

# PT. Steel Pipe Industry of Indonesia Tbk.

## Back For Good

16 October 2019

**Strong Buy**

### INVESTMENT THESIS

**Gov. Infra Spending Still the Main Catalyst.** There is a fairly high correlation between government infrastructure spending and the Company's revenue. In our modeling, each increase in Government infrastructure spending by IDR 1 trillion can increase the Company's Revenue by IDR 42.8 billion. Based on the state budget, infrastructure spending in 2020 reached IDR 419 trillion or grew 5% YoY.

**Better Margins.** 2018 is a turning point for the Company to improve performance. The Company's Margins have continued to decline since 2015 starting to recover in 2019. In our projections Gross Margin can grow to 13.1% in 2021 compared to 11.9% in 2018, Operating Margin rose to the level of 8.7% from 6.9% and Net Margin to 2.7% from 1.1%.

### FINANCIAL PROJECTION

**Balanced Sheet.** We project Total Asset in 2019 to grow 16.7% YoY to IDR 7.6 trillion and in 2020 increase to IDR 8.3 trillion. Total Liabilities in 2019 increase to IDR 4.6 trillion (+27%YoY) and to IDR 5.2 trillion in 2020. And Total Equity in 2019 up 3.7% YoY to IDR 3 trillion and to IDR 3.2 trillion in 2020.

**Profit & Loss.** We project a total Revenue in 2019 to grow 13.6% YoY to IDR 5.1 trillion and in 2020 jump to IDR 5.8 trillion. Net Profit to jump 33% YoY in 2019 to IDR 413 billion in 2019 and to rise 17.5% YoY in 2020 to IDR 485 billion.

### INVESTMENT RISK

**Increasing Inventory Level.** The level of the Company's Inventory in our view is quite high, which can disrupt the Company's cash flow, especially those related to working capital. Inventory in Days touched 247 days in 2018 and in 2019-2020 we projected at the level of 270-280 days. This makes the Company's Cash Convention Cycle at 320-330 days.

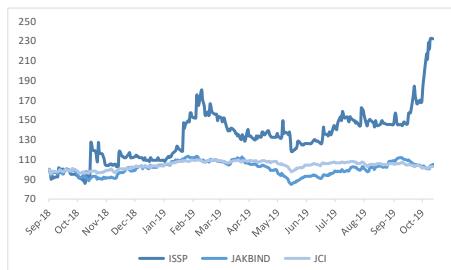
**Higher Iron Ore Price.** The increase in iron ore prices in the international market is our concern because it will affect the Company's COGS. Based on our modeling, an increase in iron ore prices by 100 bps can reduce the Company's Gross Margin by 1.5 bps. The price of iron ore which was stable at the level of USD 70/M.ton in 2017-2018, began to increase in 2019 to the level of USD 93/M.ton.

### VALUATION & RECOMMENDATION

By using the Relative Valuation Model, we set **12mo ISSP price target at IDR 370**, which implied PER'20E 18.9x. Comparing the closing price of ISSP on Monday (14/10) at the level of IDR 179, where there is still an upside potential of 106%, we recommend **Strong Buy** for ISSP.

Price (14/10)	IDR 179
<b>Target Price</b>	<b>IDR 370</b>
Ticker (Bloomberg)	ISSP.IJ
IDX Sector	Basic Industry

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### Company Description:

The company is a steel pipe producer with the largest production capacity in Indonesia. The current total production capacity is 612 thousand metric tons per year, which are spread in six factories owned by the Company in East Java and West Java.

The types of pipes produced by the Company (based on the type of welding) are HFW, TIG and SAW.

### Stock Data

52-week Range (IDR)	194   179
Mkt Cap (IDR bn)	1,286
JCI Weight	0.02%
Shares O/S (mn)	7,186
Shares Float	44%

### Share Holders:

Cakra Bhakti Para Putra, PT	56.8%
Public/Others (<5%)	43.2%

	FY16	FY17	FY18	FY19F	FY20F	FY21F
Revenue (IDR tn)	3.3	3.7	4.5	5.1	5.8	6.6
Profit before income tax (IDR bn)	139	20	60	138	179	230
Net income (IDR mn)	103	9	49	109	140	180
EPS (IDR)	14	1	7	15	20	25
BV (IDR)	841	872	904	1,055	1,161	1,286
Revenue growth (%)	-9.1%	12.4%	22.0%	13.6%	13.4%	14.0%
Net Income growth (%)	-35.3%	-91.6%	464.0%	122.8%	29.3%	28.1%
Current ratio (X)	1.2	1.5	1.4	1.2	1.2	1.2
Debt-to-equity (X)	1.1	0.9	1.1	1.3	1.4	1.6
ROE (%)	3.9%	0.3%	1.7%	3.6%	4.4%	5.4%
P/E (X)	25.8	307.8	54.6	24.5	18.9	14.8
P/BV (X)	0.4	0.4	0.4	0.4	0.3	0.3

Source : Bloomberg, MCS Research

*Your Trusted Professional*



## I. BUSINESS MODEL

### I.1. Value Proposition

*The biggest non-SOE steel pipe producer in Indonesia.*

PT. Steel Pipe Industry of Indonesia Tbk. (ISSP.IJ) is a private steel pipe producer with the largest production capacity in Indonesia. In 2018, ISSP succeeded in selling steel pipes totaling 346 thousand tons. Based on data released by the Company, during the first five months of 2019 it had succeeded in selling steel pipes totaling 151 thousand tons.

*Product categories.*

Based on the types of products sold by the Company, we divide into seven categories of steel pipes (plus one service); namely structural pipes, water pipes, oil and gas pipes, stainless steel pipes, galvanized pipes, steel poles and mechanical tubes. In addition, we can also divide the Company's pipe type categories based on the welding process namely high frequency welding (HFW), stainless steel tungsten inert gas welding (TIG) and spiral submerged arc welding (SSAW).

#### I.1.1. Structural Pipes

*ERW & SSAW structural pipes.*

ERW steel pipes have been used in several bridge projects, construction projects especially for wide span buildings such as airports, stadium and halls, as well as building envelope structural applications. SSAW steel pipe have been used in a variety of structural applications such as foundation work and on piers, bridges and construction of project buildings.

*Picture 1. Structural Pipes*



*Source: Company*





### I.1.2. Water Pipes

*Water pipes.*

This steel pipe product is mainly used for water network installations, especially those related to infrastructure projects.

*Picture 2. Water Pipes*



*Source: Company*

### I.1.3. Oil and Gas Pipes

*Oil & gas pipes.*

The Company produces high quality large diameter SSAW pipes for the oil and gas industry. It also the main supplier of ERW pipes for oil and gas with API 5L certification.

*Picture 3. Oil & Gas Pipes*



*Source: Company*



#### I.1.4. Stainless Steel Pipes

*Stainless steel pipes.*

Ornamental tubes are widely used for various appliances for its durability and its ability to withstand corrosion. This kind of pipe is rust and heat resistant along with other extreme conditions.

*Picture 4. Stainless Steel Pipes*



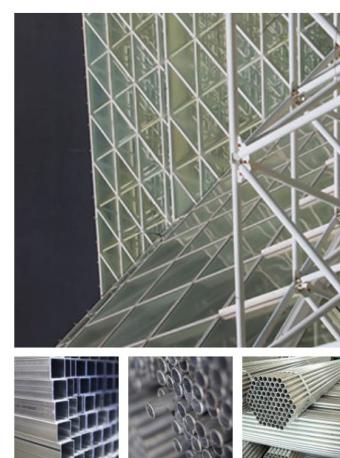
*Source: Company*

#### I.1.5. Galvanized Pipes

*Galvanized pipes.*

Galvanized pipe is a pipe made of steel and coated with a protective material made of zinc. The coating is intended to protect steel from corrosion and increase its durability. The Company's galvanized iron pipes are mostly applied as ceiling or ceiling frames, wall partition frames, canopies, fences, gates, electrical and telecommunication cable channels.

*Picture 5. Galvanized Pipes*



*Source: Company*





### I.1.6. Steel Poles

*Steel poles.*

The Company has three steel poles; telephone poles, electric poles and lighting poles. ISSP's telephone poles are designed to meet various customer requests and it has the advantage of being lighter than concrete poles. Its electric poles are available in various sizes and types for various voltage requirements.

*Picture 6. Steel Poles*



*Source: Company*

### I.1.7. Mechanical Tubes

*Mechanical tubes.*

ISSP produces mechanical tubes that can be applied for various purposes, such as furniture materials, bus frame structures, bicycle frames and automotive parts.

*Picture 6. Mechanical Tubes*



*Source: Company*

## 1.2. Client Segments

*Four customers classification.*

We classify the Company's customers according to industry types, where we see there are four broad categories of customers; namely 1) construction, Infrastructure & utilities, 2) oil & gas, 3) automotive and 4) furniture.

*Construction contributes the biggest share.*

Based on the data we obtained from management, customers from the construction, infrastructure and utilities industries made the biggest contribution to the Company's Revenue. In 2018 customers from this industry accounted for 67% of Revenue and in the first five months of 2019 the industry had accounted for 64% of Revenue.

*Next is contribution from automotive customers.*

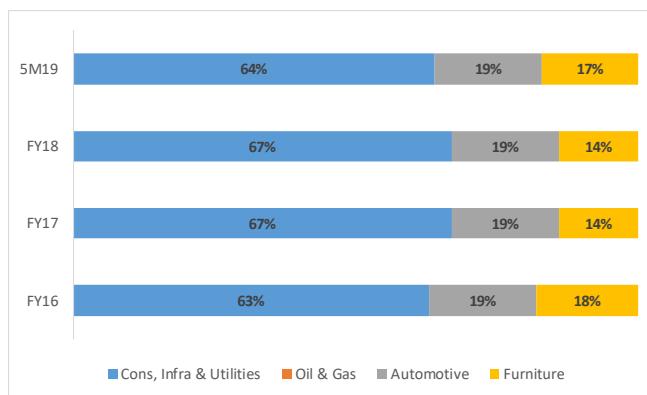
The second largest contribution came from automotive industry customers who contributed 19% of the Revenue. What is interesting is the customers from the oil & gas industry which since 2016 have not contributed at all. We have already discussed with management on this matter, at the end the management continues to make oil & gas customers as their market niche even though there are currently no orders. In the future it is expected that the Company can obtain contracts from this industry.

*Table 1. Client Segments*

Market	Main Uses
<b>Construction, Infrastructure &amp; Utilities</b>	Piling pipes Structural pipes Fire hydrant (sprinklers) Scaffolding Electrical poles & conduits Power & water treatment plants Water pipes
<b>Oil &amp; Gas</b>	Transmission & distribution pipelines
<b>Automotive</b>	Motorcycles & car parts; e.g. car seat frames, motorcycle frame, shock absorbers, cylinders & muffers
<b>Furniture</b>	Kettles, stoves, broomsticks, desks, chairs, wheelchairs, hospital beds, towel racks, trolleys, bicycles, clothes hangers & baby walkers.

*Source: Company*

*Graph 1. Clients Contribution*



*Source: Company*

### I.3. Channels and Client Relationship

*The Company uses Direct and Indirect Sales method.*

In marketing and selling its products, the Company uses two methods, namely Direct Sales and Indirect Sales. In Direct Sales, the Company sells business-to-business (B to B) steel pipe products to end users. A number of large customers from Direct Sales include PT. Waskita Karya Tbk. (WSKT.IJ), PT. Wijaya Karya Tbk. (WIKA.IJ), PT. Adhi Karya Tbk. (ADHI.IJ) and PT. Pertamina. Meanwhile, in Indirect Sales the Company sells to Distributors or Retail Stores, henceforth they will deal with end users who are usually retail customers.

*Picture 7. Marketing Channels*



*Supported by four distributions center .*

To support the sales strategy, the Company currently has four distribution centers or warehouses with a total area of 12.6 thousand m<sup>2</sup>. These four distribution centers are scattered in Bandung, Jakarta, Samarinda and Makassar. For Bandung, Jakarta and Samarinda are now fully operational, while for Makassar, they are still under construction.

*Table 2. Distributions Centers*

Warehouse	Location	Area (m <sup>2</sup> )	Status
Bandung	Bizpark Commercial Estate	1,746	Operated
Jakarta Barat	Kawasan Pergudungan Semanan Megah	2,150	Operated
Samarinda	Mangkupalas Business Center	2,652	Operated
Makassar	Jl. IR Sutami no 22	6,057	In Progress

*Source: Company*

## I.4. Key Activities

*Cut, flat, welded.*

Broadly speaking, the Company's production process is not too complicated but requires a high degree of accuracy. The main raw materials used by the Company are carbon steel and stainless steel coils. To make steel pipes, the Company cuts the steel coils wide, then is curved and welded at the end of the connection. Cutting steel coils according to the desired steel pipe size and welding method is also adjusted to the desired final product.

*Picture 8. Steel Pipe Production Process*



## I.5. Key Resources

*Six factories with a total capacity 612 thousand m.ton per year.*

The Company currently has six factory units spread across East Java and West Java, with a total current production capacity of 612,600 metric tons per year. This production capacity has almost doubled compared to 2012, when at that time the production capacity was only 318,000 metric tons per year. The biggest addition to production capacity occurred in 2015 at the Karawang Unit 5 Factory to 166,200 metric tons per year from the previous two years of 51,000 metric tons per year.

*Table 3. Production Capacity (M.ton/year)*

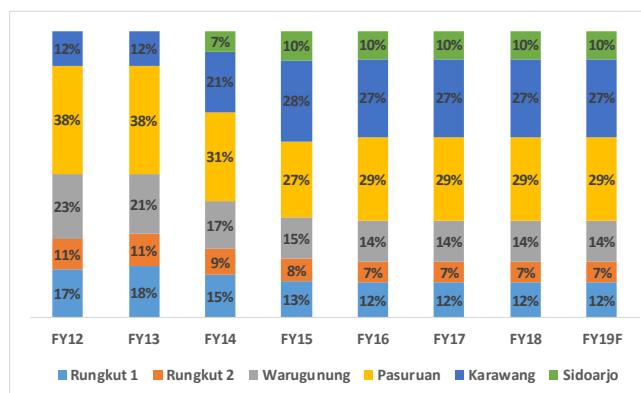
Factory	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19F
<b>Total</b>	<b>318,000</b>	<b>413,400</b>	<b>505,800</b>	<b>588,600</b>	<b>612,600</b>	<b>612,600</b>	<b>612,600</b>	<b>612,600</b>
Rungkut 1	54,000	75,000	75,000	75,000	75,000	75,000	75,000	75,000
Rungkut 2	33,600	45,600	45,600	45,600	45,600	45,600	45,600	45,600
Warugunung	72,000	85,800	85,800	85,800	85,800	85,800	85,800	85,800
Pasuruan	120,000	156,000	156,000	156,000	180,000	180,000	180,000	180,000
Karawang	38,400	51,000	107,400	166,200	166,200	166,200	166,200	166,200
Sidoarjo	0	0	36,000	60,000	60,000	60,000	60,000	60,000

Source: Company

*Unit 4 & Unit 5 the biggest factory.*

In term of production capacity, the Pasuruan and Karawang factories have the largest production capacity for the Company. The factory in Pasuruan (Unit 4) has a production capacity of 15,000 metric tons per month and is the only factory of the Company that manufactures steel pipes using the SSAW (Spiral Submerged Arch Welding) method with pipe sizes of 6 "to 120". Meanwhile the factory in Karawang (Unit 5) has a production capacity of 13,850 metric tons per month for steel pipes using the HFW (High Frequency Welding) method specifically for non-construction applications.

*Graph 2. Production Capacity*



*Source: Company*

*Table 4. Factories Details*

Plant	Location	Land Area (000 m <sup>2</sup> )	Established	Production	
				Capacity (M.ton)	Products
Unit 1 - Rungkut I	Rungkut Industri I Surabaya, East Java	30.1	1978	75,000	HFW 1/4"-8"
Unit 2 - Rungkut 2	Rungkut Industri II Surabaya, East Java	15.3	1982	42,000	HFW 5/8"-3"
				3,600	TIG 1/4"-4"
Unit 3 - Warugunung	Warugunung, Karangpilang Surabaya, East Java	29.8	1972	85,800	HFW 1/2"-8"
Unit 4 - Pasuruan	Cangkringmalang Beji Pasuruan, East Java	143.3	1992	180,000	SSAW 6"-120"
Unit 5 - Karawang	Kawasan Industri Mitrakarawang Karawang, West Java	50.0	2005	166,200	HFW Heavy Gauge Carbon Steel 1"-21/2" HFW Carbon Steel 1/2"-4" HFW SS 1"-21/2"
Unit 6 - Sidoarjo	Jl. Pahlawan, Cemengkalang Sidoarjo, East Java	40.3	2013	60,000	HFW 3/8"-3"

*Source: Company*



## 1.5. Key Partners

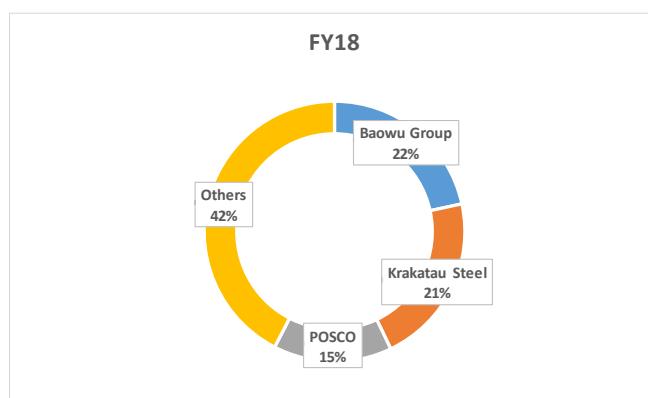
In the discussion in this section what we mean by Key Partners are those who are in contact with the Company, such as suppliers, competitors and alternative products.

### 1.5.1. Suppliers

*Three biggest suppliers.*

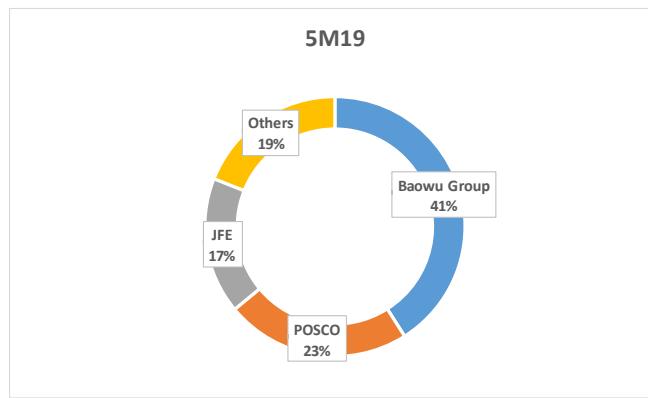
The company requires steel coils as the main raw material for making steel pipes. Based on the data we obtained from management, there are three major suppliers in the last two years, which are the Baowu Group, POSCO and JFE. Krakatau Steel was once a large supplier to the Company last year but in 2019 its position was replaced by JFE. These three suppliers have fulfilled 80% of the Company's raw material needs in 2019.

*Graph 3a. Main Suppliers 2018*



*Source: Company*

*Graph 3b. Main Suppliers 5M19*



*Source: Company*





### 1.5.2. Competitors

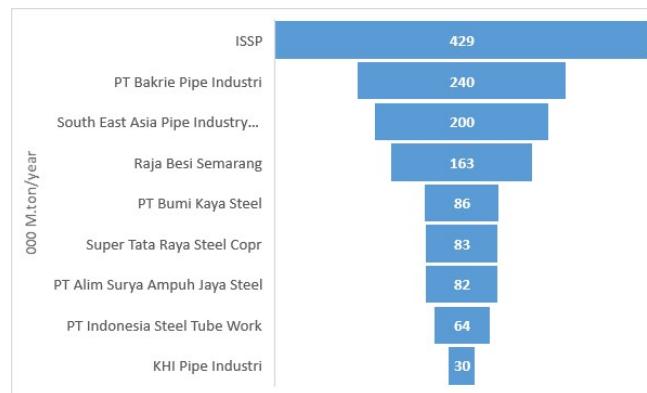
*Competition based on production capacity.*

*Market leader both in HFW and SSAW product category.*

In conducting discussions regarding competition and market share we use a benchmark of annual production capacity as a benchmark, which is adjusted based on the type of product which are HFW (high frequency welding) and SSAW (spiral submerged arc welding).

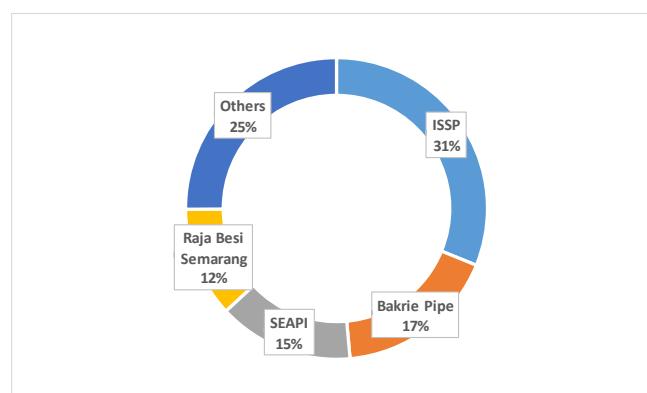
What's interesting is that in these two product categories, the Company has the largest production capacity to become a market leader. For HFW steel pipe products, the Company currently has a production capacity of 429,000 metric tons per year or controls 31% of the market share. The closest competitor in this HFW product is PT Bakrie Pipe Industri with a total production capacity of 240,000 metric tons per year, far below the Company's production capacity. Meanwhile, in the SSAW category, the Company has a production capacity of 180,000 metric tons per year and controls 35% of the market share. The closest competitor is KHI Pipe Industri (a subsidiary of PT Krakatau Steel Tbk.) With a production capacity of 120,000 metric tons per year.

*Graph 4. HFW Domestic Production Capacity*



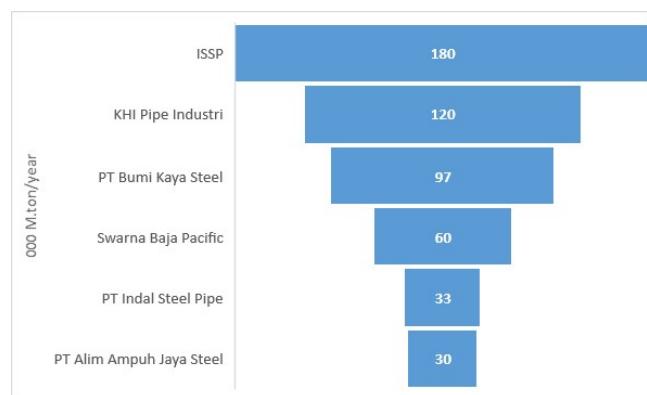
*Source: Company*

*Graph 5. HFW Domestic Market Share*



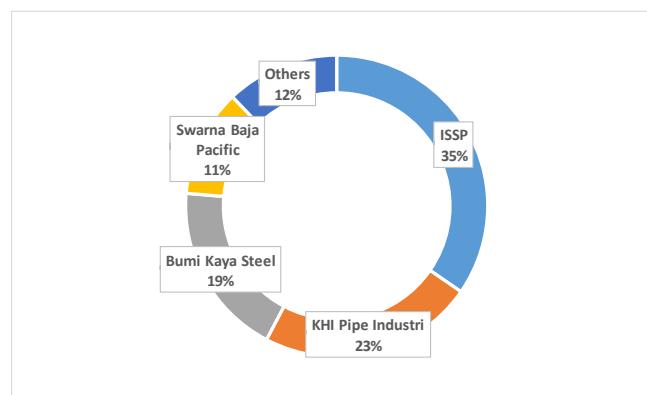
*Source: Company*

*Graph 6. SSAW Domestic Production Capacity*



Source: Company

*Graph 7. SSAW Domestic Market Share*



Source: Company

### I.5.3. Alternative Products

*Concrete poles as an alternative to steel poles.*

One that can be an alternative product for the Company's steel poles products is concrete poles. For the domestic market, we see that there are several concrete poles producers, such as PT. Wijaya Karya Beton Tbk. (WTON.IJ) and PT. Waskita Karya Beton Tbk. (WSBP.IJ). But in our discussions with management, at this time the alternative product has not become a serious threat to the Company.

## I.6. Revenue Streams

*Revenue = Sales Volume x ASP*

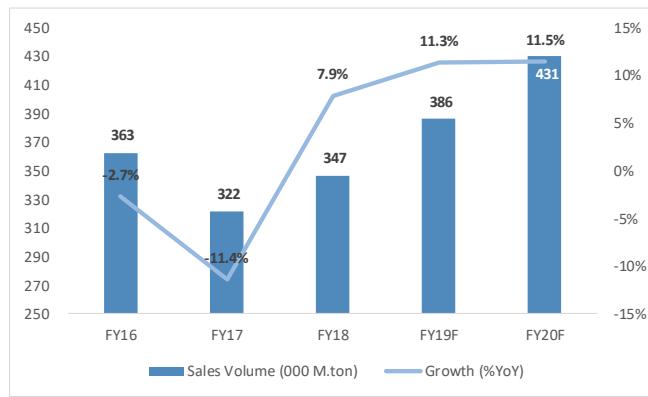
As much as 98% of the Company's Revenue is derived from the sale of various types of steel pipes, while the remaining 2% is obtained from steel pipe related services such as coating and galvanizing. Therefore, in conducting a discussion of Revenue Streams it is very simple, that is, the Revenue derived from the sales volume of steel pipes multiplied by the average price of steel pipes.

### I.6.1. Sales in Volume

*Steel pipe sales in volume up 11% YoY in 2019 & 2020.*

In 2018, the Company succeeded in selling steel pipes of 347 thousand metric tons, an increase of around 8% YoY compared to 2017. As of June 2019, based on data from management, the Company has sold steel pipes of 175 thousand metric tons. We project the Company's steel pipe sales in 2019 to grow by 11% YoY, reaching 386 thousand metric tons. Meanwhile, for 2020 we project steel pipe sales to grow again in the range of 9% YoY to 12% YoY, to the level of 430 thousand metric tons.

*Graph 8. Sales in Volume*

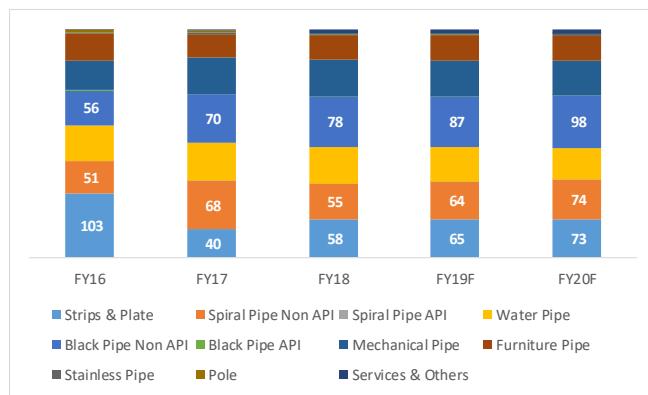


*Source: Company, MCS Research*

*Biggest contributor : Non API Black Pipe*

In terms of the types of steel pipes that make the biggest contribution, we can breakdown into three products; namely Non API Black Pipe (87 thousand metric tons), Strip and Plate (65 thousand metric tons) and Non API Spiral Pipe (64 thousand metric tons).

*Graph 9. Products Breakdown In Volume*



*Source: Company, MCS Research*

### 1.6.2. Average Selling Price

*ASP to increase 27% YoY in 2019 and 2.3% YoY in 2020.*

Average Selling Price (ASP) is one of the determinants of the Company's performance in which an increase (decrease) in ASP can have a positive (negative) effect on Revenue. ASP 2018 reached IDR 12.9 million per metric ton, up 13% YoY from ASP 2017. For ASP 2019, we projected it could increase by 27% YoY to a level of IDR 16.4 million per metric ton, which would certainly increase the Company's margins. For 2020 we project that prices will stabilize at IDR 16.8 million per metric ton (only up by 2.3% YoY); we are conservative enough to project a rise in ASP 2020 given the negative impact of trade war and de-globalization on commodity prices.

*Graph 10. Company's Average Selling Price*

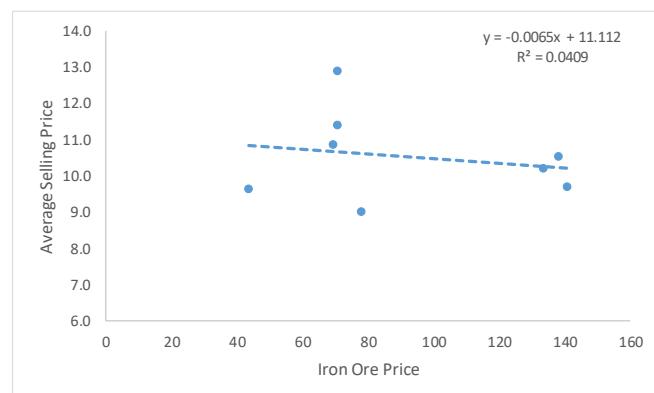


*Source: Company, MCS Research*

*Ability to set benchmark prices.*

We found one interesting thing when analyzing the Company's Average Selling Price, which is the Company's ability to determine ASP for the domestic market without being influenced by international iron ore prices. This can be seen from the statistical analysis where the coefficient of determination is only 0.0409. In our view, this strength is related to the Company's position as a market leader in the domestic market so that it is able to set ASP and make it an industry benchmark.

*Graph 11. Company's ASP vs Iron Ore Prices*



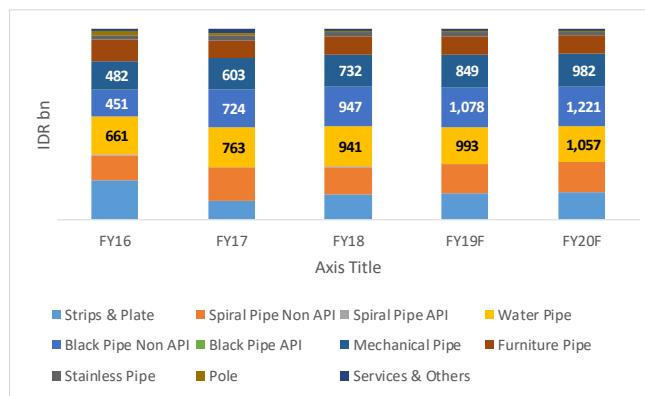
*Source: MCS Research*

### I.6.3. Revenue Streams in IDR

*Non API Black Pipe, Water Pipe and Mechanical Pipe; the biggest contributor for Revenue.*

In this section we do not discuss the Company's Revenue targets, but rather discuss Revenue breakdowns in IDR based on the contribution of each steel pipe product sold. Non API Black Pipes, Water Pipe and Mechanical Pipe in our analysis are still the main contributors to the Company. For example, we project a Revenue from Black Pipe Non API in 2019 to reach IDR 1 trillion and followed by Water Pipe IDR 993 billion and Mechanical Pipe IDR 849 billion. For 2020, revenue from Black API Non API can reach IDR 1.2 trillion, Water Pipe IDR 1 trillion and Mechanical Pipe IDR 982 billion.

*Graph 12. Revenue Breakdown in IDR*



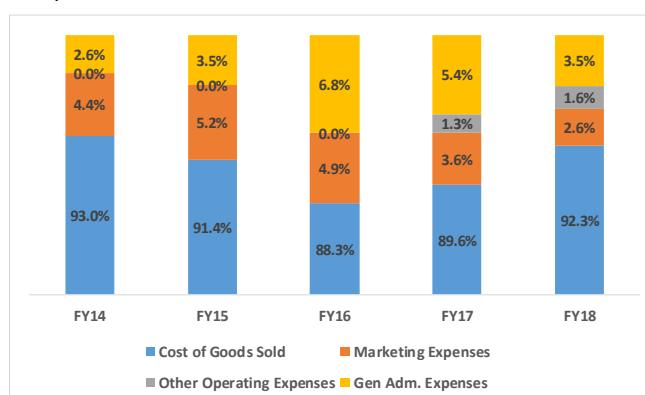
*Source: Company, MCS Research*

### I.7. Cost Structure

*Material cost is significant.*

In terms of cost structure, the biggest cost is the cost of raw materials (COGS), which is 90% of the Company's total Operating Expense.

*Graph 13. Cost Structure*



*Source: Company, Bloomberg*

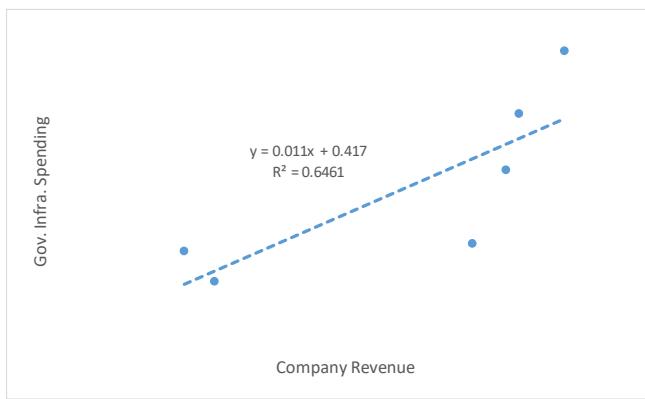
## II. INVESTMENT THESIS

### II.1. Government Infrastructure Spending Still the Main Catalyst

*Government infrastructure spending plays a key role to Company's growth.*

Infrastructure projects, especially those using steel pipes, have become the main driver for the Company's performance growth. We conducted a statistical analysis in which we found a correlation between Government infrastructure spending (as stated in the APBN) with the Company's Revenue with a coefficient of determination of 0.6461, which means that 64% of the Company's Revenue has a correlation with the Government's infrastructure budget. In addition, we also get a regression equation  $y = 0.011x + 0.417$ , which means that any additional Government infrastructure budget (x) of IDR 1 trillion can contribute to an increase in the Company's Revenue (y) of IDR 42.8 billion.

*Graph 14. Correlation Between Gov. Infra Spending and Company's Revenue*

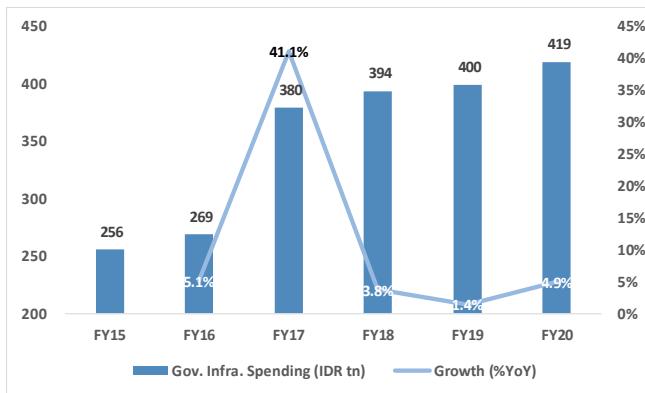


*Source: Ministry of Finance, MCS Research*

*Infra spending to rise 5% YoY at 2020.*

Based on the data we obtained from the Ministry of Finance, infrastructure spending in 2020 is targeted to grow around 5% YoY to IDR 419 trillion from IDR 400 trillion in 2019. Surely this is a positive catalyst for the Company.

*Graph 15. Infrastructure Spending at APBN 2020*



*Source: Ministry of Finance*

## II.2. Better Margins Going Forward

2016 to 2018 were tough years for the Company.

Management initiatives to conduct improve performance.

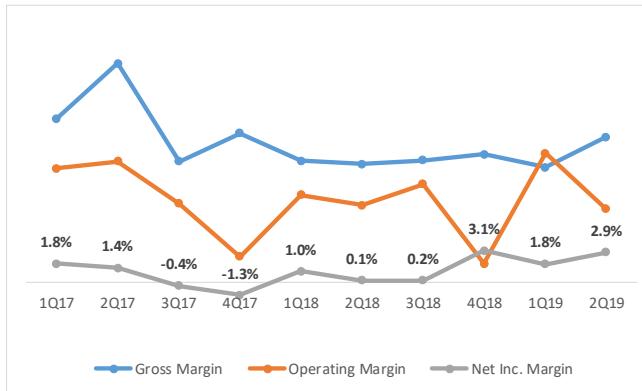
Improvement of margins since 4Q18 going forward.

Talking about the Company's performance in the future is about a turn around strategy. From 2016 to 2018 were quite a tough year for the Company, that its performance declined due to intense competition in the market related to a number of regulations and a flow of imported steel pipes. Gross Margin which in 2015 was at 21.6% fell to 11.9% in 2018 while Operating Margin dropped from 16.3% in 2015 to 6.9% in 2018. Net Income Margin dropped to a level of 1.1% in 2018 from 4.4% in 2018 2015.

In order to restore the Company's performance, management in the last two years has carried out a number of initiatives both internally and related to external parties. Internally, the Company carries out an Operational Excellence (OpEx) strategy, which in essence is to improve internal business processes to be more efficient. Meanwhile, related to external parties, management has strengthened distribution and restructured sales agents. In addition, the Company is also closer to end users by providing education related to the quality and safety of steel pipes in order to ward off imported steel that does not meet national standardization criteria.

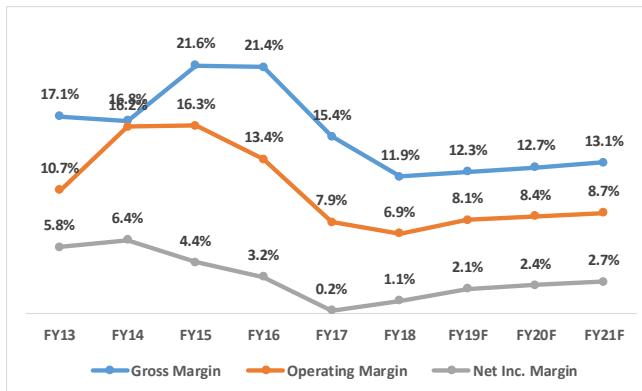
Management's hard work in improving the Company's performance began to show results, which at 3Q18 margins began to improve. In 3Q18 Net Margin remained at the level of 0.1% starting to improve in 4Q18 to 3.1% and in 2Q19 at the level of 2.9%. We project that the full year Net Margin in 2019 will still be very conservative at the 2.1% level and will continue to increase to 2.7% in 2021.

*Graph 16. Quarterly Margins*



Source: Bloomberg

*Graph 17. Yearly Margins*



Source: Bloomberg, MCS Research

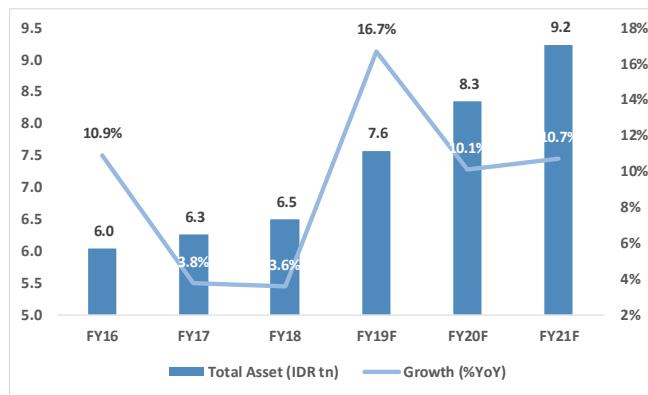
### III. FINANCIAL PROJECTIONS

#### III.1. Balanced Sheet

*Total Asset to grow CAGR 7.4% between 2016-2021.*

We project a Total Asset in 2019 to reach IDR 7.6 trillion or grow 16.7% YoY. Meanwhile, for 2020 we project Total Assets to grow again by around 10% YoY to IDR 8.3 trillion. Between 2016 and 2021 based on our projections Total Assets can grow CAGR 7.4%.

*Graph 18. Total Assets*



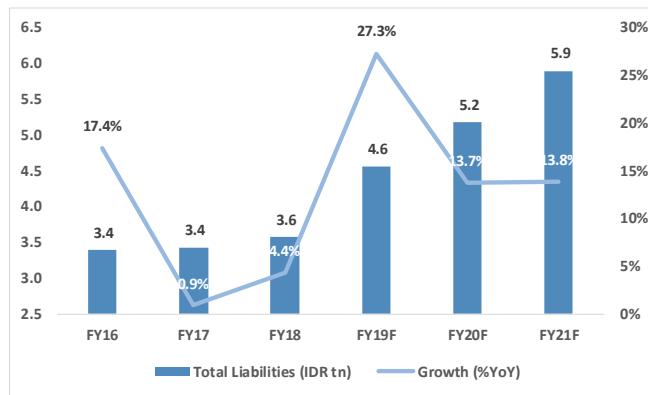
*Source : Company, Bloomberg, MCS Research*

*Total Liabilities to grow CAGR 9.6% between 2016-2021.*

We project a Total Liabilities in 2019 to reach IDR 4.6 trillion or grow 27.3% YoY.

Meanwhile, for 2020 we project Total Liabilities to grow again by around 13.7% YoY to IDR 5.2 trillion. Between 2016 and 2021 based on our projections Total Liabilities can grow CAGR 9.6%.

*Graph 19. Total Liabilities*

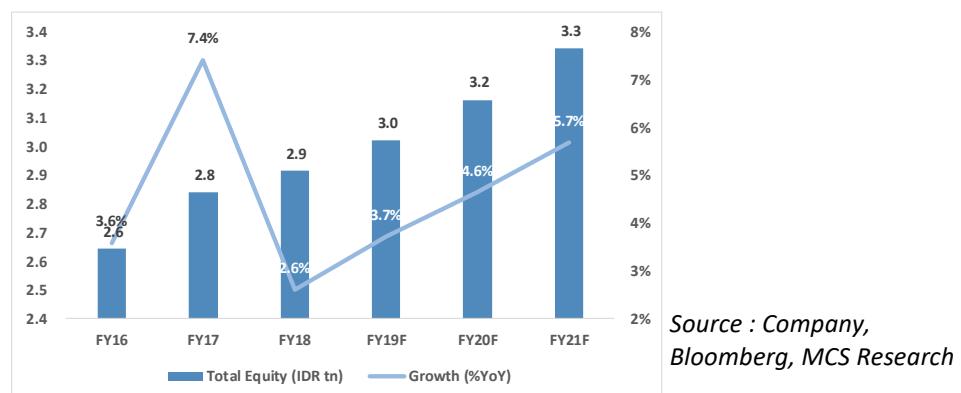


*Source : Company, Bloomberg, MCS Research*

*Total Equity to grow CAGR 4.1% between 2016-2021.*

We project a Total Equity in 2019 to reach IDR 3.0 trillion or grow 3.7% YoY. Meanwhile, for 2020 we project Total Equity to grow again by around 4.6% YoY to IDR 3.2 trillion. Between 2016 and 2021 based on our projections Total Equity can grow CAGR 4.1%.

*Graph 20. Total Equity*

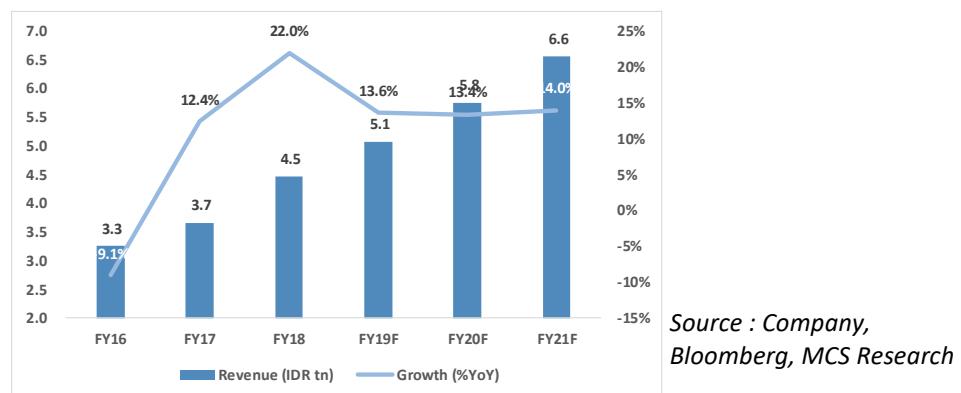


### III.2. Profit & Loss

*Revenue to grow CAGR 12.3% between 2016-2021.*

We project a Total Revenue in 2019 to reach IDR 5.1 trillion or grow 13.6% YoY. Meanwhile, for 2020 we project Total Revenue to grow again by around 13.4% YoY to IDR 5.8 trillion. Between 2016 and 2021 based on our projections Total Revenue can grow CAGR 12.3%.

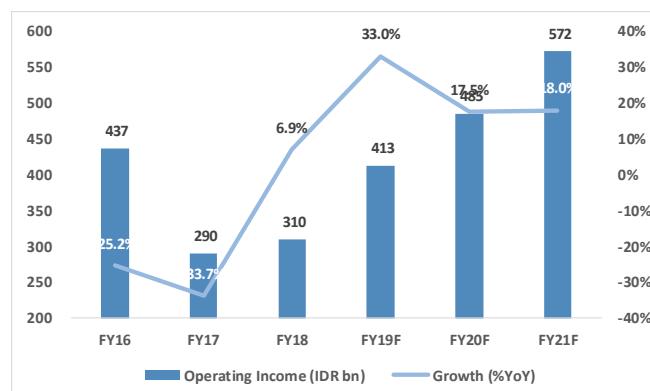
*Graph 21. Total Revenue*



*Operating Income to grow CAGR 4.6% between 2016-2021.*

We project a Operating Income in 2019 to reach IDR 413 billion or grow 33% YoY. Meanwhile, for 2020 we project Operating Income to grow again by around 17.5% YoY to IDR 485 billion. Between 2016 and 2021 based on our projections Operating Income can grow CAGR 4.6%.

*Graph 22. Operating Income*



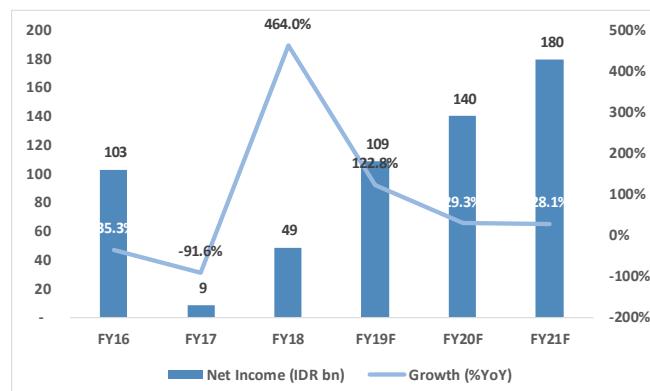
Source : Company,  
 Bloomberg, MCS Research

*Net Income to grow CAGR 9.8%  
 between 2016-2021.*

We project a Net Income in 2019 to reach IDR 109 billion or grow 122.8% YoY.

Meanwhile, for 2020 we project Net Income to grow again by around 29.3% YoY to IDR 140 billion. Between 2016 and 2021 based on our projections Net Income can grow CAGR 9.8%.

*Graph 23. Net Income*



Source : Company,  
 Bloomberg, MCS Research

## IV. VALUATION & RECOMMENDATION

### IV.1. Valuation

*We use Relative Valuation with regional peers as a comparison.*

In valuing ISSP, we use the relative valuation method. As a comparison (peers) we use a number of regional companies in Asia Pacific similar to ISSP. The three relative models we use are Price to Sales (P/S), Price to Book Value (P/BV) and Price to Earnings (P/E). For P/S we get a range between 0.2x to 0.3x, P/BV 0.3x to 0.6x and P/E 8.0x to 10.7x. For Sales Per Share (SPS) we use SPS FY20 of IDR 801, Book Value of Per Share FY20 of IDR 1,161 and Earnings Per Share of FY20 of IDR 19.5.

*12mo target price IDR 370/share.*

From these data we obtained an ISSP valuation in a fairly wide price range between IDR 123 to IDR 669. In this report, we set a fair value or **12mo target price** for ISSP of **IDR 370** per share. In our view, the valuation is very conservative, where the Fair Value only reflects PER'20E of 18.9x and PBV'20E of 0.3x.

*Graph 24. Relative Valuation*



*Source : Bloomberg, MCS Research*

### IV.2. Recommendation

*Recommendation Strong Buy*

By comparing the closing price of the Company on Monday (14/10) at the level of IDR 179, we recommend **Strong Buy** for ISSP shares, where there is still an **upside potential of 106%** if our 12mo target price at IDR 370 is reached.

Following is the classification of recommendations that we issue :

Recommendation	Potential Return
Strong Buy	>40%
Buy	10% to 39%
Neutral	0% to 9%
Reduce	<0%
No Rating	No Coverage

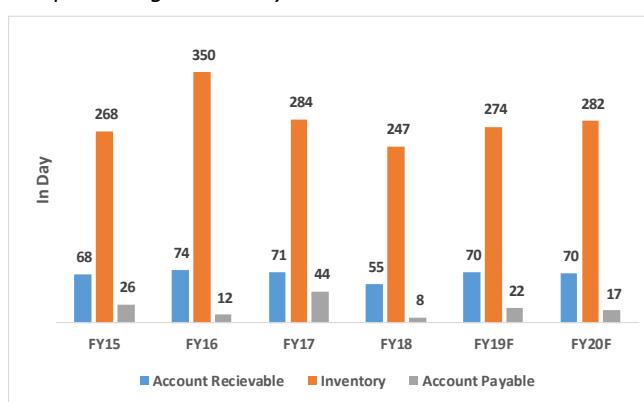
## V. INVESTMENT RISKS

### V.1. An Increasing Inventory Level

#### *Inventory level above 250 days.*

Our main concern for the Company is how the Company manages their working capital, especially related to Inventory. Based on our data, the Company's Inventory level averaged over 250 days (it even touched 350 days in 2016, in other words the Company could only sell their inventory one year later). There has been an improvement in Inventory from 350 days in 2016 to 247 days in 2018, but we need to see whether this trend continues in the coming years.

*Graph 25. High Inventory*

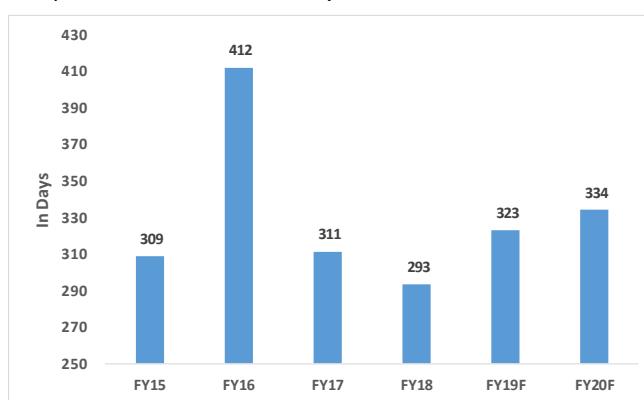


Source : Bloomberg, MCS Research

#### *In need or more working capital.*

We are very concerned about how the Company manages their Inventory because this involves the working capital they must set aside. The greater the working capital needed will certainly make the need for cost of funds even greater. For example, the 2016 cash convention cycle is 412 days, which means that for every Rupiah Sales made by the Company, they only get the cash one year a month and two weeks later. Surely this will tie up the Company's internal cash.

*Graph 26. Cash Convention Cycle*



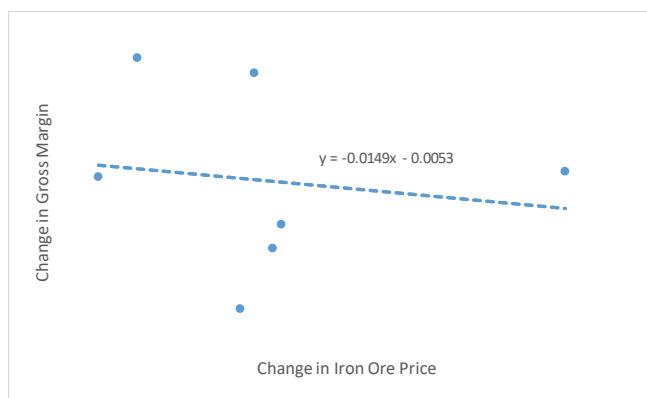
Source : Bloomberg, MCS Research

## V.2. Higher Iron Ore Price

*A 100 bps increase of iron ore price, Company's Gross Margin to decrease 1.5 bps.*

Our second concern for the Company's performance is the increase in iron ore prices in the international market. The movement of iron ore prices can indirectly affect the Company's Gross Margin, where iron ore is the raw material for sheet steel, of which sheet steel is the Company's raw material. Based on our analysis, every increase in the price of iron ore by 100 bps will increase pressing Gross Margin by 1.5 bps.

*Graph 27. Iron Ore Price vs Company's Gross Margin*

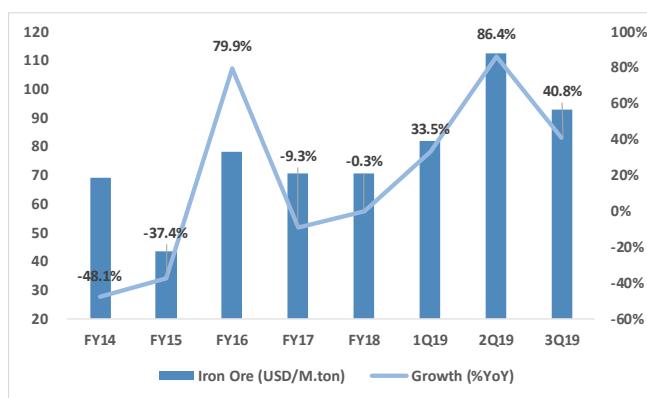


*Source : Bloomberg, MCS Research*

*Iron ore price jumped in 2019 to USD 93/M.ton from USD 70/M.ton in 2018.*

Our concern is reasonable after the price of iron ore on the international market has increased during the first 9 months of 2019. Between 2014 and 2018 international iron ore prices have stabilized at the level of USD 60-70/M.ton (although in 2015 it had dropped to the level of USD 43/M.ton), however, entering 2019 the price of iron ore began to increase. In 1Q19 the price of iron ore was at the level of USD 82/M.ton or up 33.5% YoY and in 2Q19 it rose again to the level of USD 113/M.ton or jumped up to 86.4% YoY. In 3Q19 the price of iron ore declined slightly to the level of USD 93/M.ton due to fears of a trade war between the USA and China continued to heat up.

*Graph 28. International Iron Ore Price*



*Source : Bloomberg, MCS Research*

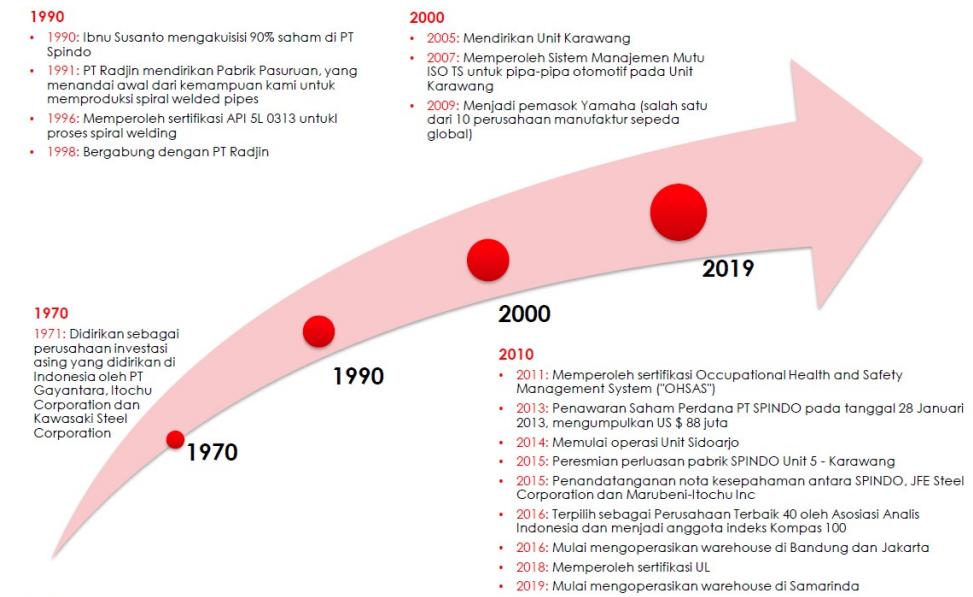
## VI. ABOUT THE COMPANY

### VI.1. Brief History

*Established in 1971, became PMDN in 1990 and go public in 2013.*

The company was founded in 1971 as a foreign company (PMA) by PT. Gayantara, Itochu Corp. and Kawasaki Steel Corp. In 1990 Mr. Susanto (who currently serves as the President Director of the Company) acquired 90% of the Company's shares and turned into PMDN. In 1998 the Company joined PT Radjin (which in 1991 established the Pasuruan Factory - Unit 4). In 2005 the Karawang Plant - Unit 5 was operational and in 2014 the Sidoarjo Plant - Unit 6 was operational. In the previous year 2013, the Company conducted a quantum leap by listing its shares on the Indonesia Stock Exchange. Latest developments in 2016 to 2018, the Company operates warehouses in Bandung, Jakarta and Samarinda.

*Picture 9. Company's Milestone*



*Source : Company*



## VI.2. The Managements

### Board of Commissioners

President Commissioner	:	Wardana Hudianto
Vice President Commissioner	:	Makmur Widjaja
Commissioners	:	Ingewati
Commissioners	:	Endang Fifi Susanto
Independent Commissioner	:	Soesilo Widjaja

### Board of Directors

President Director	:	Ibnu Susanto
Vice President Director	:	Tedja Sukaman Hudianto
Director	:	Tikman Utomo
Director	:	Soediarto Soerjoprahono
Independent Director	:	Hanny Prunomo

## VI.3. Corporate Information

### JAKARTA OFFICE

Gedung Baja Lt. 7  
Jl. Pangeran Jayakarta No. 55  
Jakarta 10730

Phone : +6221 62313502  
Fax : +6221 6240313

Website : [www.spindo.com](http://www.spindo.com)  
Email : [corsec@spindo.co.id](mailto:corsec@spindo.co.id)

**Appendix 1-Balanced Sheet Statement**
*(In IDR bn)*

BALANCED SHEET	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19F	FY20F	FY21F
<b>Total Assets</b>													
+ Cash, Cash Equivalents & STI	17	6	33	14	119	198	25	31	170	232	228	278	337
+ Accounts & Notes Receiv	275	276	704	591	888	792	664	660	716	670	980	1,103	1,249
+ Inventories	674	711	1,140	1,632	1,767	2,375	2,062	2,453	2,415	2,658	3,343	3,879	4,514
+ Other ST Assets	176	76	36	100	229	215	168	0	130	81	106	93	99
<b>Total Current Assets</b>	<b>1,142</b>	<b>1,069</b>	<b>1,913</b>	<b>2,337</b>	<b>3,003</b>	<b>3,580</b>	<b>2,919</b>	<b>3,278</b>	<b>3,432</b>	<b>3,641</b>	<b>4,657</b>	<b>5,354</b>	<b>6,198</b>
+ Property, Plant & Equip, Net	539	499	622	781	1,158	1,561	1,873	1,984	2,200	2,197	2,236	2,300	2,372
+ <i>Property, Plant &amp; Equip</i>	609	571	643	806	1,158	1,591	1,909	2,021	2,249	2,253	2,303	2,378	2,461
- <i>Accumulated Depreciation</i>	70	72	21	24	0	30	35	36	50	56	67	78	89
+ LT Investments & Receivables	0	0	0	0	0	0	5	5	9	9	9	9	9
+ Other LT Assets	145	138	107	164	233	302	651	775	629	647	675	682	658
<b>Total Noncurrent Assets</b>	<b>684</b>	<b>638</b>	<b>729</b>	<b>946</b>	<b>1,390</b>	<b>1,863</b>	<b>2,529</b>	<b>2,764</b>	<b>2,838</b>	<b>2,853</b>	<b>2,921</b>	<b>2,991</b>	<b>3,039</b>
<b>Total Assets</b>	<b>1,826</b>	<b>1,707</b>	<b>2,643</b>	<b>3,283</b>	<b>4,394</b>	<b>5,443</b>	<b>5,448</b>	<b>6,042</b>	<b>6,269</b>	<b>6,494</b>	<b>7,578</b>	<b>8,344</b>	<b>9,238</b>
<b>Liabilities &amp; Shareholders' Equity</b>													
+ Payables & Accruals	292	352	654	199	625	706	259	103	444	97	300	274	245
+ ST Debt	772	743	892	1,740	1,307	1,756	1,935	2,643	1,803	2,440	3,394	4,205	4,998
+ ST Borrowings	767	740	888	1,736	1,300	1,740	1,919	2,622	1,695	2,223	3,178	4,108	4,926
+ ST Finance Leases	5	3	4	4	7	17	16	21	7	9	8	8	8
+ Current Portion of LT Debt	0	0	0	0	0	0	0	0	101	208	208	89	63
+ Other ST Liabilities	74	84	183	156	165	174	134	0	33	43	59	92	133
<b>Total Current Liabilities</b>	<b>1,139</b>	<b>1,178</b>	<b>1,730</b>	<b>2,095</b>	<b>2,097</b>	<b>2,636</b>	<b>2,328</b>	<b>2,827</b>	<b>2,280</b>	<b>2,579</b>	<b>3,752</b>	<b>4,571</b>	<b>5,375</b>
+ LT Debt	301	99	186	132	151	256	292	288	787	633	526	320	230
+ LT Borrowings	295	95	178	126	140	225	275	270	776	620	516	309	219
+ LT Finance Leases	6	4	8	6	11	31	17	18	11	12	10	11	11
+ Other LT Liabilities	61	80	182	287	212	246	274	282	361	367	276	288	288
<b>Total Noncurrent Liabilities</b>	<b>362</b>	<b>179</b>	<b>369</b>	<b>419</b>	<b>363</b>	<b>502</b>	<b>566</b>	<b>570</b>	<b>1,149</b>	<b>999</b>	<b>802</b>	<b>608</b>	<b>519</b>
<b>Total Liabilities</b>	<b>1,501</b>	<b>1,358</b>	<b>2,099</b>	<b>2,514</b>	<b>2,459</b>	<b>3,138</b>	<b>2,894</b>	<b>3,397</b>	<b>3,428</b>	<b>3,579</b>	<b>4,555</b>	<b>5,179</b>	<b>5,894</b>
+ Share Capital & APIC	429	429	429	429	1,228	1,228	1,228	1,228	1,228	1,228	1,228	1,228	1,228
+ Common Stock	0	0	0	0	0	0	0	0	719	719	719	719	719
+ Additional Paid in Capital	0	0	0	0	0	0	0	0	509	509	509	509	509
- Treasury Stock	0	0	0	0	0	0	20	20	20	20	20	20	20
+ Retained Earnings	-236	-211	-101	11	214	415	574	642	640	688	797	937	1,117
+ Other Equity	132,193	132,193	215,833	329	492	662	771	795	993	1,019	1,019	1,019	1,019
<b>Equity Before Minority Interest</b>	<b>325</b>	<b>350</b>	<b>544</b>	<b>769</b>	<b>1,934</b>	<b>2,305</b>	<b>2,553</b>	<b>2,645</b>	<b>2,841</b>	<b>2,915</b>	<b>3,024</b>	<b>3,164</b>	<b>3,344</b>
+ Minority/Non Controlling Interest	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>Total Equity</b>	<b>325</b>	<b>350</b>	<b>544</b>	<b>769</b>	<b>1,934</b>	<b>2,305</b>	<b>2,553</b>	<b>2,645</b>	<b>2,841</b>	<b>2,915</b>	<b>3,024</b>	<b>3,164</b>	<b>3,344</b>
<b>Total Liabilities &amp; Equity</b>	<b>1,826</b>	<b>1,707</b>	<b>2,643</b>	<b>3,283</b>	<b>4,394</b>	<b>5,443</b>	<b>5,448</b>	<b>6,042</b>	<b>6,269</b>	<b>6,494</b>	<b>7,578</b>	<b>8,344</b>	<b>9,238</b>
<b>Book Value per Share (BVPS)</b>	<b>254</b>	<b>238</b>	<b>368</b>	<b>457</b>	<b>611</b>	<b>757</b>	<b>758</b>	<b>841</b>	<b>872</b>	<b>904</b>	<b>1,055</b>	<b>1,161</b>	<b>1,286</b>

*Source : Bloomberg, MCS Research*

## Appendix 2-Profit & Loss Statement

(In IDR bn)

INCOME STATEMENT	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19F	FY20F	FY21F
<b>Revenue</b>	<b>1,785</b>	<b>1,711</b>	<b>2,577</b>	<b>3,093</b>	<b>3,534</b>	<b>3,368</b>	<b>3,584</b>	<b>3,259</b>	<b>3,663</b>	<b>4,468</b>	<b>5,077</b>	<b>5,757</b>	<b>6,563</b>
- Cost of Revenue	1,975	1,473	2,181	2,692	2,929	2,804	2,811	2,561	3,100	3,936	4,452	5,026	5,703
<b>Gross Profit</b>	<b>-190</b>	<b>238</b>	<b>396</b>	<b>401</b>	<b>605</b>	<b>564</b>	<b>773</b>	<b>699</b>	<b>563</b>	<b>532</b>	<b>624</b>	<b>731</b>	<b>860</b>
+ Other Operating Income	0	0	0	0	0	192	78	77	87	106	102	115	131
- Operating Expenses	128	120	158	132	226	211	266	339	360	328	314	362	419
<b>Operating Income (Loss)</b>	<b>-318</b>	<b>118</b>	<b>238</b>	<b>269</b>	<b>379</b>	<b>546</b>	<b>585</b>	<b>437</b>	<b>290</b>	<b>310</b>	<b>413</b>	<b>485</b>	<b>572</b>
- Non-Operating (Income) Loss	155	126	143	183	183	138	151	208	270	251	275	306	342
+ Interest Expense, Net	171	130	124	147	129	138	151	222	268	249	275	306	342
+ Interest Expense	171	130	124	147	132	138	151	222	268	256	282	314	352
- Interest Income	0	0	0	0	4	0	0	0	0	7	7	8	10
+ Foreign Exch (Gain) Loss	-16	-4	19	36	56	0	0	-14	0	0	0	0	0
+ (Income) Loss from Affiliates	0	0	0	0	-1	0	0	0	0	0	0	0	0
+ Other Non-Op (Income) Loss	0	0	0	0	0	0	0	0	2	2	0	0	0
<b>Pretax Income (Loss), GAAP</b>	<b>-410</b>	<b>33</b>	<b>146</b>	<b>149</b>	<b>251</b>	<b>262</b>	<b>195</b>	<b>139</b>	<b>20</b>	<b>60</b>	<b>138</b>	<b>179</b>	<b>230</b>
- Income Tax Expense (Benefit)	-102	8	35	38	48	47	36	36	12	11	29	38	50
<b>Income (Loss) Incl. MI</b>	<b>-308</b>	<b>24</b>	<b>111</b>	<b>111</b>	<b>204</b>	<b>215</b>	<b>159</b>	<b>103</b>	<b>9</b>	<b>49</b>	<b>109</b>	<b>140</b>	<b>180</b>
- Minority Interest	0	0	-0	-0	-0	-0	-0	0	-0	0	0	0	0
<b>Net Income Avail to Common, GAAP</b>	<b>-308</b>	<b>24</b>	<b>111</b>	<b>111</b>	<b>204</b>	<b>215</b>	<b>159</b>	<b>103</b>	<b>9</b>	<b>49</b>	<b>109</b>	<b>140</b>	<b>180</b>
<b>Earnings per Share (EPS)</b>	<b>-43</b>	<b>3</b>	<b>15</b>	<b>15</b>	<b>28</b>	<b>30</b>	<b>22</b>	<b>14</b>	<b>1</b>	<b>7</b>	<b>15</b>	<b>20</b>	<b>25</b>

Source : Bloomberg, MCS Research

## Appendix 3-Financial Ratio

RATIO	FY09	FY10	FY11	FY12	FY13	FY14	FY15	FY16	FY17	FY18	FY19F	FY20F	FY21F
<b>LIQUIDITY &amp; TURNOVER</b>													
Current ratio (X)	1.0	0.9	1.1	1.1	1.4	1.4	1.3	1.2	1.5	1.4	1.2	1.2	1.2
Account Receivable (Day)	56.2	58.8	99.7	69.7	91.7	85.8	67.7	73.9	71.3	54.7	70.5	69.9	69.4
Inventory (Day)	124.5	176.2	190.8	221.2	220.2	309.2	267.8	349.7	284.3	246.5	274.1	281.7	288.9
Account Payable (Day)	59.7	75.0	92.6	23.4	64.5	76.5	26.4	11.5	44.2	7.9	21.6	17.4	13.6
Cash Convention Cycle (Day)	121.0	160.0	197.8	267.6	247.4	318.5	309.0	412.1	311.4	293.3	323.0	334.2	344.7
<b>GROWTH</b>													
Revenue growth (%)	-4.1%	50.6%	20.0%	14.3%	-4.7%	6.4%	-9.1%	12.4%	22.0%	13.6%	13.4%	14.0%	
Operating income growth (%)	-137.3%	101.0%	13.1%	40.9%	44.0%	7.2%	-25.2%	-33.7%	6.9%	33.0%	17.5%	18.0%	
Profit before income tax growth (%)	-108.0%	347.5%	2.2%	68.5%	4.3%	-25.6%	-28.6%	-85.3%	191.9%	130.6%	29.9%	28.5%	
Net income growth (%)	-107.9%	354.5%	0.4%	83.1%	5.6%	-26.0%	-35.3%	-91.6%	464.0%	122.8%	29.3%	28.1%	
<b>PROFITABILITY</b>													
Gross profit margin (%)	-10.6%	13.9%	15.4%	13.0%	17.1%	16.8%	21.6%	21.4%	15.4%	11.9%	12.3%	12.7%	13.1%
Operating income margin (%)	-17.8%	6.9%	9.2%	8.7%	10.7%	16.2%	16.3%	13.4%	7.9%	6.9%	8.1%	8.4%	8.7%
Net income margin (%)	-17.3%	1.4%	4.3%	3.6%	5.8%	6.4%	4.4%	3.2%	0.2%	1.1%	2.1%	2.4%	2.7%
Return on equity (%)	-94.7%	7.0%	20.4%	14.5%	10.5%	9.3%	6.2%	3.9%	0.3%	1.7%	3.6%	4.4%	5.4%
Return on assets (%)	-16.9%	1.4%	4.2%	3.4%	4.6%	3.9%	2.9%	1.7%	0.1%	0.8%	1.4%	1.7%	1.9%
<b>LEVERAGE</b>													
Debt-to-equity (X)	3.3	2.4	2.0	2.4	0.8	0.9	0.9	1.1	0.9	1.1	1.3	1.4	1.6
Debt-to-asset (X)	0.6	0.5	0.4	0.6	0.3	0.4	0.4	0.5	0.4	0.5	0.5	0.5	0.6
<b>VALUATION</b>													
Price to earnings ratio (X)	(8.6)	109.2	24.0	23.9	13.1	12.4	16.7	25.8	307.8	54.6	24.5	18.9	14.8
Price to book ratio (X)	1.5	1.6	1.0	0.8	0.6	0.5	0.5	0.4	0.4	0.4	0.4	0.3	0.3

Source : MCS Research

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