	389	441	456	534	599
EBITDA	3,035	3,497	3,585	3,565	3,754
Pre-tax income	2,720	3,091	3,247	3,194	3,365
Income tax expense	663	740	812	798	841
Minority interest	54	51	51	51	51
Net profit	2,003	2,300	2,384	2,344	2,473
EPS	43	49	51	50	53
EPS growth (%)	-3%	15%	4%	-2%	5%
DPS	17	19	19	22	23

Source: Company, Sucor Sekuritas Research

Fig 25 KLBF Balance sheet (IDR Bn)

Balance sheet (IDR Bn)	2015	2016	2017F	2018F	2019F
Cash	2,719	2,895	3,583	4,022	4,895
Accounts receivables	2,434	2,725	2,601	2,812	3,019
Inventories	3,003	3,344	3,591	3,976	4,294
Others	593	608	693	735	776
Total current assets	8,749	9,572	10,469	11,544	12,985
Fixed assets - Net	3,938	4,556	5,299	5,765	5,966
Goodwill - Net	415	400	399	399	399
Others	595	697	697	697	697
Total non-current assets	4,948	5,653	6,395	6,861	7,062
Total assets	13,697	15,225	16,864	18,405	20,047
ST borrowing	266	135	100	100	100
Current maturities of LT borrowings	-	12	29	29	29
Accounts payable	1,460	1,578	1,796	1,988	2,147
Others	640	592	732	811	876
Total current liabilities	2,366	2,317	2,657	2,927	3,152
LT borrowing	128	132	115	86	58
Others	265	312	312	312	312
Total non-current liabilities	393	444	427	398	370
Total liabilities	2,759	2,761	3,084	3,326	3,521
Shareholders equity	435	434	434	434	434
Minority interests	473	555	606	657	708
Retained earnings	10,006	11,415	12,741	13,990	15,385
Others	24	61	-	-	-
Total Equity	10,938	12,464	13,781	15,080	16,526

Source: Company, Sucor Sekuritas Research

Fig 26 KLBF Cash Flow (IDR Bn)

Cash flow (IDR Bn)	2015	2016	2017F	2018F	2019F
EBIT	2,646	3,056	3,129	3,031	3,155
D&A	389	441	456	534	599
Changes in working capital	119	(554)	149	(366)	(343)
Interest & taxes	58	104	178	222	271
Others	(85)	(136)	(60)	(60)	(60)
Operating cash flow	2,427	2,159	3,041	2,564	2,780
Capital expenditures	(904)	(1,039)	(1,199)	(1,000)	(800)
Change in ST investment	32	(46)	-	-	-
Others	17	23	-	-	-
Investing cash flow	(801)	(1,015)	(1,199)	(1,000)	(800)
Free cash flow	1,523	1,120	1,842	1,564	1,980
Change in equity	-	-	-	-	-
Net change in LT borrowings	75	(126)	-	(29)	(29)
Net change in ST borrowings	-	-	(35)	-	-
Cash dividends paid	(907)	(902)	(1,058)	(1,096)	(1,078)
Others	44	80	(61)	-	-
Financing cash flow	(788)	(948)	(1,153)	(1,125)	(1,107)
Net change in cash	838	196	688	439	873
Cash in beginning of the year	1819	2658	2895	3583	4022
Cash at the end of the year	2,657	2,854	3,583	4,022	4,895

Source: Company, Sucor Sekuritas Research

Sucor Sekuritas rating definition, analysts certification, and important disclosure

Ratings for Sectors

Overweight	: We expect the industry to perform better than the primary market index (JCI) over the next 12 months.
Neutral	: We expect the industry to perform in line with the primary market index (JCI) over the next 12 months.
Underweight	: We expect the industry to underperform the primary market index (JCI) over the next 12 months

Ratings for Stocks

Buy	: We expect this stock to give return (excluding dividend) of above 10% over the next 12 months.
Hold	: We expect this stock to give return of between -10% and 10% over the next 12 months.
Sell	: We expect this stock to give return of -10% or lower over the next 12 months

Analyst Certification

The research analyst(s) primarily responsible for the preparation of this research report hereby certify that all of the views expressed in this research report accurately reflect their personal views about any and all of the subject securities or issuers. The research analyst(s) also certify that no part of their compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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