

Arwana Citramulia (ARNA IJ) (Buy) - Conference takeaways: Silver lining for the local ceramic industry

15 Nov
2024

Plantation

Conference takeaways: Silver lining for the local ceramic industry

We hosted Arwana Citramulia (ARNA) during our Verdhana Conference to better understand the company's strategy. Overall, ARNA demonstrated resilience and adaptability by shifting to high-value rectified ceramics, capturing market share through product differentiation and benefiting from local regulations that favor domestic manufacturers.

Local ceramic companies are protected as several regulations now in place

As of Oct-24, the government introduced several regulations that will benefit the local ceramic industry, including the new anti-dumping and SNI import regulations (Ministry of Industry Regulation No. 36 of 2024) which mandate the ceramic product to be locally certified (see [report](#)). According to the company, other than anti-dumping, the SNI regulation itself acts as a core regulation which effectively complicates foreign competition and provides an advantage to the local ceramic industry. On the cost side, management is confident that [regulated gas prices](#) will continue in the future. Furthermore, we believe Indonesia's 3mn housing program is expected to drive further demand and improve overall industry utilization while also increasing investment appetite for the industry.

Prudent strategies and innovation drive performance

Before the anti-dumping measures were introduced, management has shown operational improvements in utilization since December 2023 as it implemented several strategies: 1) a strategic shift toward high-value rectified ceramics from the red body Digi Uno 40x40 to premium 50x50 rectified tiles, which can capture additional demand despite being priced higher, 2) introduction of the 'ARNA Nusantara' product in Dec-23 with mostly plain color to compete with Chinese products and thereby improving the sell-in ratio, 3) the company became more agile to invest in new R&D and machinery improving costs. The company is still focusing on white body expansion while also turning their other factory to produce rectified products – which we believe will improve the overall margins. Furthermore, new sub-distributors have been added, totaling 49 in ARNA's distribution network for 2024 (vs 41 distributors in 2021).

Vote of confidence for management; maintain Buy on ARNA with TP of IDR940

We maintain our Buy rating with a TP of IDR940 with a WACC of 12%, a risk-free rate of 6.9% and a terminal growth rate of 1%. Our TP implies 13.8x/11.9x FY25F/FY26F P/E, at +1SD 5Y average P/E of 14x, which is favourable relative to the industry average of 25x FY25F P/E. The stock is trading at 11x FY25F P/E. ARNA's prudent management and resilience in maintaining profitability amid challenging market conditions justify a premium valuation, in our view. Furthermore, the stock provides a 5.2% dividend yield for FY25F and a robust ROE of 23%, which is nearly double that of its peers. Risks to our call are: 1) sudden changes in government regulations (i.e. gas prices and safeguard import duties), 2) fierce product competition, and 3) a slower demand recovery.

Rating Table

Rating: Buy
 Target price: IDR 940
 Remains: Buy
 Catalysts: Housing program 2024

Buy
 IDR 940
 IDR 745

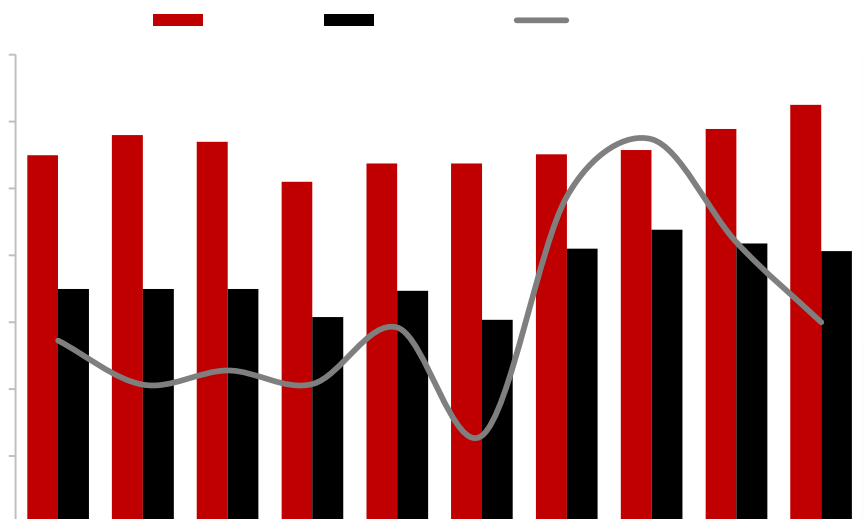
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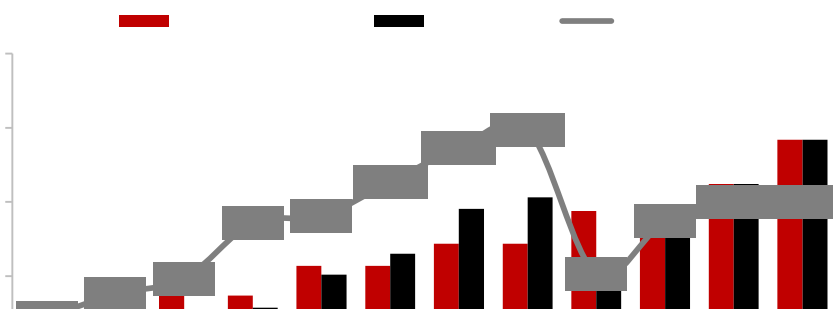
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Fig. 1: Indonesia ceramic industry currently at low utilization, set for a recovery next year



Source: Company data, Verdhana research

Fig. 2: ARNA capacity and production trend



INVESTMENT RATINGS

A rating of 'Buy', indicates that the analyst expects the stock to outperform the Benchmark over the next 12 months. A rating of 'Neutral', indicates that the analyst expects the stock to perform in line with the Benchmark over the next 12 months. A rating of 'Reduce', indicates that the analyst expects the stock to underperform the Benchmark over the next 12 months. A rating of 'Suspended', indicates that the rating, target price, and estimates have been suspended temporarily to comply with applicable regulations and/or firm policies. Securities and/or companies that are labelled as 'Not Rated' or 'No Rating' are not in regular research coverage. Benchmark is Indonesia Composite Index ('IDX Composite'). A 'Target Price', if discussed, indicates the analyst's forecast for the share price with a 12-month time horizon, reflecting in part of the analyst's estimates for the company's earnings, and may be impeded by general market and macroeconomic trends, and by other risks related to the company or the market in general.

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