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Electronic City Indonesia

Company Focus

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Undemanding Valuation to BUY

Initiate coverage with a Buy rating

We initiate our coverage on Electronic City with a BUY rating. We like Electronic City as the retailer is the market leader in electronic retail industry, with a 44% market share. The company is a beneficiary of rising middle income in Indonesia on the back of higher demands for gadgets and other home appliances. ECII trades at undemanding valuation and have decent growth opportunities.

2015 is the inflection point for Electronic City

We expect EBIT margin to bottom and EBIT growth to return this year on the back of profitability focus amidst slowing expansion. We think cost cutting initiative and scaling back expansion are the correct strategies to correspond with sluggish SSSG. We expect Electronic City to post 12/24% EBIT growth in 2015-16E which increases ROIC by 80bps from 13.2% in 2014E to 14.0% in 2016E.

Valuation undemanding with significant excess cash

The company has significant excess cash in the balance sheet from its IPO proceed. With minimal debt position and the plan to cut CAPEX, we expect Electronic City to be able to release some cash as special dividend to shareholders or conduct other structural improvements to lift SSSG. Per 9M14, net cash balance of the company makes up around 30% of its market cap.

Recommendation: BUY with price target of Rp2,000

Our target price implies 28% upside from current price. We apply DCF methodology to value Electronic City and assume WACC of 12.6%. ECII trades at 13.4x 2015E PE and 11.2x 2016E PE. It is also trading at 1.0 x 2016E PBV with 10% 2016E ROE. ECII trades at premium over ERAA, but we argue that ECII has more variants in its products to minimize the risk of holding inventory for the same product type. Moreover, ECII has a healthier balance sheet (ERAA has Rp1.5tr net debt in 9M14).

Key risk:

We view that ECII does not have significant exposure to USD/IDR, as they can pass through to customer. Yet, higher than expected OPEX will burden the company (e.g. salary increases, rental rate increases, etc). The other risks are higher inflation, weak purchasing power, intense competition.

Companies Data

Year end Dec	2012	2013	2014E	2015E	2016E
Sales	1,431	2,013	2,248	2,578	3,098
Net Profit	123	207	147	160	190
EPS (Rp)	0	155	110	120	142
EPS Growth	n/m	n/m	-28.9%	8.6%	19.0%
DPS (Rp)	0	0	39	28	30
BVPS (Rp)	n/m	1,263	1,334	1,426	1,539
P/E (x)	n/m	10.3	14.5	13.4	11.2
Div Yield	0.0%	0.0%	2.4%	1.7%	1.9%

PT Electronic City Indonesia Tbk operates a retail chain of electronic products in Indonesia. The Company primarily focuses on audio-video, home appliances, mobile devices, internet technology and office equipment.

BUY Rp2,000

Company Update

Share Price	Rp1,600
Sector	Retail
Price Target	Rp2,000(+25%)

Stock Data

Reuters Code	ECII.JK
Bloomberg Code	ECII.IJ
Issued Shares (m)	1,334
Mkt Cap (Rpbn)	2,082
Avg. Value Daily 6 month (Rpbn)	1.3
52-Wk range (Rp)	3000 / 880

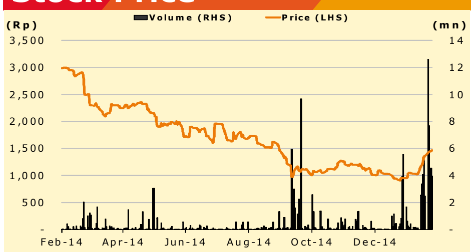
Major Shareholders

PT Graha Surya Kirana	25.6%
Andi Bharata Winata	23.2%
PT Graha Surya Kirana	25.6%
PT Graha Berkat Kirana	13.8%
Public	31.8%

Consensus

EPS	14F	15F
Consensus (Rp)	117	133
TRIM vs Cons. (%)	-5.9%	-10.1%

Stock Price



Indonesia's premier electronic store

Electronic City is Indonesia's leading electronic retailer with the highest market share at 44.6%, according to Euromonitor. The company has numerous branches throughout Indonesia that caters to various customer segments, from the low-middle income group to the middle-high income group. ECII covers all the targeted segment through its dual branding; Electronic City (blue logo) and Electronic City Outlet (red logo). This guarantees volume growth higher than industry and peers over the long term.

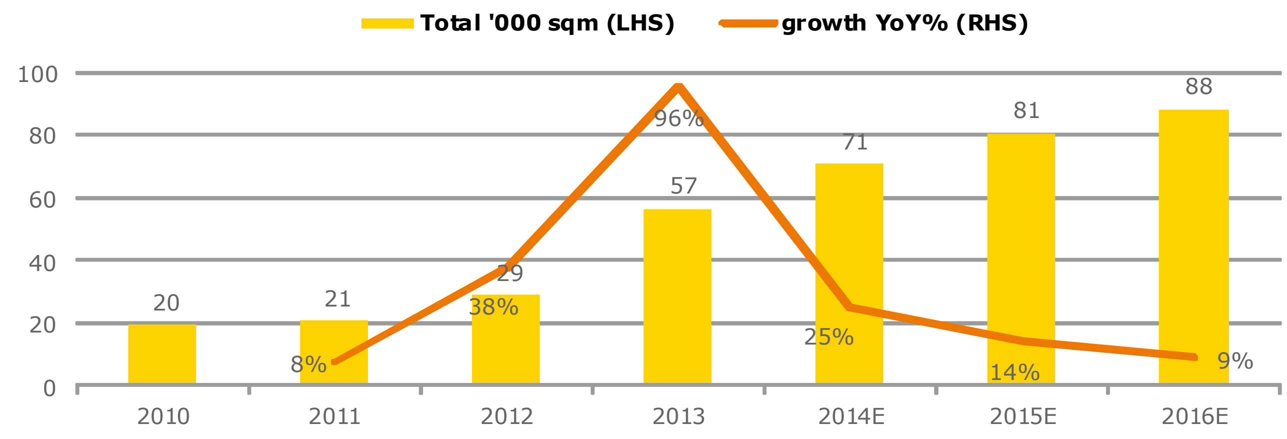
Figure 1. ECII leads the consumer electronic market in Indonesia (as of 2013)

	MRC value share	Number of stores	Sales per sqm (Rp, mn)
Electronic City	44.6%	56	34.0
Electronic Solution	34.8%	50	20.3
Best Denki	20.3%	15	12.5
Agis	0.2%	1	5.3

Source: Euromonitor, TRIM Research

We like Electronic City story on the long term. This company presents one of the best proxies to take advantage of the rising demand for electronics (home appliances and gadgets, among others). According to Euromonitor, the demand for electronics should increase by 8% CAGR over the next three years.

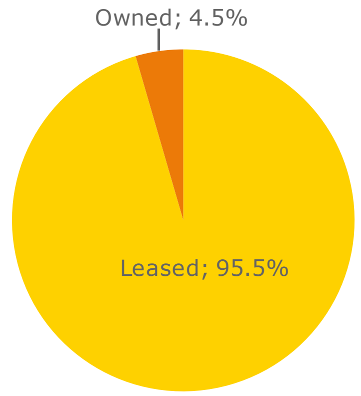
Figure 2. The company's store expansion



Source: Company, TRIM Research

Electronic City is mostly expanding its outlet via rental, which is the most capital efficient method in our view. However, the company does operate stand-alone stores that it owned and managed to act as beach head to come into area.

Figure 3. Most of the stores are leased



Source: Company, TRIM Research

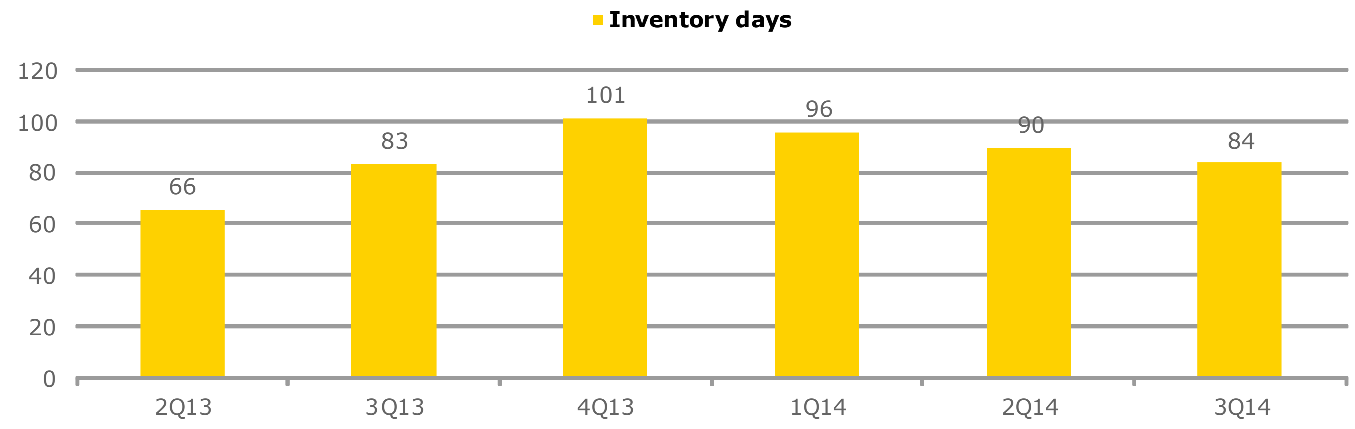
Two improvements to cash flow and earnings in 2015

We believe that management is doing initiatives to improve EBIT and cash flow: it is scaling back expansion and reduce investment in working capital, particularly inventory spending. We believe these measures should be benefitting Electronic City in 2015E and further improve the cash flow of the company.

We view the management strategy as appropriate given the response against slowing SSSG. We view that Electronic City has low pricing power against customer and made its revenue growth via volume growth, given that the price changes strategy could bring a price war in the industry. We think the best way to improve earnings is to cut operating expenditure, particularly rental cost that makes up around 24% of total OPEX.

Electronic City have also stocked-up its inventory in 4Q13 that when combined with slowing SSSG, resulted in higher inventory days. We view that this condition should improve in the coming quarters as the company will instead focus on emptying its inventory level and normalizing inventory days.

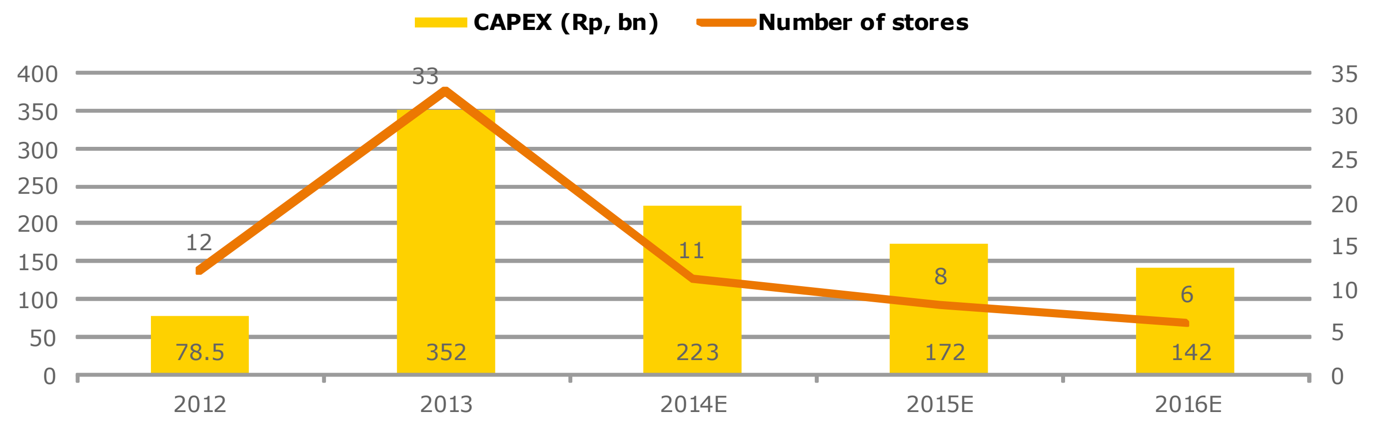
Figure 4. Inventory days improvement



Source: Company, TRIM Research

Management is guiding for Rp200bn CAPEX in 2015E which may come from opening a stand-alone store. However, we estimate that there is scope for further reduction especially if management decided to lower its target for number of stores. We estimate that Electronic City will open 8 outlets this year versus 11 that the company opened last year.

Figure 5. CAPEX spending depends on expansion strategy

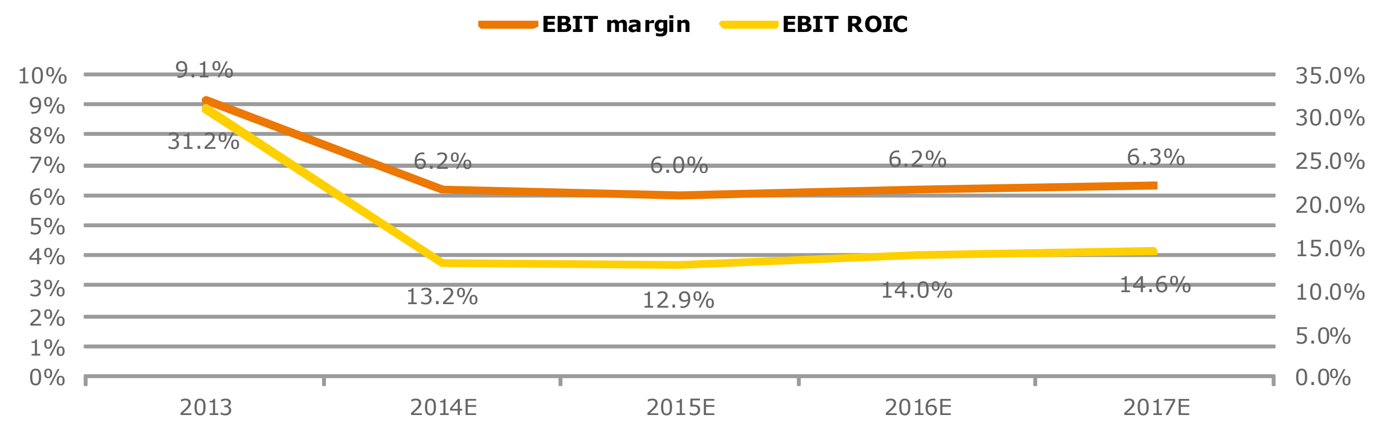


Source: Company, TRIM Research

All in all, we expect EBIT margin to bottom in 2015E following period of dramatic decline in the past 5 quarters. Indeed, we expect EBIT margin of 6.0% in 2015E before finally climbing back to 6.2% in 2016E on the back of slower OPEX growth.

This would entail ROIC improvement from 13.2% in 2014E to 14.0% in 2016E as EBIT improve relative to its operating assets.

Figure 6. Expectation of improvement in EBIT ROIC, along with EBIT margin expansion



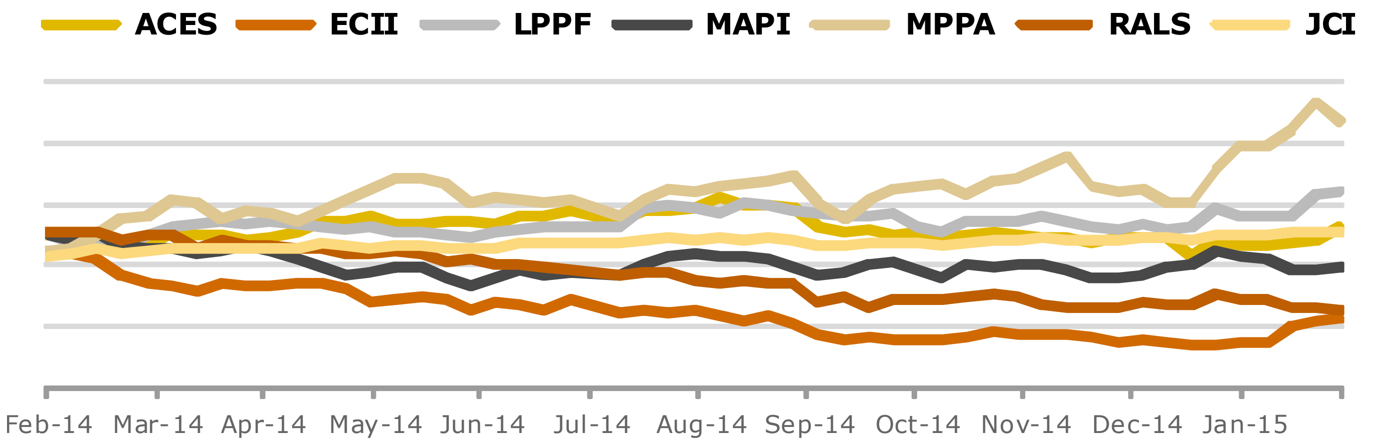
Source: Company, TRIM Research

Valuation undemanding with significant excess cash

Electronic City is sitting on excess cash from its IPO proceeds. Per 9M14, Electronic City holds around Rp609bn net cash balance, which translate roughly to Rp457/share. Given the current share price of Rp1,560, we estimated that around 29% of the share price accounts for excess cash hold by the company.

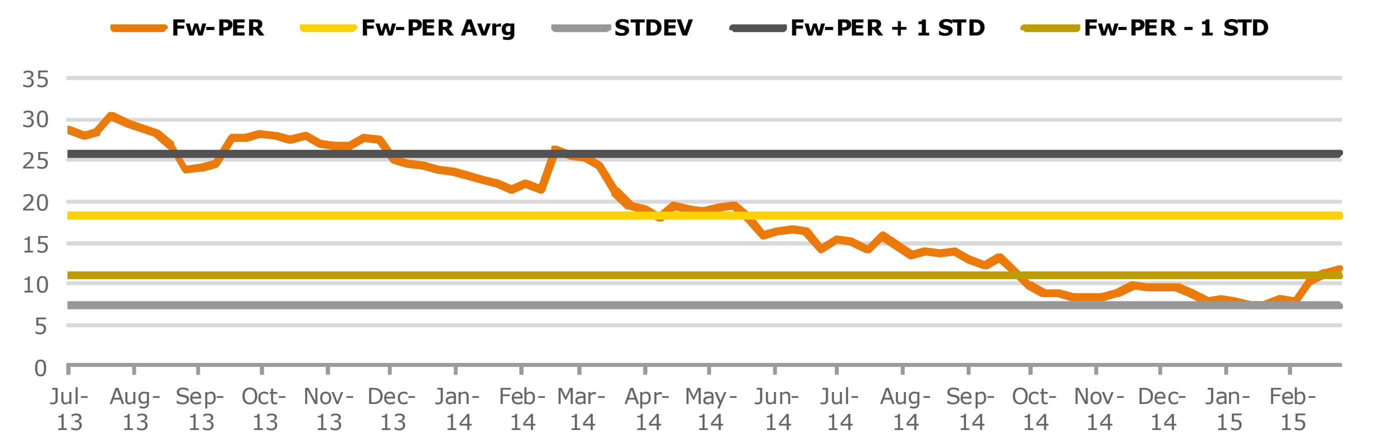
Electronic City share performance has also been dismal since its IPO, falling about 63% since its debut in 2013 at Rp4,050, making it one of the worst underperforming retailers.

Figure 7. Retailers share price performances (1 year)



Source: Bloomberg, TRIM Research

Figure 8. ECII's PE Band



Source: Bloomberg, TRIM Research

Despite recent rebound of c.70% from the bottom, we believe there is still significant upside from current price. We believe all the negatives news is currently priced in and investors are giving very big discount to its future expansion plan. We estimate around 70% of current valuation accounts for the cash and 2016E earnings.

Electronic City is trading at 13.4x 2015E PE and 11.2x 2016E PE, a significant discount of >50% to retailer's average of 30x 2015E PE and 23.8x 2016E PE. We also make a comparison to ERAA, as we see that ERAA sells gadgets as same as one of ECII's products. ERAA is traded at discount compared to ECII at 8.9-8.3x 2015-16E PE. We argue that ECII is an electronic retailer that has more variants in its products, which minimize the risk of holding inventory for the same type of product. Moreover, ECII has healthier balance sheet compared to ERAA, with Rp609bn net cash position in 9M14, while ERAA stood at Rp1,5tr net debt position. We see that ERAA has

Financials

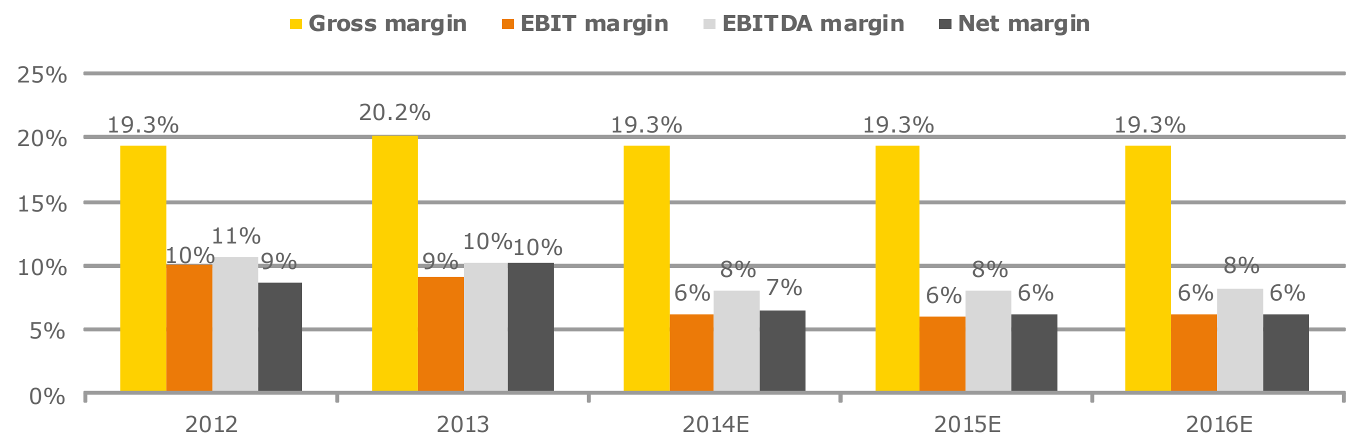
Income statement

We are forecasting revenue growth of 15% in 2015E, on the back of 14% sqm expansion from 8 outlets in 2015E, and SSSG of 5.3% (in-line with 9M14) from its old stores. We expect some ramp-up from stores that opened last year as well.

Overall, we are still expecting OPEX to grow faster than revenue in 2015E albeit at a much much slower pace relative to 2014E. We are forecasting 2015E OPEX growth of 16% versus the growth of 33% in 2014. This is the result of scaling back expansion by management to improve profitability.

This allows EBIT margin to bottom in 2015E and ROIC to improve.

Figure 9. The company's level of margin



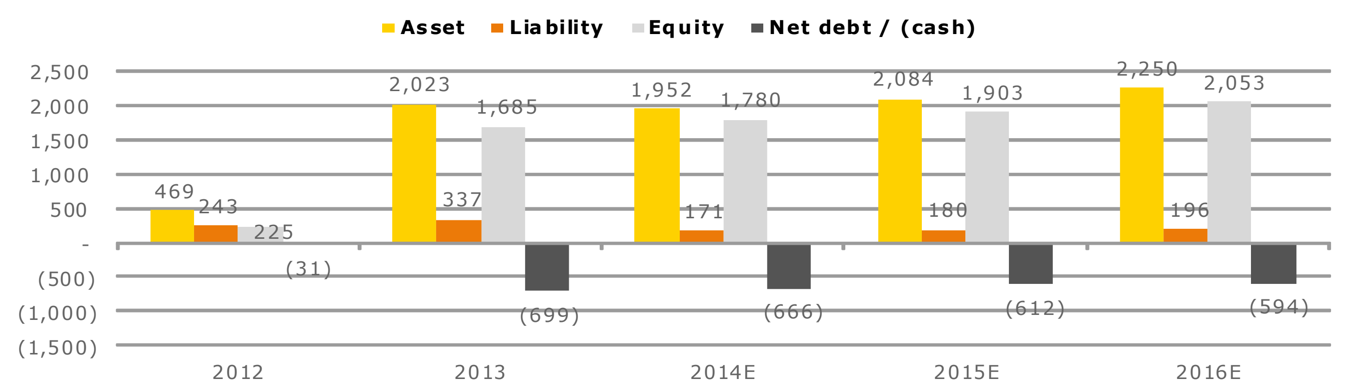
Source: Company, TRIM Research

Balance sheet

Electronic City has significant net cash balance from its IPO money, which will be disbursed for expanding its business up to 2016E. Management has stated that the company is not yet keen to add significant debt into the balance sheet. With expansion slowing down, we think cash balance is likely going to sustain at the net cash position in the coming years.

We believe that management is unlikely to stock-up its inventory further, thus alleviating the pressure on cash conversion.

Figure 10. ECII shows net cash balance and to continue...



Source: Company, TRIM Research

Valuation: BUY TP Rp2,000

We have a BUY rating on Electronic City with target price of Rp2,000, signifying a 28% upside from current share price. We like Electronic City from its OPEX savings initiatives, cheap valuation, and significant cash portion on its balance sheet.

We value Electronic City using DCF, assuming risk-free rate of 7.3% and Beta of 1.08x. We also assume terminal forward PE multiple of 8.0x (50% discount to its average forward PE of c.18x).

Electronic City currently trades at 13.4x and 11.2x 2015-16E PE respectively, which we think is relatively cheap for retailers against the typical average of 30.0x and 23.8x 2015-16E PE.

Figure 11. WDCF Calculations

Risk free rate	7.3%									
Market premium	5.0%									
Beta	1.08									
Debt proportion	1.3%									
Tax rate	15.0%									
Equity cost of capital	12.7%									
Debt cost of capital	10.3%									
WACC	12.6%									
Terminal forward PE	8.0x									
Description	**2016E**	**2017E**	**2018E**	**2019E**	**2020E**	**2021E**	**2022E**	**2023E**	**2024E**	**2025E**
EBIT x (1 - tax)	166	193	219	244	266	290	314	339	366	394
Less: Capital Expenditure	(142)	(130)	(86)	(94)	(104)	(114)	(126)	(138)	(152)	(167)
Changes in Working Capital	(91)	(78)	(71)	(66)	(63)	(67)	(71)	(75)	(79)	(84)
Add: Depreciation & Amortization	64	74	83	89	96	103	111	120	130	140
FCFF	(1)	60	146	173	196	212	229	246	265	283
Terminal value										4,082
Discounted FCFF	**(1)**	**47**	**102**	**108**	**108**	**104**	**100**	**95**	**91**	**1,332**
Total discounted FCFF	2,087									
Net debt / (Net cash)	(594)									
Minority Interest	0									
NAV	2,680									
# of shares (bn)	1.3									
NAV / share	**2,000**									

Source: TRIM Research

Key risk:

We view that ECII doesn’t have significant exposure to USD/IDR, given that they can pass through to customer directly if their principal increase the prices. Yet, higher than expected OPEX will burden the company (e.g. salary increases, rental rate increases, etc). The other risks are higher inflation, weak purchasing power, intense competition.

Income Statement (Rpbn)

Year end Dec	2012	2013	2014E	2015E	2016E
Revenue	1,431	2,013	2,248	2,578	3,098
Revenue Growth (%)	23.1%	40.7%	11.7%	14.7%	20.2%
Gross Profit	276	406	434	498	598
Opr. Profit	145	184	139	155	192
EBITDA	153	205	181	207	257
EBITDA Growth (%)	400.3%	34.1%	-11.8%	14.6%	23.9%
Net Int Inc/(Exp)	1	11	31	29	27
Gain/(loss) Forex	0	0	0	0	0
Other Inc/(Exp)	(0)	44	0	0	0
Pre-tax Profit	146	239	170	184	219
Tax	(22)	(32)	(23)	(25)	(29)
Minority Int.	0	0	0	0	0
Extra. Items	0	0	0	0	0
Reported Net Profit	123	207	147	160	190
Core Net Profit	124	169	147	160	190
Growth (%)	428.0%	36.6%	-13.0%	8.6%	19.0%
Dividend per share	0	0	39	28	30
growth (%)	0	0	0	(0)	0
Dividend payout ratio	0.0%	0.0%	25.0%	25.0%	25.0%

Balance Sheet (Rpbn)

Year end Dec	2012	2013	2014E	2015E	2016E
Cash and equivalents	86	957	696	641	623
Other curr asset	242	601	610	678	785
Net fixed asset	117	448	628	748	825
Other asset	24	17	17	17	17
Total asset	469	2,023	1,952	2,084	2,250
ST debt	0	0	0	0	0
Other curr liab	181	280	114	124	141
LT debt	44	31	31	30	30
Other LT Liab	18	26	26	26	26
Minority interest	0	0	0	0	0
Total Liabilities	243	337	171	180	196
Shareholders Equity	225	1,685	1,780	1,903	2,053
Net debt / (cash)	(31)	(699)	(666)	(612)	(594)
Total cap employed	0	0	0	0	0
Net Working capital	91	350	512	570	660
Debt	55	43	31	30	30

Cash Flow (Rpbn)

Year end Dec	2012	2013	2014E	2015E	2016E
EBIT	145	184	139	155	192
Depr / Amort	8	21	42	52	64
Chg in Working Cap	(170)	(258)	(163)	(57)	(91)
Others	65	(41)	8	5	(2)
CF's from oprs	49	(94)	26	155	164
Capex	(127)	(393)	(223)	(172)	(142)
Others	(9)	(98)	215	0	0
CF's from investing	(136)	(491)	(8)	(172)	(142)
Net change in debt	27	(12)	(13)	(1)	0
Others	53	1,253	(52)	(37)	(40)
CF's from financing	79	1,241	(65)	(38)	(40)
Net cash flow	(8)	656	(46)	(55)	(18)
Cash at BoY	94	86	742	696	641
Cash at EoY	86	742	696	641	623
Free Cashflow	(167)	(479)	(227)	(47)	(5)

Key Ratio Analysis

Year end Dec	2012	2013	2014E	2015E	2016E
Profitability					
Gross Margin (%)	19.3%	20.2%	19.3%	19.3%	19.3%
Opr Margin (%)	10.1%	9.1%	6.2%	6.0%	6.2%
EBITDA Margin (%)	10.7%	10.2%	8.0%	8.0%	8.3%
Core Net Margin (%)	8.6%	10.3%	6.5%	6.2%	6.1%
ROAE (%)	90.1%	21.7%	8.5%	8.7%	9.6%
ROAA (%)	34.0%	16.6%	7.4%	7.9%	8.8%
Stability					
Current ratio (x)	1.8	5.6	11.4	10.6	10.0
Net Debt to Equity (x)	(0.1)	(0.4)	(0.4)	(0.3)	(0.3)
Net Debt to EBITDA (x)	(0.2)	(3.4)	(3.7)	(3.0)	(2.3)
Interest Coverage (x)	146.0	16.8	4.5	5.3	7.1
Efficiency					
A/P (days)	43	51	14	14	14
A/R (days)	2	1	2	2	2
Inventory (days)	52	101	90	90	90

Interim Result (Rpbn)

	3Q13	4Q13	1Q14	2Q14	3Q14
Sales	482	655	461	546	514
Gross Profit	90	145	88	109	97
Opr. Profit	19	78	21	20	20
Net profit	18	111	26	34	33
Gross Margins (%)	18.8%	22.1%	19.1%	20.0%	18.9%
Opr Margins (%)	3.9%	11.9%	4.6%	3.7%	3.8%
Net Margins (%)	3.8%	16.9%	5.6%	6.3%	6.4%

Capital History

Date	
3 Jul 2013	**IPO @ Rp. 4050**

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