December 2018

Monthly Commentary

Indonesia update

- Indonesian stocks rebounded in November on robust domestic demand
- Central bank raised interest rates for the sixth time since May
- Rupiah resilient against US dollar, while most other Asian currencies weaken

Market overview

Indonesian equities rebounded in November as oil prices fell. Consumer and banking stocks rallied on news of the government's planned stimulus package, which would lower income tax and offer tax breaks for commodities exporters who keep their revenues within the domestic banking system. Local markets also reacted to the US Federal Reserve's switch to a dovish stance, which pushed US Treasury yields lower. The rupiah strengthened by 6.3% against the US dollar, which further lifted sentiment.

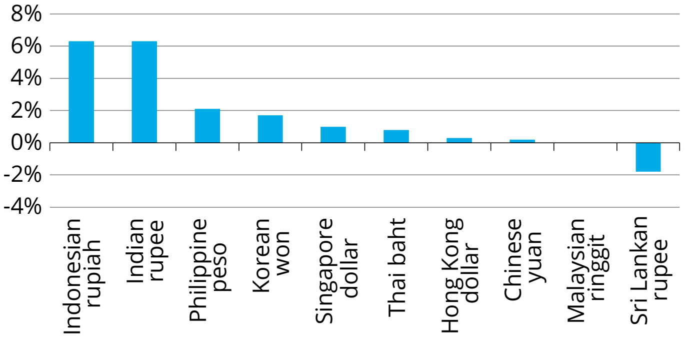
Third-quarter GDP growth was reported at 5.17% year-on-year, helped by robust domestic demand, notably fixed investments and government expenditure.

Foreign reserves rose in October for the first time in nine months, to stand at US$115.2 billion. The increase was mainly influenced by favourable oil-and-gas foreign exchange revenues and a reduction in external debt. This strengthened the rupiah against the US dollar, which bucked the downtrend of other Asian currencies, and supported the appetite for domestic spending.

The sell-off in global oil prices amid concerns of a supply glut contributed to an increase in oil-and-gas imports in October. This, along with much lower export growth, contributed to the trade deficit of US$1.82 billion.

Rupiah rebounds, outperforms peers

Spot returns vs USD



Source: Bloomberg, 30 November 2018

As expected, Bank Indonesia (BI) raised interest rates by 25 basis points, bringing the total increase to 175bps so far this year. The move was seen as BI erring on the side of caution in order to manage the current account deficit.

Robust consumer demand boosts third-quarter earnings

In the retail sector, **Ace Hardware** and **Delfi** exceeded earnings expectations. Ace Hardware enjoyed better operating leverage, driven by robust same-store sales and new store roll-outs. Chocolate producer Delfi benefited from a better sales mix from premium brands and ongoing cost controls that partially offset weak regional currencies. Retail group **Ramayana**'s top-line was driven by department stores and a turnaround in the supermarket business, with continued improvement from upgraded IT and discounting systems. **Surya Citra Media** saw profits grow by 35% year-on-year thanks to the Asian Games, despite higher programming and operating costs.

Conglomorate **Astra International**'s robust third-quarter results was attributed to its star performer **United Tractors**, stabilising financial services and a marginal improvement in its auto business.

Telkom Indonesia delivered better-than-expected results for the quarter, as price hikes were implemented and its fixed broadband business cushioned lower mobile contributions. The average revenue per user recovered from the prior quarter but was still weaker on a year-on-year basis.

Banking on loan growth

Both **Bank Permata** and **Bank OCBC** reported strong nine-month results and an increase in net profits, attributed to good loan growth and lower provisioning. We continued to see an improvement in asset quality but we reiterate a "hold" recommendation for Bank Pertama due to its sizeable non-performing loans that requires restructuring.

Aberdeen Standard Investments

Semen Indonesia cements its dominant position

Semen Indonesia, the country's largest cement manufacturer, made an offer to acquire a 80.6% stake in Holcim Indonesia. The US$917 million deal would strengthen the company's leadership position in the domestic market. The cement market is expected to look attractive post consolidation and might trigger further consolidation among the smaller cement players. This bodes well for existing players, namely **Indocement**. Separately, Indocement's third-quarter earnings rose on the back of price and volume increases, and the absence of plant overhauls.

Muted gains in industrial and material stocks

AKR posted soft petroleum volumes, following the government's chaotic implementation of the mandatory use of the 20% blended biodiesel B20. AKR was prudent and refrained from selling the diesel to avoid the huge penalty fee imposed by the government. The market seemed to have priced in AKR's weak performance, as the share price was little changed after the results. Instead, the share price rallied following weaker global oil prices.

Delay in excise tax hike positive for tobacco sales

The finance ministry decided against increasing cigarette excise tax duties in 2019, in order to boost consumer confidence and protect the welfare of tobacco farmers. However, we are still concerned that there might be an excise tax hike after the 2019 presidential election, or a directive to cigarette makers to pay two months of excise taxes in advance, as was the case in 2015. This could hurt sales. Nonetheless, **HM Sampoerna**'s saw good revenue growth (10.4% year-on-year), supported by volume growth and higher selling prices.

What we've been busy with

In portfolio activity, we exited our position in Kalbe, given increasing pains in its pharmaceutical division as the government focuses on cheaper generics in the rollout of its national healthcare agenda.

Note: Any changes refer to those of our model portfolio, which is the basis for actual portfolios we manage that have similar investment objectives. However, there might be minor variations, so the comments may not apply to all portfolios.

Outlook

We have started to see some positive signs since the end of October. The rupiah strengthened sharply in November, around 4%, well ahead of other regional currencies. This bodes well for our consumer holdings, where a significant amount of their input costs are priced in US dollars. A number of factors have contributed to the currency move; a drop in the dollar index on the back of easing tensions between China and the US; steady inflows into government bonds, helped by the highest real rate differentials with US treasuries in the region; and modest inflows into equities following the recent third-quarter results, which were fairly in line with market expectations. Domestically, we are starting to see an acceleration of sales in a few consumer names, and a lower oil price environment would further curb inflation, and consequently, margin pressures in the coming quarters.

We hold the companies highlighted.

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