AUTOMOTIVE PARTS SECTOR/COMPANY UPDATE

Selamat Sempurna

A beneficiary of global recovery

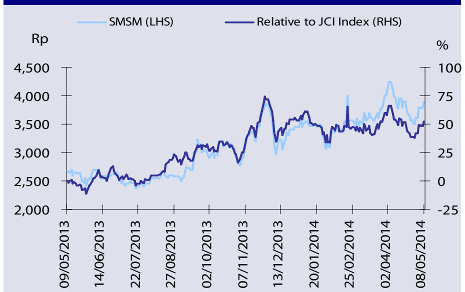
BUY

Target Price, Rp	4,350
Upside	11,9%
SMSMIJ/SMSMJK	
Last Price, Rp	3,885
No. of shares (bn)	1,439
Market Cap, Rp bn	**5,591**
(US$ mn)	484
3M T/O, US$mn	0.2

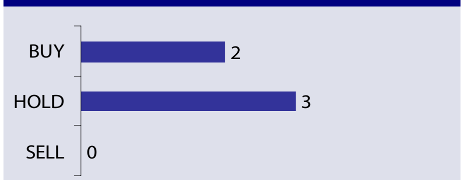
Last Recommendation

09-Jan-14	HOLD	Rp 3,350
17-Dec-13	BUY	Rp 3,350
31-Jul-13	HOLD	Rp 2,850

SMSM relative to JCI Index



Market Recommendation



Danareksa vs Consensus

	Our	Cons	% Diff
Target price, IDR	4,350	3,175	37.0
EPS 14F, Rp	198	207	-4.3
PE 14F, x	17.1	18.7	-8.5

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Danareksa research reports are also available at Reuters Multex and First Call Direct and Bloomberg.

With encouraging signs on the global recovery as seen in 1Q14, SMSM should extend its record of 21 years of consecutive revenues growth. Currently SMSM is trading at FY14 PE of 16.7x, a 10% premium to the JCI market of 15.2x. Yet, this is justifiable due to: 1) the company's high exposure to the exports market with the currently weaker rupiah and better demand, 2) its stronger balance sheet than ever, and 3) its highest ROE in the sector. We change our recommendation to BUY with a new Target Price of Rp4,350, implies PE FY14-15 of 19.2-15.9x. While the lack of share liquidity may mean the stock price stays volatile, we believe it remains as one of the outstanding value stock in the Indonesian market.

Exports gain traction

Recording its best performance since early 2012, SMSM's revenues jumped 26% yoy in 1Q14 owed to the quick recovery in export market. In 1Q14, the growth in exports reached 43% yoy with all regions posting double digits growth indicating that earnings bottomed out last year. Thus, export exposure getting higher with 68% as in 1Q14 which will bring beneficiary for SMSM from the currently weaker rupiah. As such, we raise our revenues targets for 2014-2015 by 4% from our previous forecasts and expect the company to post 13% CAGR revenues growth in the next three years (vs. 7% CAGR in 2011-2013), with catalysts coming from: 1) the organic growth from the main products, 2) stronger demand on the exports side, and 3) weaker rupiah condition which will keep ASP elevated.

Moving towards net cash with a better ROE

SMSM currently has solid working capital with only a four months cycle. Going forward, we expect both the capex and investments activities to remain low given company can grow through its organic growth. Hence, the balance sheet should remain healthy with strong cash flow going forward. As a result, we expect SMSM to be in a net cash position by 2016 after the repayment of Rp80bn bonds in July 2015. In our view, the ROE is also on track to improve given the company's ability to maintain its profitability coupled with better assets turnover, which is a good sign for well-managed company. For these reasons, we feel that SMSM warrants selection as one of the best defensive picks in the Indonesian auto segment.

Margins maintained thanks to higher exposure to exports and low steel prices

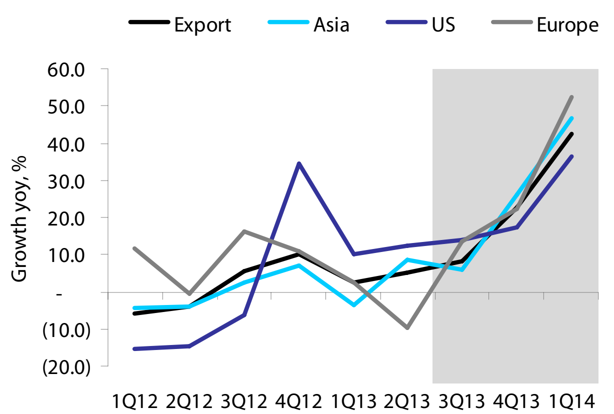
70% of SMSM's COGS are derived from the cost of materials, with more than 50% of the cost of materials being steel-related products which mostly imported from POSCO. Hence, USD-related costs are around 35% of the COGS. Thus, a higher proportion of exports will provide SMSM with a natural hedge of its costs. Since the company is also benefitting from the low global steel prices, we expect that the company can maintain its gross margins for its main products at their current high level – i.e. above 25%. Note that since the proportion of filter sales is still increasing, the impact from the low margin in Hydraxle will be less.

Year end to Dec	2012	2013	2014F	2015F	2016F
Revenue, Rp bn	2,269	2,373	2,710	3,094	3,457
EBITDA, Rp bn	508	534	602	689	749
EBITDA Growth, %	18.7	5.1	12.7	14.4	8.8
Net Profit, Rp bn	252	321	327	393	439
Core Profit, Rp bn	252	282	327	393	439
Core EPS, Rp	175	196	227	273	305
Core EPS Growth, %	20.1	11.9	16.0	20.1	11.7
Net Gearing, %	35.0	23.2	11.4	1.8	Net cash
PER, x	22.2	17.4	17.1	14.2	12.7
Core PER, x	22.2	19.9	17.1	14.2	12.7
PBV, x	6.1	5.6	4.8	4.1	3.6
EV/EBITDA, x	11.6	10.8	9.4	8.1	7.3
Yield, %	2.7	3.0	3.5	4.2	4.7

Exports gain traction

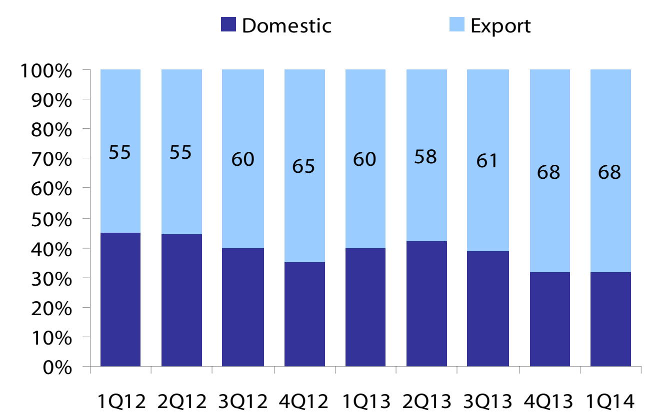
Recording its best performance since early 2012, SMSM's revenues jumped 26% yoy in 1Q14. This owed to the quick recovery in the company's export markets since, at the same time, domestic revenues were flat due to the slump in Hydraxle's revenues. In 1Q14, the growth in exports reached a very brisk 43% yoy, with all regions posting double digits growth. The fastest recovery came in the European region (where revenues grew 52% yoy in 1Q14), indicating that earnings bottomed out last year. Looking ahead, we expect a further improvement in SMSM's sales to the export market, which reached 68% of total sales in 1Q14 or up from 62% in FY13. Thanks to higher exports exposure, SMSM stands to benefit from the currently weaker rupiah.

Exhibit 1. Strong upturn in exports



Source: Company

Exhibit 2. Higher exposure to exports market

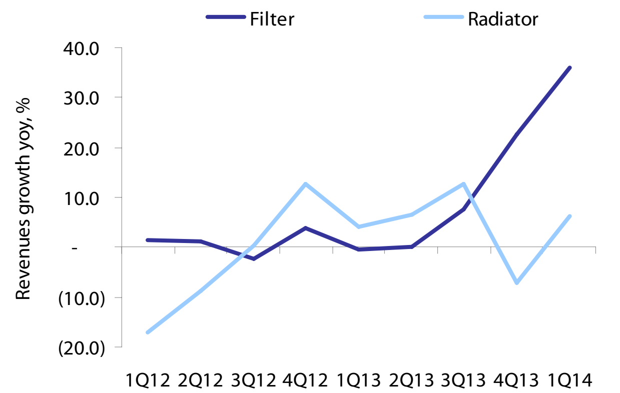


Source: Company

Filters as the main growth driver

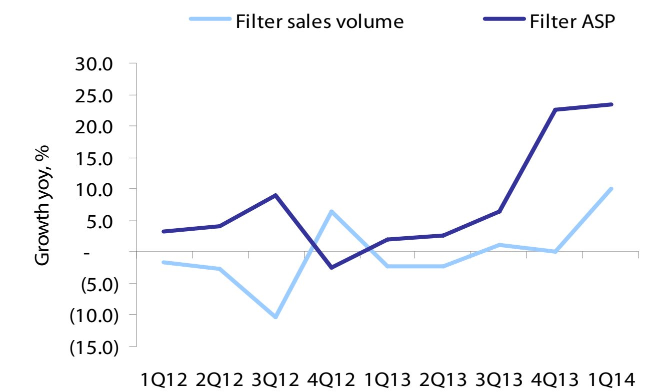
SMSM's strong exports growth owed largely to higher sales of the company's main product, filters - which have trended higher since 3Q13. On another positive note, the company benefited from the weaker rupiah which gave a boost to the ASP. As a result, filters contributed 77% of total revenues in 1Q14, or up from 66% in 1Q12. Sales of radiators, the company's other main product and which are mostly exported to the US market through its partnership with Donaldson, appeared to show nascent signs of improvement in 1Q14. Nonetheless, negatively affected by the mild commodity prices, weak sales of Hydraxle dump trucks continued to exert a drag on domestic sales performance even though the company attempted to shift its focus toward construction machinery. Looking ahead, however, Hydraxle sales may soon pick up in 2H14, lifted by a budding recovery in commodity prices which would boost demand for dump trucks.

Exhibit 3. Growth from the main product, filters



Source: Company

Exhibit 4. Higher ASP growth thanks to weaker rupiah



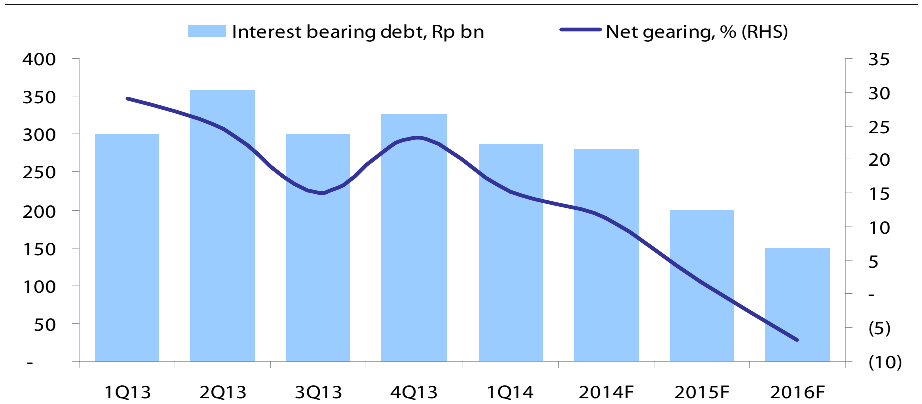
Source: Company

Going forward, we expect SMSM to face less challenging market conditions than in 2012-2013, thanks to the global economic recovery story. As such, we raise our revenues targets for 2014-2015 by 4% from our previous forecasts and expect the company to post 13% CAGR revenues growth in the next three years (vs. 7% CAGR in 2011-2013), with catalysts coming from: 1) the organic growth from the main products, 2) stronger demand on the exports side, and 3) a weaker rupiah which will keep ASP elevated. Potential upside would come from better Hydraxle performance in the coming quarters if commodity prices can maintain their momentum.

Moving towards net cash with a better ROE

SMSM currently has solid working capital with only a four months cycle. Going forward, we expect both the capex and investments to remain low given the less challenging environment than in 2012-2013. Hence, the balance sheet should remain healthy with strong cash flow going forward. For now, the company has only budget around Rp100bn p.a. on capex for maintenance in consideration of the low utilization at the company's existing factories. What's more, further acquisitions seem unlikely, we believe, given the stronger expected demand as seen in the 1Q14 figures. Presently, the company's only long-term financing is its Rp80bn series-C bonds which carry a 10.8% coupon and mature in July 2015 – when we believe the company's internal cash flow will be sufficient to repay the debt. As a result, we expect SMSM to be in a net cash position by 2016, meaning the company will be less exposed to increasing borrowing costs in the future.

Exhibit 5. Net cash by 2016



Source: Company, Danareksa Sekuritas

In our view, the ROE is also on track to improve given the company's ability to maintain its profitability coupled with better assets turnover - a good sign of a well-managed company. For these reasons, we feel that SMSM warrants selection as one of the best defensive picks in the Indonesian auto segment.

Exhibit 6. High ROE from better profitability and asset turnover

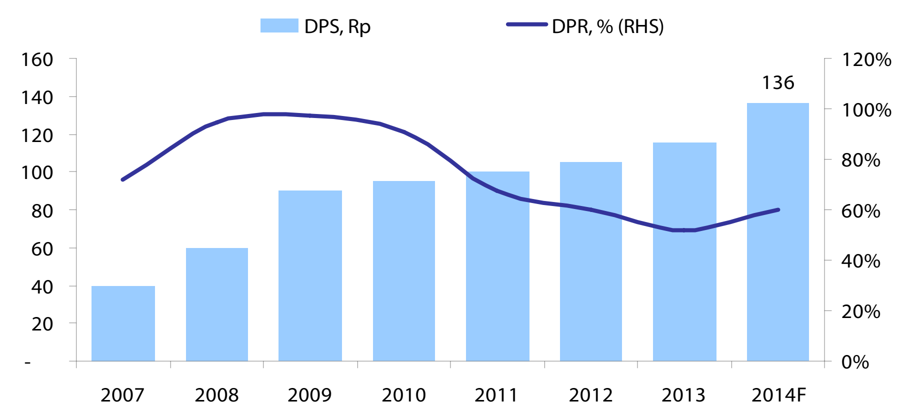
	2011	2012	2013	2014F	2015F
Core margin, %	10.1	11.1	11.9	12.1	12.7
Asset turnover, x	1.6	1.5	1.5	1.5	1.6
Equity multiplier, x	1.7	1.7	1.7	1.6	1.5
ROE, %	27.0	28.2	29.4	30.2	31.3

Source: Company, Danareksa Sekuritas

Still dividend player as well

Also, we expect SMSM to distribute at least 60% of its earnings as dividends, considering both its ample cash flow and dividend track record. Thus, we expect the 2014 dividend yield to be around 4%, with the large interim cash dividend paid to shareholders in mid-2014. Over the longer term, the company is still committed to its generous dividend policy with the target of raising nominal dividends every year.

Exhibit 7. Expecting a DPR of 60% supported by ample cash flow

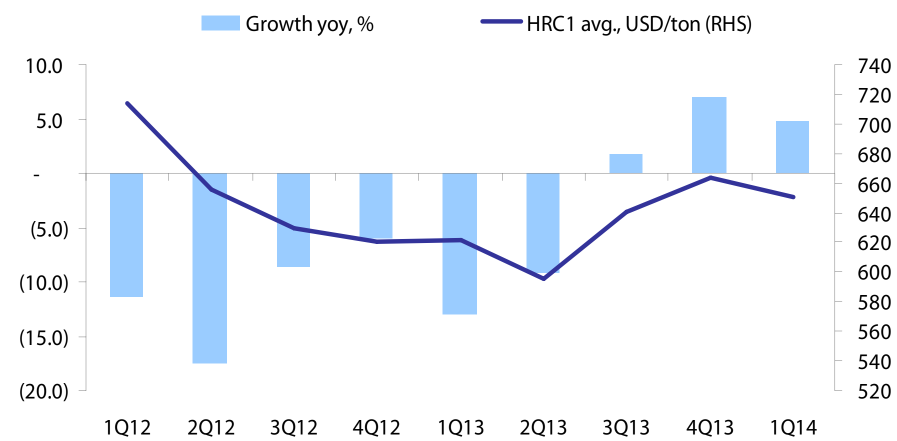


Source: Company, Danareksa Sekuritas

Margins maintained thanks to higher exposure to exports and low steel prices

Currently, around 70% of the COGS are derived from the cost of materials, with more than 50% of the cost of materials being steel-related products. Most of SMSM's steel is imports from POSCO as domestic steel doesn't meet its minimum requirements. Hence, USD-related costs are around 35% of the COGS. As we have previously mentioned, a higher proportion of exports will provide SMSM with a natural hedge of its costs. Since the company is also benefitting from the low global steel prices, we expect that the company can maintain its gross margins for its main products, filters and radiators, at their current high level – i.e. above 25%. Nonetheless, the deterioration in Hydraxle sales may encourage the company to give discounts in a bid to boost sales volume. Note, however, that since the proportion of filter sales is still increasing, the impact from Hydraxle will be less. All in all, we expect gross margins of 26.3% in 2014-2015 (vs. 26.9% in 2013).

Exhibit 8. Low steel prices will help SMSM to maintain its profitability



Source: Company

Valuation: Outstanding value stock

SMSM currently trades at FY14 PE of 16.7x, a 10% premium to the JCI's 15.2x, yet justifiable, we feel, due to: 1) the company's high exposure to the exports market with the currently weaker rupiah and better demand, 2) its stronger-than-ever balance sheet, and 3) its highest ROE in the sector. Nonetheless, share price volatility has been quite high in the past few months due to a lack of share liquidity since most owners are long on the stock as seen in the foreign holdings that increased significantly from only 9% in December 2012 to 22% in April 2014.

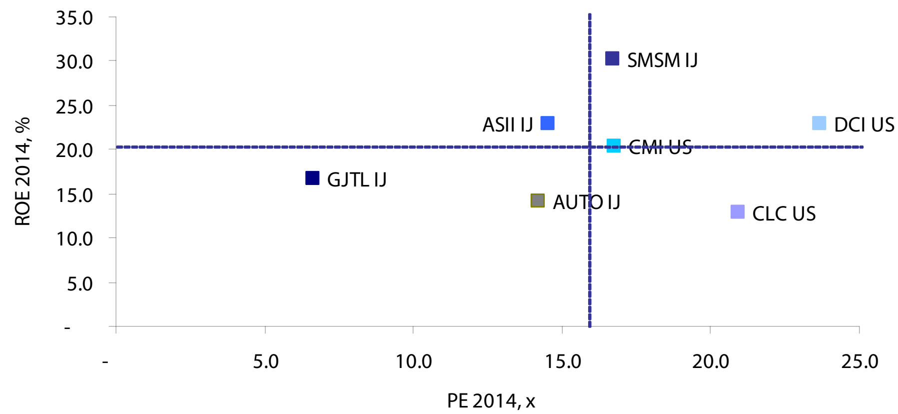
In our valuation, we continue to use the DCF valuation method with a WACC of 10.8% and 3.0% terminal growth to arrive at our new Target Price of Rp4,350, implying PE FY14-15 of 19.2-15.9x. While the lack of share liquidity may mean the stock price stays volatile, we believe SMSM remains as one of the outstanding value stocks in the Indonesian market. BUY.

Exhibit 9. DCF valuation

	2014F	2015F	2016F	2016F	2018F	2019F	2020F
DCF Based, Rp bn							
EBIT	472	551	602	667	741	824	921
Tax on EBIT	(94)	(110)	(120)	(133)	(148)	(165)	(184)
Depreciation	130	138	147	157	167	178	189
Capex	(102)	(109)	(116)	(123)	(130)	(138)	(147)
WC	(82)	(119)	(115)	(129)	(145)	(160)	(181)
FCFF	323	351	398	438	485	538	599
Terminal Value							7,934
Discounted Cash Flow	323	317	324	322	322	323	4,619
Enterprise Value	6,550						
Net Debt	(132)						
Equity Value	6,418						
Minority Interest	(173)						
Net Equity Value	6,245						
Net Equity Value per shares, Rp	**4,350**						

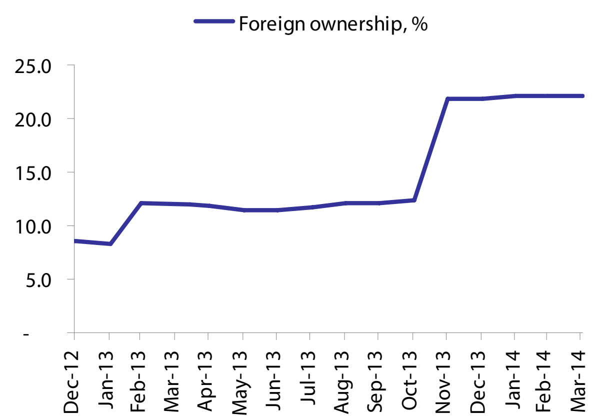
Source: Danareksa Sekuritas

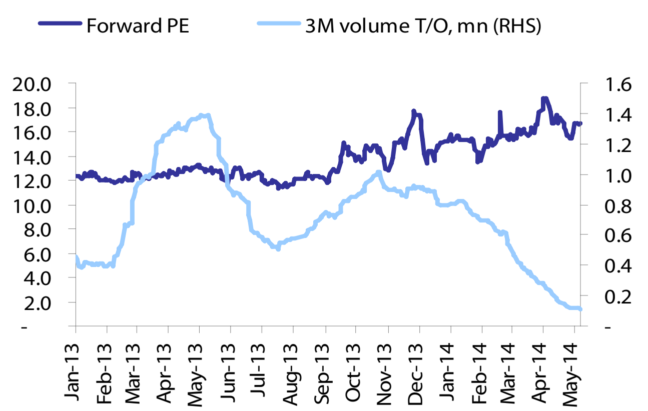
Exhibit 10. Comparison with auto players



Source: Bloomberg

Exhibit 11. Significant increase in foreign holding limit the liquidity in the market





Source: Bloomberg

Exhibit 12. Profit and loss (Rp bn)

	2012	2013	2014F	2015F	2016F
Revenue	2,269	2,373	2,710	3,094	3,457
COGS	1,669	1,735	1,999	2,280	2,566
Gross Profit	600	638	711	814	891
Operating Expenses	211	216	239	264	289
Operating Profit	389	421	472	551	602
Net Interest	(29)	(27)	(26)	(19)	(12)
Other Income (Expenses)	10	65	0	1	1
Pre-tax Income	370	459	447	532	591
Income Tax	(83)	(108)	(89)	(106)	(118)
Minority Interest	(35)	(30)	(30)	(33)	(34)
Net Profit	252	321	327	393	439
Core Profit	252	282	327	393	439

Source: Company, Danareksa Sekuritas

Exhibit 13. Balance sheet (Rp bn)

	2011	2012	2013F	2014F	2015F
Cash & Equivalent	63	93	148	176	257
Trade Receivables	467	558	602	688	768
Inventories	425	398	444	507	570
Other Current Assets	32	48	46	52	58
Total Current Assets	986	1,097	1,241	1,422	1,653
Property, Plant, Equipment	514	492	465	435	404
Investment in Shares of Stocks	35	36	37	37	38
Other Non-current Assets	21	76	76	76	76
Total Non-current Assets	570	604	577	548	517
Total Assets	**1,556**	**1,701**	**1,818**	**1,970**	**2,170**
Bank Loans	191	212	150	150	125
Trade Payables	97	164	167	190	214
Short-term Portion of Bonds	80	-	80	-	-
Other Current Liabilities	113	147	151	166	180
Total Current Liabilities	481	523	548	506	519
Long-term Portion of Bonds	80	80	-	-	-
Other Liabilities	54	56	60	63	66
Total Non-current Liabilities	165	171	110	113	91
Minority Interest	175	169	173	188	207
Capital Stock	144	144	144	144	144
Additional Paid in Capital	42	49	49	49	49
Retained Earnings	459	644	794	971	1,160
Other Equity	90	-	-	-	-
Total Equity	910	1,007	1,160	1,352	1,560
Total Liabilities and Equity	**1,556**	**1,701**	**1,818**	**1,970**	**2,170**

Source: Company, Danareksa Sekuritas

Exhibit 14. Cash flow (Rp bn)

	2012	2013	2014F	2015F	2016F
Pretax Profit	370	459	447	532	591
Minority Interest	(35)	(30)	(30)	(33)	(34)
Tax	(92)	(105)	(89)	(103)	(115)
Depreciation	119	113	130	138	147
Change in W/C	(27)	13	(82)	(119)	(115)
Others	4	(52)	3	3	3
CFO	339	398	378	418	478
Capex	(115)	(91)	(102)	(109)	(116)
Investment	(27)	1	(0)	(1)	(1)
CFI	(142)	(90)	(103)	(110)	(116)
ST Debt	31	22	(62)	-	(25)
Current Portion of LT Debt	80	(80)	80	(80)	-
LT Debt	(48)	4	(65)	-	(25)
Equity	(0)	(89)	4	15	19
Dividend	(187)	(122)	(177)	(216)	(249)
CFF	(125)	(265)	(220)	(281)	(280)
Change in Cash	73	43	55	27	81

Source: Company, Danareksa Sekuritas

Exhibit 15. Ratios

	2012	2013	2014F	2015F	2016F
Profitability, %					
Gross Margin	26.4	26.9	26.3	26.3	25.8
Operating Margin	17.1	17.8	17.4	17.8	17.4
Net Margin	11.1	13.5	12.1	12.7	12.7
Core Margin	11.1	11.9	12.1	12.7	12.7
ROAE	28.1	33.5	30.2	31.3	30.1
ROAA	16.8	19.7	18.6	20.7	21.2
Leverage					
Debt to Equity, %	41.9	32.5	24.1	14.8	9.6
Net Debt to Equity, %	35.0	23.2	11.4	1.8	(6.8)
Interest Coverage, x	12.5	13.9	15.1	21.7	32.9
Turnover, days					
Trade Receivables	74.1	84.7	80.0	80.0	80.0
Inventories	91.6	82.5	80.0	80.0	80.0
Trade Payables	21.0	34.0	30.0	30.0	30.0
Growth, %					
Sales	9.5	4.6	14.2	14.2	11.7
Gross Profit	19.5	6.3	11.6	14.5	9.4
Operating Profit	18.4	8.3	12.1	16.6	9.3
EBITDA	18.7	5.1	12.7	14.4	8.8
Net Profit	18.5	27.4	1.9	20.1	11.7
Core Profit	20.1	11.9	16.0	20.1	11.7

Source: Company, Danareksa Sekuritas