

## Equity Strategy Testing resiliency

Sep 1, 2022

### Navigating through difficult options on subsidized fuel prices

Due to the dwindling quota of subsidized fuel (i.e. Peralite and Biosolar), gov't still mulls over the decision to increase subsidized fuel prices in the past 2 months, having previously kept them at the same price since Jan2019 to anchor inflation expectations. Both Ministry of Finance (MoF) and Bank Indonesia (BI) have taken necessary measures to maintain people purchasing power to support domestic economic growth and curb the impact of potentially surging inflation.

## Neutral

**Index Target: 7,300 (end FY22)**

JCI Index (Aug 31):7,179

### A glance at a similar situation ~8 years ago

When gov't increased both Premium (RON 88) and Solar (CN48) by 30.7% and 36.4%, respectively in Nov2014, inflation surged to as high as 8.3% (from 4.8% before fuel price hike) before settling around 6-7% range, while GDP growth dipped below 5% for the next three quarters (vs. 5.1% in 4Q14). However, on the equity side, JCI index fell just 0.5% within a month before bouncing back strongly with heavyweights from trade, financials, and consumer sectors leading the way.

### Transport & cement sectors are potentially being hit the hardest

Our sensitivity analysis showed that transportation, cement & consumer non-cyclical are susceptible to severe earnings impact if fuel price increases are not passed on to customers. Meanwhile, infrastructure, telco, and real estate sectors are the most impacted by interest rate hikes due to their leverage and floating debt structure.

### Stick with counters generating all-time high earnings

We expect a 16.7% EPS growth in 2022 for our coverage universe, primarily driven by banks' earnings recovery continuation and sustained-high selected commodities-related. We expect JCI to trade at its +1 std dev of its FY22F PE, translating to an index target of 7,300 at the end of 2022. Amid global uncertainties and potential inflation pressure, we prefer exposure to: 1) reasonably-valued big SOE banks (BBNI, BMRI), 2) beneficiaries of sustained high coal prices (ITMG, ADRO, UNTR) and & crude oil prices (PGAS) and 3) steady earnings generators in the current volatile environment (TLKM, TOWR).

### JCI Index performance



Source: Bloomberg

### Key picks

Stock	Market cap IDR tn	Current price IDR / share	EPS growth (%)		Price to earnings (x)		ROE (%)
			FY22F	FY23F	FY22F	FY23F	FY22F
ADRO	88.6	2,770	62.7	(30.3)	5.2	7.5	28.6
BBNI	142.7	7,650	47.2	24.9	9.9	7.9	11.8
BMRI	351.2	7,525	5.0	14.4	10.9	9.5	16.5
ITMG	36.2	32,000	122.6	(30.3)	2.9	4.2	60.0
PGAS	37.1	1,530	NM	3.6	8.8	8.5	9.8
TLKM	398.2	4,020	4.3	5.1	15.4	14.7	20.0
TOWR	57.6	1,130	5.0	17.2	19.6	16.7	24.2
UNTR	100.0	26,800	86.0	(40.7)	6.6	11.1	23.5

Source: Bloomberg, KISI

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Amid soaring crude price (i.e. ICP was +45.5% YTD at the end of Jul2022), **Ministry of Finance (MoF) revised FY22 state budget assumptions** onto Presidential decree (Perpres) no. 98/2022 issued on 27Jun2022 **to accommodate higher Indonesian Crude Price (ICP) assumption of USD100/bl** (vs. previous assumption of USD63/bl).

**Table 1. Budget changes for energy subsidies**

Item	unit	APBN 2022	Perpres no. 98/2022	Addressed subsidy gap	1H22 achievement	1H22 as % of budget
<i>Indonesia Crude Price (ICP) assumption</i>	<i>USD/bl</i>	63.0	100.0		99.7	
<b>Energy subsidy</b>	<b>IDR tn</b>	<b>134.0</b>	<b>208.9</b>	<b>74.9</b>	<b>75.6</b>	<b>36%</b>
Fuel & LPG	<i>IDR tn</i>	77.5	149.4	71.9	54.3	36%
Electricity	<i>IDR tn</i>	56.5	59.6	3.1	21.3	36%
<b>Compensation</b>	<b>IDR tn</b>	<b>18.5</b>	<b>293.5</b>	<b>275.0</b>	<b>104.8</b>	<b>36%</b>
<b>Total energy subsidy &amp; compensation</b>	<b>IDR tn</b>	<b>152.5</b>	<b>502.4</b>	<b>349.9</b>	<b>75.6</b>	<b>15%</b>

Source: Ministry of Finance (MoF), KISI

**Insufficient quota for subsidized fuel this year**

According to Pertamina data, 7M22 Pertalite (RON 90) and Biosolar (CN 48) consumption has reached 16.8mn kL (73% of 23mn kL FY22 quota) and 10.4mn kL (68% of 15.1mn kL FY22 quota). At the current rate, the quota would be used up by Oct2022. **With additional quota volume, MoF calculated that gov't needs to budget for additional IDR195.6tn compensation** (~90% extra from the current energy subsidy budget) if both Pertalite (RON 90) and Biosolar (CN 48) prices are not adjusted up.

**Gov't mulls over a decision to increase subsidized fuel price**

Therefore, **gov't have mulled over the decision to increase subsidized fuel prices in the past 2 months**, having previously kept them at the same price since Jan2019 to anchor inflation expectations. This is a way to ease pressure on state budget, **despite great accomplishments in 1H22 with IDR73.6tn surplus (~0.4% of GDP)**. The outstanding 1H22 domestic revenue achievements were mostly supported by non-oil & gas taxes (+71% YoY, 39% of total revenue) and VAT (+38% YoY, 23% of total revenue).

**Table 2. Surplus achieved in 1H22**

Item	unit	APBN 2022	Perpres no. 98/2022	1H22 achievement	1H22 vs. 1H21	1H22 as % of budget
<b>Revenue</b>	<b>IDR tn</b>	<b>1,846.1</b>	<b>2,266.2</b>	<b>1,317.2</b>	<b>49%</b>	<b>58%</b>
Tax & Duties	<i>IDR tn</i>	1,510.0	1,784.0	1,035.9	52%	58%
Non O&G income tax	<i>IDR tn</i>	633.6	749.0	519.6	71%	69%
O&G income tax	<i>IDR tn</i>	47.3	64.7	43.0	93%	66%
VAT	<i>IDR tn</i>	554.4	639.0	300.9	38%	47%
Excise	<i>IDR tn</i>	203.9	220.0	121.5	33%	55%
Other taxes & duties	<i>IDR tn</i>	29.7	32.3	4.8	-67%	15%
Import duties	<i>IDR tn</i>	35.2	36.7	23.1	31%	63%
Export taxes	<i>IDR tn</i>	5.9	42.3	23.0	74%	54%
Non-tax	<i>IDR tn</i>	335.6	481.6	281.0	36%	58%
<b>Expenditures</b>	<b>IDR tn</b>	<b>2,714.2</b>	<b>3,106.4</b>	<b>1,243.6</b>	<b>6%</b>	<b>40%</b>
<b>Surplus (deficit)</b>	<b>IDR tn</b>	<b>(868.1)</b>	<b>(840.2)</b>	<b>73.6</b>		
<b>Surplus (deficit) as % of GDP</b>	<b>%</b>	<b>-4.9</b>	<b>-4.5</b>	<b>0.4</b>		

Source: Ministry of Finance (MoF), KISI

**Securing budget for assistance to maintain purchasing power**

Gov't has yet to announce a substantial subsidized fuel price hike but based on the current dwindling quota, the following price hike can be expected in the near term: 1) Peralite (RON 90) to IDR9,500/l (+24.2%), and 2) Biosolar (CN48) to IDR7,200/l (+39.8%). Those fuels made up ~80% of Pertamina's product sales nationwide. **To maintain people purchasing power affected by global price spike, MoF announced an additional IDR24.17tn budget allocation** through 1) direct cash assistance (BLT) for 20.65mn families (IDR600k each), 2) wage subsidy assistance (BSU) for 16mn workers (IDR600k each) and 3) transportation subsidy.

**Table 3. Annual fuel consumption by type**

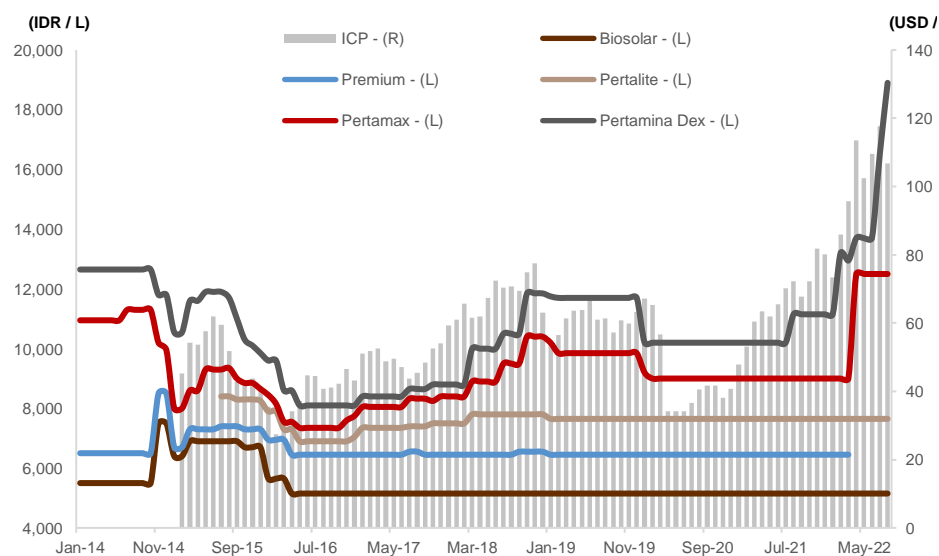
Pertamina fuel type	unit	2021 consumption	% of total	2022 quota	2022 est. consumption	% of total
Premium (RON 88)	mn kL	3.5	7.0%		2.0	3.6%
Peralite (RON 90)	mn kL	23.3	47.2%	23.0	28.8	51.9%
Pertamax (RON 92)	mn kL	5.7	11.6%		6.0	10.8%
Pertamax Turbo (RON 98)	mn kL	0.4	0.8%		0.4	0.7%
Biosolar (CN48)	mn kL	15.5	31.4%	15.1	17.3	31.2%
Dexlite (CN51)	mn kL	0.7	1.4%		0.7	1.2%
Pertamina Dex (CN53)	mn kL	0.3	0.7%		0.3	0.5%
<b>Total</b>	<b>mn kL</b>	<b>49.4</b>	<b>100%</b>	<b>38.1</b>	<b>55.5</b>	<b>100%</b>

Source: Ministry of Energy & Mineral Resources (MoEMR), KISI

**Potential impact from fuel hike based on last experience in Nov2014**

**To analyze the impact of fuel hike on this magnitude, we have to go back ~8 years to 18Nov2014**, when gov't increased 1) Premium (RON 88) to IDR8,500/l (+30.7% from IDR6,500/l) and 2) Solar (CN48) to IDR7,500/l (+36.4% from IDR5,500/l). Subsequently, starting Jan2015, gov't implemented a more dynamic monthly pricing for these two types of subsidized fuel depending on ICP until Jan2019.

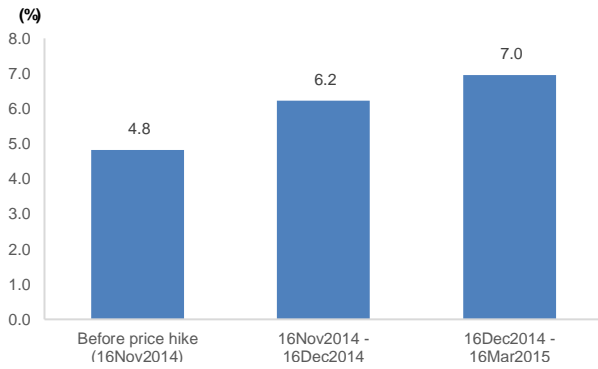
**Fig 1. Fuel prices vs. ICP**



Source: Various sources, Bloomberg, KISI

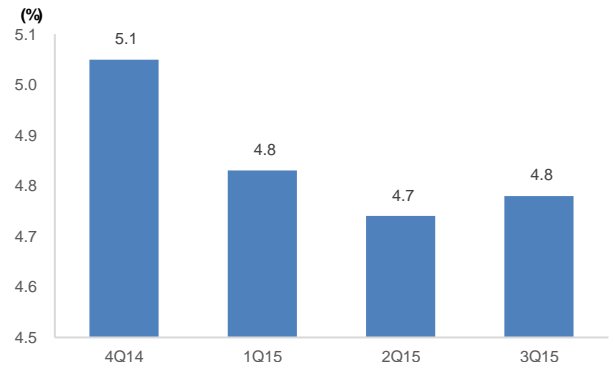
**Inflation surged by 1.4ppts to 6.2%** in the following month after the significant fuel price hike **and continued on the uptrend to 8.3%** before settling around 6-7% for most of 2015. In addition, this **slowed GDP growth** by ~0.3-0.4% (from 5.1% in 4Q14) **for the next two quarters**

**Fig 2. ID CPI (after a significant fuel price hike)**



Source: Bloomberg, KISI

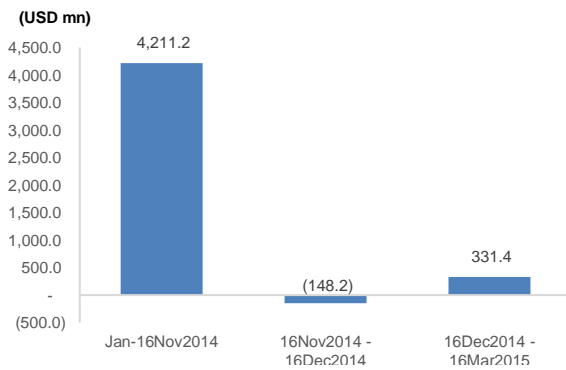
**Fig 3. ID GDP growth (after a significant fuel price hike)**



Source: Bloomberg, KISI

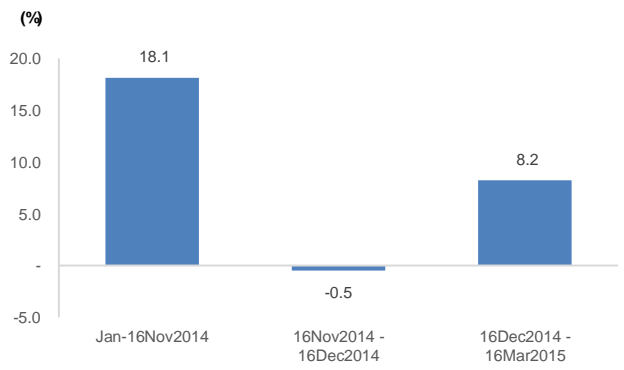
**On the equity side**, 1 month after the significant fuel hike **JCI Index** experienced an outflow of USD445mn, which resulted in a **0.5% correction**. It was just a temporary reaction as **inflows resumed (USD331.4mn)** and **JCI rebounded strongly by 8.2% in the following 3 months**, with heavyweights from trade, financials, and consumer sectors leading the way.

**Fig 4. ID equity flows (after a significant fuel price hike)**



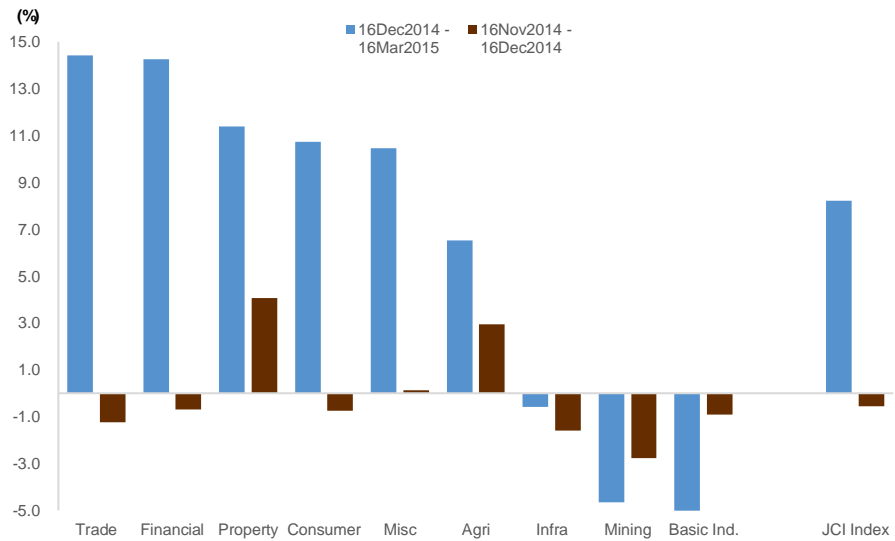
Source: Bloomberg, KISI

**Fig 5. JCI Index perf (after a significant fuel price hike)**



Source: Bloomberg, KISI

**Fig 6. Heavyweights led the index rebound temporary drop due to fuel price hike**



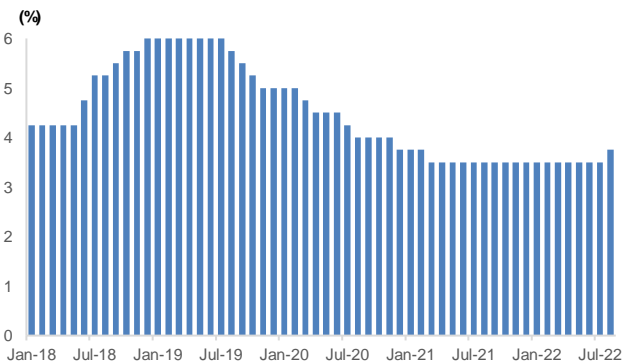
Source: Bloomberg, KISI

At the current juncture, Indonesia’s headline inflation in Jul2022 (at 4.94%) which was much higher than most economists’ expectations, prompted Bank Indonesia (BI) to expect FY22 inflation to be 4.5-4.6% (higher than its official target of 3% ± 1%) before the potential impact of subsidized fuel price hikes.

**All hands on deck to counter surging inflation**

BI has done remarkably well to **stabilize IDR exchange rate given its ample forex reserves** (latest position at USD132bn as of end Jul2022 vs. USD144.9bn at the end of Dec2021). In addition, as a preemptive measure to anticipate higher fuel prices and maintain real yield attractiveness, BI **has started to hike its 7D-RRR (1<sup>st</sup> time since 2018)** by 25bps in Aug2022 (out of 100bps rate hike expected in FY22).

**Fig 7. First 7D-RRR increase since 2018**



Source: Bloomberg, KISI

**Fig 8. Real yield spread between ID & US 10-yr treasury**

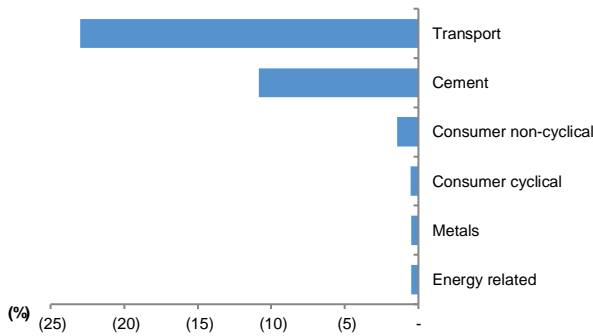


Source: Bloomberg, KISI

**Transport, cement, and consumer non-cyclical sectors will be severely impacted by fuel price hike**

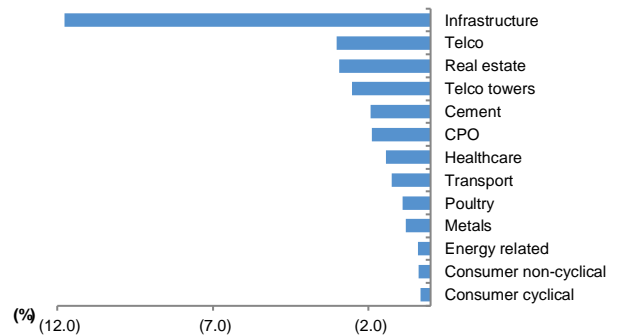
We did a sensitivity analysis to assess the potential earnings' impact on sectors vulnerable to significant fuel price hikes and increasing interest rates. **Transportation, cement, and consumer non-cyclical are severely impacted given the much-increased inputs costs** (if not passed on) from fuel price hikes. Meanwhile, **infrastructure, telco, and real estate sectors are the most impacted by interest rate hikes** due to their leverage and floating debt structure.

**Fig 9. Earnings impact from subsidized fuel price hikes**



Source: KISI

**Fig 10. Earnings impact from 50 bps rate increase**

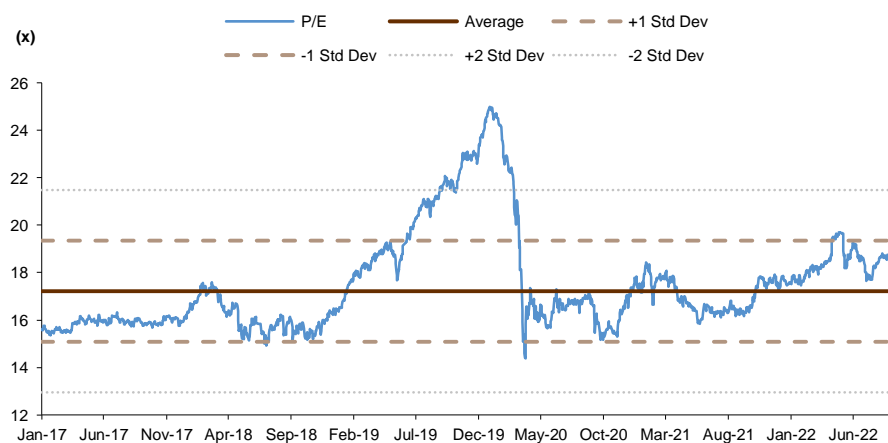


Source: KISI

**Neutral with an index target of 7,300 at the end of 2022**

For our coverage universe, we expect a **16.7% EPS growth in 2022, primarily driven by sustained high coal and crude oil price and conventional banks' continuing earnings recovery**. We expect JCI to trade at its +1 std dev of its FY22F PE, translating to an index target of 7,300 at the end of 2022.

**Fig 11. JCI Index – PE Band**



Source: Bloomberg, KISI

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