Company Initiation

INDONESIA

TEXTILES

3 April 2017

BUY

TP: IDR 720

▲ 34.6%

PT Pan Brothers Tbk

PBRX IJ

Best dressed – initiate with BUY

Pan Brothers is Indonesia's leading garment maker with 13 factories and 47,000 employees, serving global brands. We expect that EBITDA margins will rise from 6.8% to 9.2% between FY15 and FY17 following a 215% expansion phase since 2010 as the company better utilizes its existing asset base to manufacture higher value products. PBRX trades in line with a Chinese and Taiwanese peer group at 10.9x FY18E PE but trades at a wide discount on PB that will close as ROE increases with capacity utilisation. Our FY18 price target of IDR720 implies a PE of 14.7x and 35% upside, initiate with BUY.

- **Indonesia's leading garment maker expanding to become a regional player:** Established in 1980, PBRX has operations spanning 13 factories and employing 47,000 people, to serve global brands such as *Uniqlo*, *The North Face*, *Adidas* and *Kathmandu*. Capacity growth of 215% since 2010 and an export focus have enabled PBRX to compete with regional manufacturers in Vietnam and China.
- **Rising margins with better utilization and richer product mix:** Under-utilization of capacity during the expansion phase has suppressed margins. We expect that the mix will shift to high value products as labour skill increases in low wage regions, with EBITDA margins expected to rise from 6.8% to 9.2% between FY15 and FY17.
- **Higher return on capital to drive re-rating, initiate with BUY:** On a PE basis, PBRX trades in line with its peer group at 10.9x FY18E, while its low ROE weighs on PB valuation relative to its peer group. As higher utilization drives margins and ROE up over the coming years, we anticipate that the PB will re-rate to 1.4x in FY18 and 2.0x by FY20. This would still place PBRX toward the low-end of the valuation range compared with large, integrated Chinese and Taiwanese peers. Our FY18 price target of IDR720 implies a PE of 14.7x and 35% upside. BUY.

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PRICE CLOSE (31 Mar 17)
IDR 535

MARKET CAP
USD 260.1 mln

SHARES O/S
6,478.30 mln

FREE FLOAT
38.68%

3M AVG DAILY VOLUME/VALUE
USD 1.19 mln

52 WK HIGH	52 WK LOW
IDR 590	IDR 398

Financial Highlights

Y/E 31 Dec (USD mln)	FY14A	FY15A	FY16A	FY17E	FY18E
Revenue	338.5	418.6	482.2	568.7	705.2
- Growth (%)	*(0.4)*	*23.6*	*15.2*	*17.9*	*24.0*
EBITDA	22.1	26.7	41.6	52.1	60.9
- Margin (%)	*6.5*	*6.4*	*8.6*	*9.2*	*8.6*
- Growth (%)	*-0.4*	*23.6*	*15.2*	*17.9*	*24.0*
Net Income	9.6	9.4	14.6	18.1	23.8
- Margin (%)	*2.8*	*2.2*	*3.0*	*3.2*	*3.4*
- Growth (%)	*(9.3)*	*(1.9)*	*55.3*	*24.1*	*31.7*
Capex	22.5	61.9	18.6	21.0	21.0
- Capex % Sales	*6.6*	*14.8*	*3.9*	*3.7*	*3.0*
Net debt/(cash)	(32.0)	67.4	127.4	117.5	126.1
- ND / EBITDA (x)	*(1.4)*	*2.5*	*3.1*	*2.3*	*2.1*
EV/EBITDA (x)	NA	10.9	9.7	7.5	6.6
PE (x)	NA	NA	17.6	14.2	10.8
PB (x)	NA	NA	1.2	1.1	1.0
Div Yield (%)	-	-	-	0.0	0.0

Source: Company, Bloomberg, RCML Research

Company background

Indonesia's largest garment maker

PBRX is Indonesia's largest garment manufacturer with a current capacity of 26,000 sewing machines and 90mn garment pieces per year. The company also engages in garment development, fabric manufacture and is a buying agent. It operates through various subsidiaries under the listed parent.

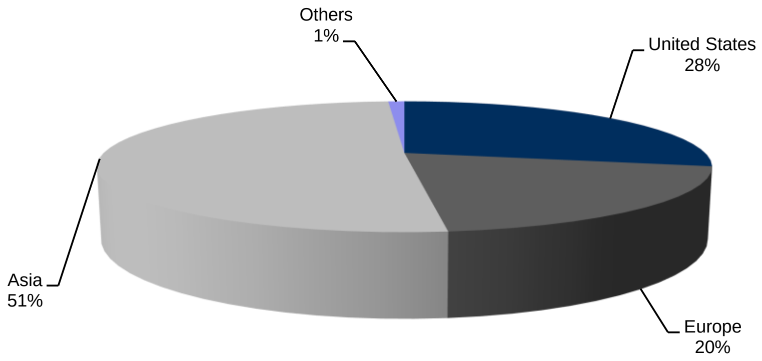
Fig 1 - Business segments and ownership structure

Business	Region	Ownership	Description
Garment segment			
PT. Pan Brothers Tbk (PBRX IJ)	Listed holding company		
PT. Pan Brothers Tbk	Tangerang factory, Boyolali factory, Sragen factory	100.0%	Produces cut & sewn knit garments such as polo shirts, golf shirts, track suits and sweat shirts, as well as woven garments such as padded and lightweight jackets, formal pants, shorts and casual pants with various fabrics
PT. Pancaprima Ekabrothers	Tangerang factory, Boyolali factory, Sukabumi factory	99.9%	Manufactures technical, functional and active wear jackets suited for snowboarding, ski outer wear, active wear, jogging, hiking, and other sports and outdoor activities
PT. Eco Smart Garment Indonesia	Seven planned factories	85.0%	Started operations in 2015. Produces woven garments such as padded and lightweight jackets, formal pants, shorts and casual pants with various fabrics
PT. Prima Sejahtera Sejati	Boyolali factory	99.0%	Manufactures technical, functional and active wear jackets suited for snowboarding, ski outer wear, active wear, jogging, hiking, and other sports and outdoor activities
PT. Teodore Pan Garmindo	Bandung	51.0%	Started operations in 2015. Produces cut & sewn knit garments such as polo shirts, golf shirts, track suits and sweat shirts, as well as woven garments such as padded and lightweight jackets, formal pants, shorts and casual pants
Product development and buying agent			
PT. Hollit Internation	Jakarta	51.0%	Manages product development, collections and production for world renowned fashion brands. Cooperates with PBRX's factories as well as with other select garment manufacturing partners
Continental 8 Pte, Ltd	Singapore	51.0%	Apparel buying agent company and also involved in garment product development
Cosmeic Gear Ltd	Hong Kong	51.0%	Apparel buying agent company and also involved in garment product development
Textile and yarn segment			
PT. Ocean Asia Industry	Serang	51.0%	Focused on circular knitted fabric and on dyeing, knitting, yarn dyeing and fabric printing. Supplies to international brand labels
PT. Victory Pan Multitex	Bandung	51.0%	Started operations in 2015. Produces sewing thread and embroidery thread

Source: RCML Research, Bloomberg

PBRX is an export-oriented company with more than 90% of its revenues coming from overseas sales denominated in US dollars. Domestic sales are predominantly requests from brand owners to supply local dealers and also from textile sales. The export destinations vary by customer request. In 2015, PBRX's sales split was as follows: 28% to the US, 20% to Europe and 51% to Asia.

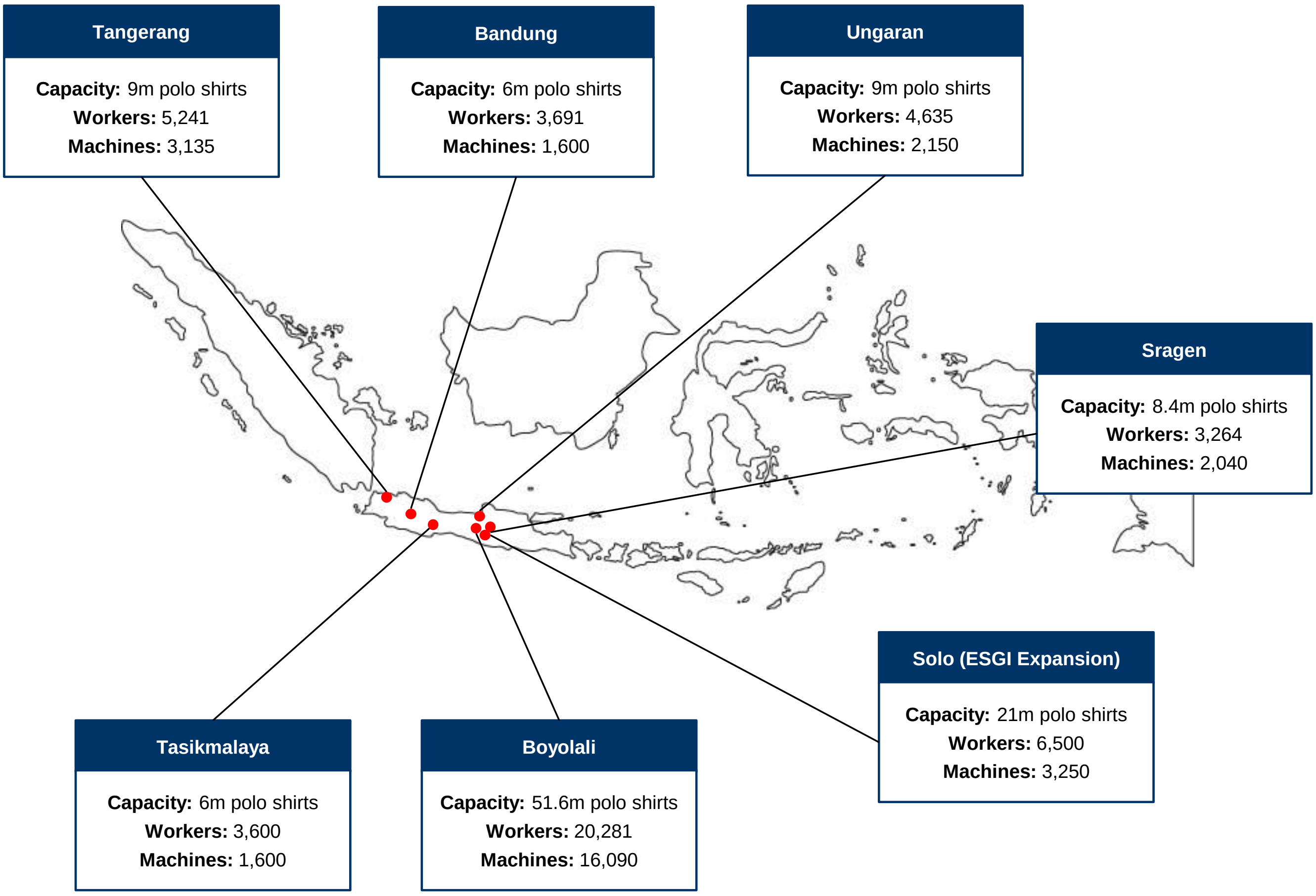
Fig 2 - 2015 geographical sales breakdown



Source: Company, RCML Research

PBRX's original production was in Central Java. After expanding the Boyolali operation with three additional factories, the company built two factories in Tangarang, west of Jakarta.

Fig 3 - Pan Brothers' production is in Java Island, Indonesia



Source: Company, RCML Research

PBRX, as a garment manufacturer, is in the downstream segment of the textile and clothing value chain. Its clients include world-leading brands such as *Uniqlo, Adidas, The North Face, Salomon, Nike, Under Armour* and *Calvin Klein*. The company has wide ranging competition from China, Taiwan and South Korea where companies are concentrated in garment manufacture or spread across the value chain. From a market perspective, its best-known competitors are Shenzhou, Makalot and Eclat.

Fig 4 - A map of the key Asian garment and textile manufacturers

Company	Value chain (Fiber › Yarn › Fabric › Garment › Brand)	Products	Market cap	2011-15 NI CAGR	2016-18E NI CAGR
Pan Brothers (PRBX IJ)	Garment	Sports & casual	258	3.3%	NA
Toray (3402 JT)	Yarn	Synthetic fibers (nylon, polyester, Lycra/spandex, etc.), fabrics	14792	5.2%	8.3%
Kuraray (3405 JT)	Fiber – Yarn	Synthetic fibers	5431	5.6%	6.5%
Lu Thai Textile (000726 CH)	Fiber – Garment	Fully integrated from cotton production	1451	-4.3%	13.5%
Ningxia Zhongyin (000982 CH)	Yarn – Garment	Yarn, fabrics, garment manufacturing	NA	NA	NA
Bros Eastern (601339 CH)	Yarn	Specialty yarn spinning and dying	1393	-23.6%	12.7%
Jiangsu Sunshine (600220 CH)	Yarn – Fabric	Woolen yarn and fabrics	1089	89.1%	NA
Shijiazhuang Changshan Textile (000158 CH)	Fiber – Garment	Cotton yarn and fabrics, as well as downstream garment/bedding products	2259	44.4%	27.9%
Fujian Zhonghe (002070 CH)	Fabric	Fabric printing and dying	1429	NA	NA
Anhui Huamao Textile (000850 CH)	Yarn – Fabric	Yarn and fabric manufacturing	850	-28.2%	NA
Zhejiang Hangmin (600987 CH)	Fabric	Fabric printing and dying	1205	16.3%	19.3%
Shanghai Dragon (600630 CH)	Fabric – Brand	Garment manufacturing and branded apparel	913	15.1%	NA
Huafu Top Dyed (002042 CH)	Yarn	Specialty yarn spinning and dying	1755	-4.7%	23.0%
Shenzhou (2313 HK)	Fabric – Garment	Specialty fabrics and garment manufacturing	9214	8.4%	18.3%
Pacific Textiles (1382 HK)	Fabric	Fabrics	1635	5.2%	-2.0%
Texwinca (321 HK)	Fabric	Fabric manufacturer with retail business	964	-9.1%	-22.9%
Best Pacific (2111 HK)	Fabric	Specialist materials manufacturer globally	794	17.4%	19.6%
Luen Thai (311 HK)	Garment	Garment and accessories manufacturing & trading	236	-21.9%	NA
Billion Industrial (2299 HK)	Fiber – Yarn	Polyester yarns	1447	-31.2%	NA
Weiqiao Textile (2698 HK)	Yarn – Fabric	Cotton yarns, fabric and denim	858	41.3%	NA
Texhong Textile (2678 HK)	Yarn – Fabric	Cotton and synthetic fiber yarns, fabrics	1294	76.2%	12.5%
Eclat (1476 TT)	Fabric – Garment	Specialty fabrics and garment manufacturing	2806	37.1%	21.0%
FENC (1402 TT)	Yarn – Fabric	Polyester, fabrics and garment	4759	-7.7%	20.9%
Makalot (1477 TT)	Garment	Sports & casual	885	18.1%	3.5%
Shinkong Synthetic (1409 TT)	Fiber – Yarn	Synthetic fibers & yarn	531	-12.2%	NA
Shinkong Textile (1419 TT)	Fabric	Specialty fabrics and garment manufacturing	395	-17.3%	NA
Formosa Taffeta (1434 TT)	Yarn – Fabric	Cotton and synthetic yarn and fabrics	1766	8.0%	13.8%
Tainan Spinning (1440 TT)	Fiber – Yarn	Yarn (e.g. cotton, polyester, blended) and polyester fibers	837	22.2%	NA
Lealea Enterprise (1444 TT)	Fiber – Yarn	Polyester and nylon textured yarns	262	-14.8%	NA
Li Peng Enterprise (1447 TT)	Fiber – Fabric	Nylon fiber and yarn, woven fabric	247	NA	NA
Nien Hsing Textile (1451 TT)	Yarn – Garment	Yarn, denim, specialty fabrics and garments	354	-2.8%	NA
Everest Textile (1460 TT)	Yarn – Fabric	Yarn and specialty fabrics	262	21.9%	NA
Toung Loong Textile (4401 TT)	Yarn	Sythetic yarn specialty fabrics	318	6.6%	11.4%
Singtex Industrial (4433 TT)	Yarn – Garment	Yarn and specialty fabrics	29	16.2%	NA
Youngone (111770 KS)	Fabric – Garment	Fabrics, garments and accessories	1261	2.6%	6.2%
Hansae (105630 KS)	Garment	Casual & fashion	860	20.1%	14.0%
Willbes (008600 KS)	Garment	Casual & fashion	166	8.3%	NA

Source: RCML Research

Investment thesis

Domestic market consolidation

The history of dramatic geographic shifts in the primary production bases for the textile and garment industry is underpinned by the importance of low production costs to competitiveness. There have been three major shifts to date in search for low wages, with the rising wealth in China being the catalyst for a fourth shift from China to South East Asian countries.

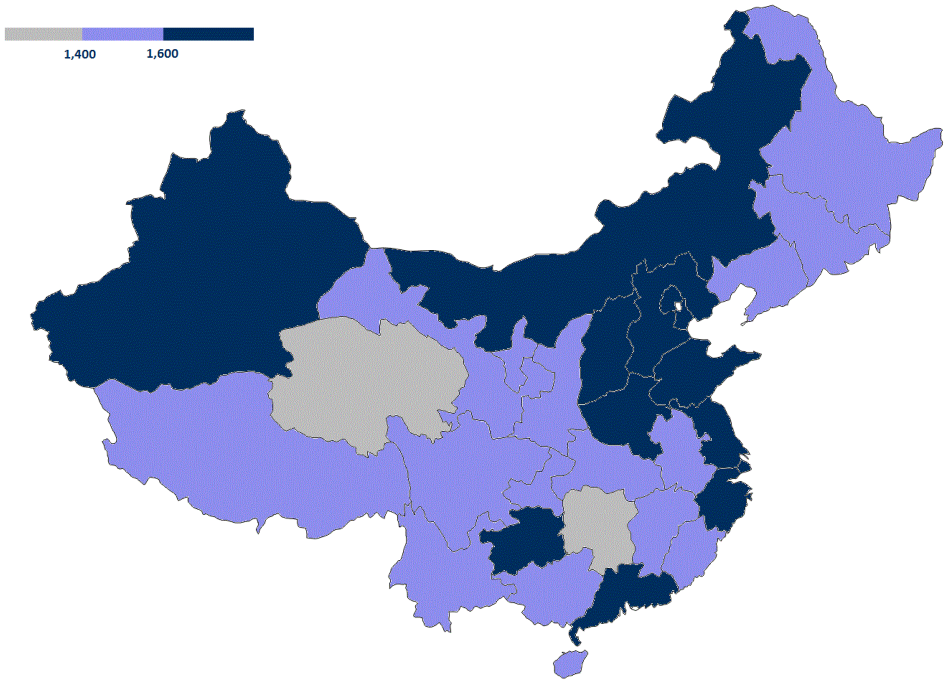
Fig 5 - The textile industry is shifting from China to ASEAN

Late 18th century	**Origin** Modern textile manufacturing with machines dates from the industrial revolution in late 18th century Britain which was based on imported cotton and eventually spread throughout the West.
1950s and early 1960s	**1st Shift – From the West to Japan** Initially based on British spinning machinery and later on its own state-of-the-art equipment, Japan became the most preferred destination for textile manufacture.
1970s and early 1980s	**2nd Shift – Japan to Hong Kong, Taiwan and South Korea** The second shift was from Japan to Hong Kong, Taiwan and the Republic of Korea whose technological capabilities grew ahead of labour costs. These countries dominated textile and clothing exports in the 1970s and early 1980s.
1980s and early 1990s	**3rd Shift – Hong Kong, Taiwan and South Korea to Mainland China** The third migration was to mainland China in the 1980s where companies could achieve scale and be closer to the fast growing domestic market.
2010 onward	**4th Shift – China to Vietnam, Indonesia and Cambodia?** Rising labour costs, currency appreciation and logistics costs are driving another geographical shift to countries in South East Asia as China begins to lose its competitive advantage.

Source: RCML Research

China's dominance in the textile and garment industry has been built on low production costs. However, the country's growing wealth is translating to rising labour, land and regulatory costs. Vietnam and Indonesia are best positioned to benefit from this trend, particularly in labour intensive segments such as garment manufacturing.

Fig 6 - Minimum wage across Chinese provinces (RMB/mo)

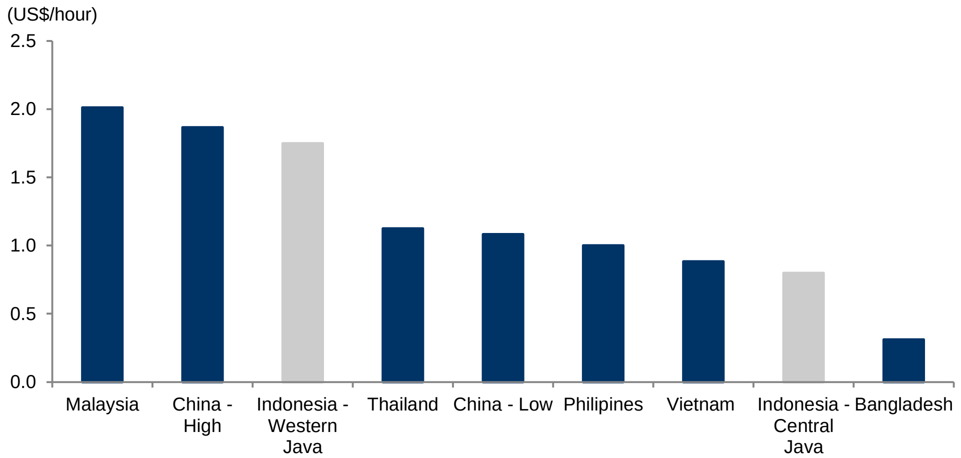


Source: RCML Research

The same forces that led China to become the largest producer and exporter of textiles and clothing in the world are now being undermined by rising production costs, driving customers to find alternate suppliers in South East Asia.

Labour costs in Central Java, where PBRX's production bases are concentrated, are some of the lowest across South Asia and ASEAN. While it pays above the minimum wage in both West and Central Java, its Tangarang factory remain profitable by producing high value garments such as technical sportswear, where labour makes up a small fraction of total cost and skill is important.

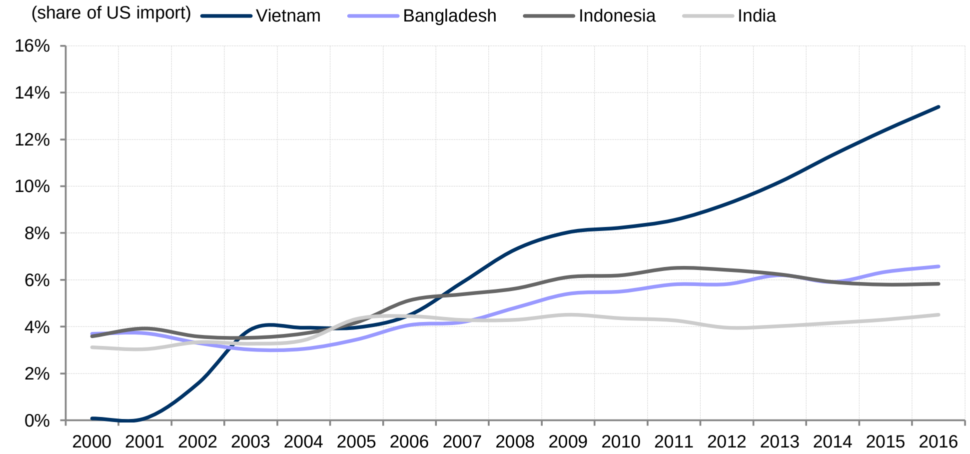
Fig 7 - Indonesia has some of the lowest labour costs in South Asia



Source: RCML Research, Multiple sources

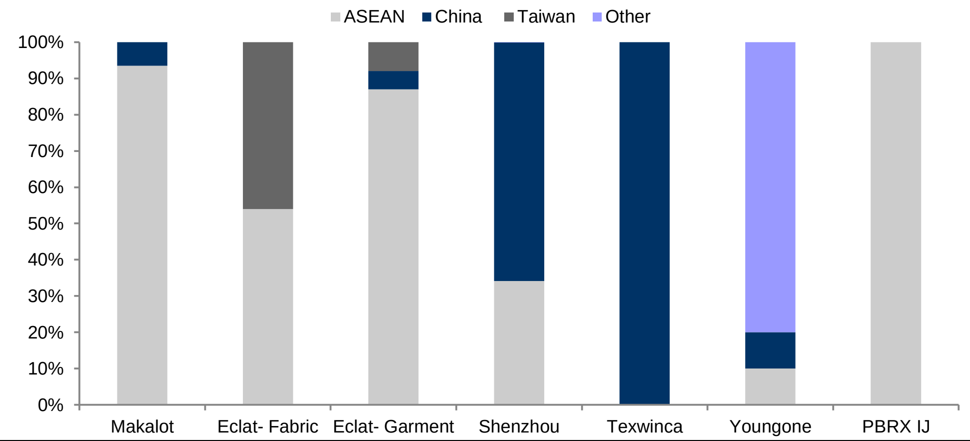
The scale of China's supply chain will take years to replicate in the new production centers, though manufacturers are already diverting investment from peripheries such as Taiwan and South Korea which haven't been able to overcome rising costs with scale. Incumbents in these countries are being led by customer demand to relocate in search of lower labour and energy costs.

Fig 8 - Shift from China benefiting South Asian countries



Source: RCML Research

Fig 9 - Garment producers have diversified away from China and Taiwan



Source: Companies, RCML Research

High entry barriers to supplying MNC customers

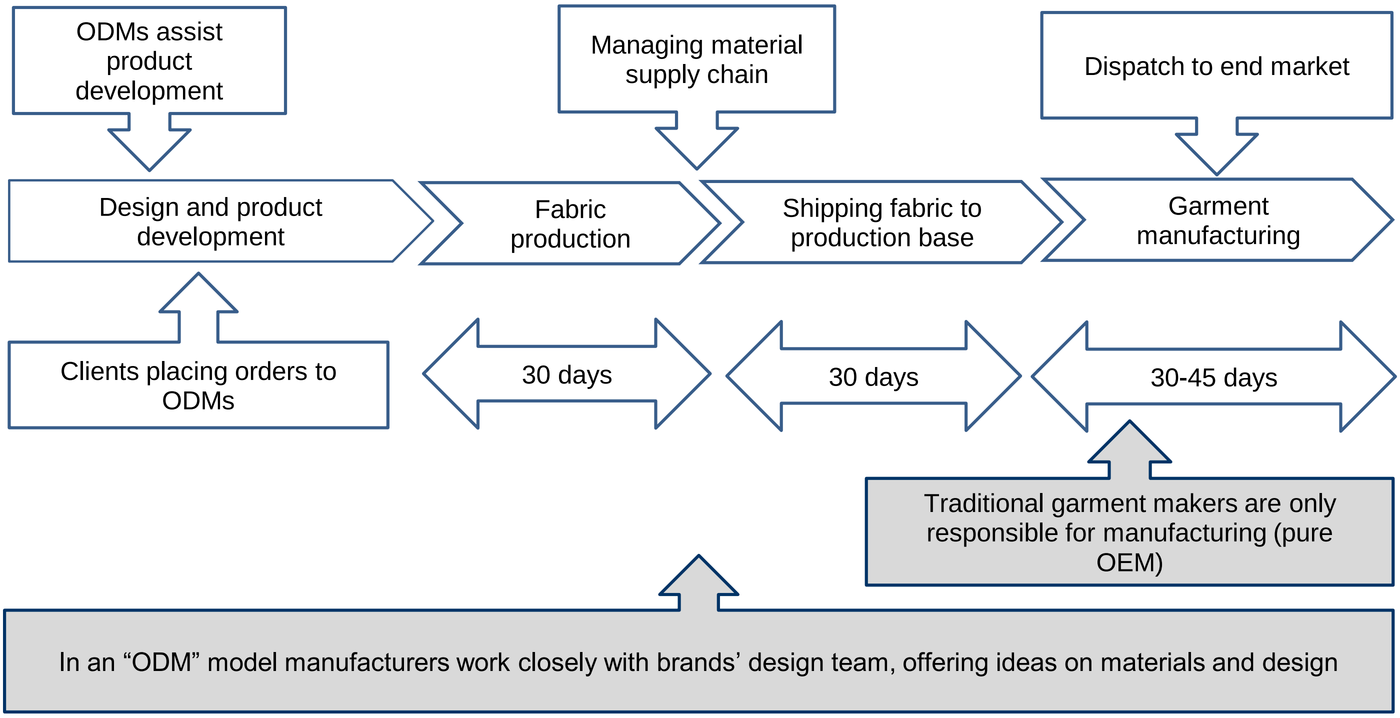
The technical sportswear and 'athleisure' trends have led consumer brands to focus on product functionality rather than fashion or brand as a key differentiator. Garment suppliers have become more integrated with customers as product complexity increased. Major garment manufacturers have employees permanently dedicated to key customers and in some cases have seconded staff to their procurement and product development divisions.

Industry transition to higher margin ODM business

PBRX's latest generation of growth and capacity upgrade comes with changes in the way it interacts with customers. Orders were previously tendered with product and quality specifications and manufacturers would compete for business for a fixed period of 'runs'. The company now interacts with customers completely differently, as an ODM (originate design manufacturer) rather than an OEM.

As with many established Chinese players, PBRX is highly integrated with design and procurement teams of key customers and hosts their staff in-house. The extent of the relationship between customer and ODM runs deeper in that they are 'open book' with their costing and have agreed margins for particular garment styles, order quantities and delivery timelines.

Fig 10 - Pan Brothers has transitioned to a higher margin ODM model



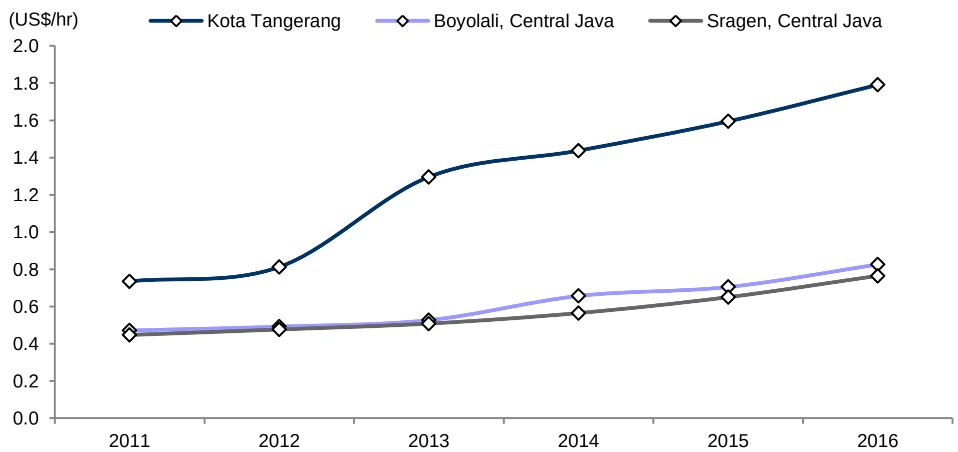
Source: RCML Research

Imported technology divides emerging manufacturers

As large Chinese garment manufacturers move production to South East Asia, they are bringing technology and intellectual property (IP) with them. While regulations and reliance on a local labour force make partnerships and joint ventures with domestic manufacturers common, the techniques to produce high-end apparel and footwear are rarely home grown. Thus, the domestic manufacturers left out of such partnerships have been reduced to manufacturing low value goods for domestic consumption.

Similarly in Indonesia, small manufacturers unwilling to or unable to change have been marginalized to produce low value goods for the domestic market where they are largely protected by freight costs and trade barriers. On the other hand, PBRX – the largest garment manufacturer in Indonesia – has increased capacity in line with customer requirements and competes with Chinese, Taiwanese and Korean manufacturers. It is the only independent garment manufacturer of its scale in the country.

Fig 11 - Wages have stayed lower in Central Java where PBRX is expanding

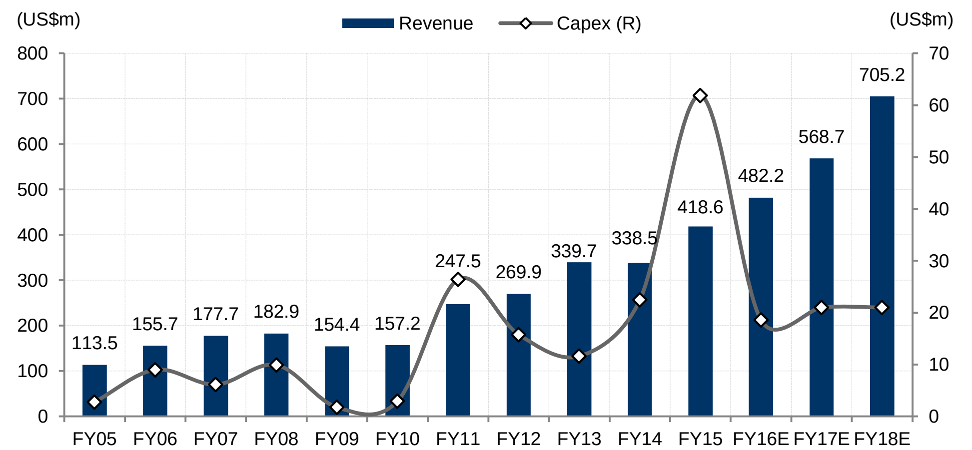


Source: RCML Research, Company

Emerging from a capex cycle

PBRX invested US$32.5m over 2005-10 compared to an estimated US$148.1m over the following five years through to 2016. Revenue grew by 166% versus 39% in the previous five years while the EBITDA margin grew 130% over 2005-10, but has since remained flat.

Fig 12 - PBRX has added capacity to grow revenue since 2010



Source: RCML Research, Company

Margin growth from transition to higher value goods

Growing into their shoes

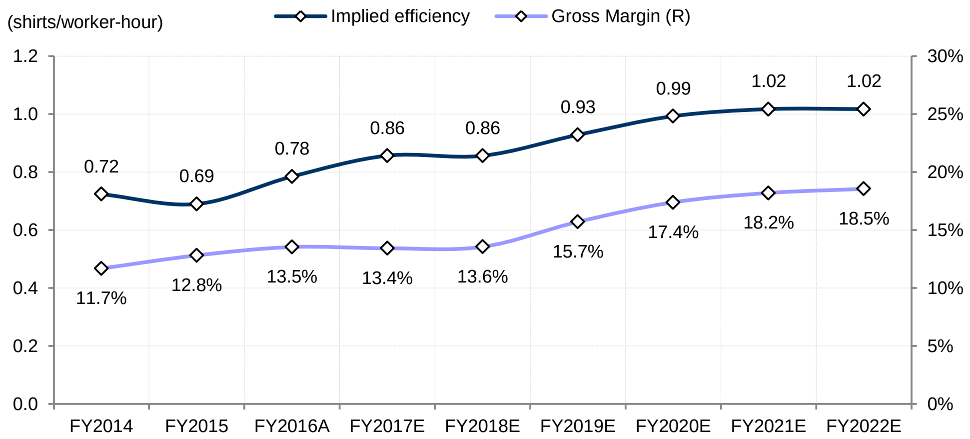
Plant utilization and worker skill are two factors which drive margins following periods of expansion. Despite having a fixed space and number of sewing machines, there is some flexibility in the workforce, in terms of stations occupied and shifts worked. The addition of new factories increases the number of machines and workstations in a single go, but it can take more than two years to ramp-up a factory to full utilization because of business and hiring limitations.

Skills that pay the bills

PBRX's expansion is concentrated in Central Java to minimize labor costs; consequently, the company is hiring unskilled labor that requires training. Over time, workers get faster at basic sewing and are able to complete more complex garment assembly, which translates to workers taking less time to complete the same task (more revenue per hour worked) or to them spending a greater proportion of time working on more complex higher margin products.

Using a standardised metric of polo shirts per worker-hour, we are able to measure PBRX's productivity since 2014. Unsurprisingly, the dip in 2014-15 came with a sharp rise in capacity (see Fig 16). A recovery in 2016 is expected to continue this year, stalling in 2018 as more capacity is added yet again. Our model, which drills down to a factory level, predicts productivity (shirts per worker-hour) to return to above one by 2020, at which point gross margins will increase from 13.4% currently to 18.2%.

Fig 13 - Higher utilization following capacity growth will drive margin recovery

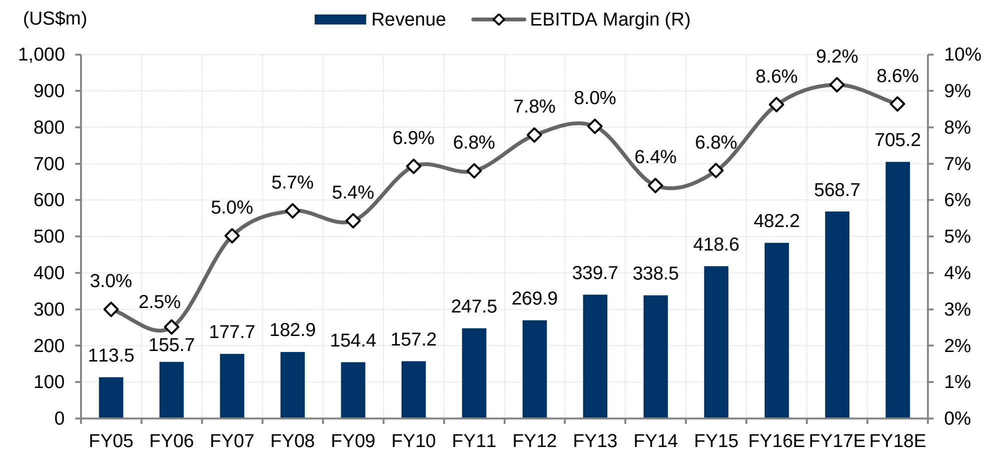


Source: RCML Research, Company

The company's original factories are in Central Java (Sragen and Boyolali) and made up the production base until 2010 when a further three factories were added to Boyolali and a further two at Tangarang, West Jakarta. We note that EBITDA margins grew from 3.0% to 6.9% during the period of 2005-10 while capacity was stable. In contrast, from 2010-15, EBITDA margins were unchanged while the company experienced huge capacity and revenue growth.

Margins increased in 2016 as the company increased utilisation at its new factories and rationalised the labour force, driving the product mix towards higher value goods. In 2016, the EBITDA margin grew 180bps from 6.8% to 8.6%. We expect the trend to continue this year to reach 9.2%.

Fig 14 - EBITDA margins grow as capacity is better utilized



Source: RCML Research, Company, Bloomberg

The potential for margin growth as the company shifts from an OEM to ODM business model is clear, looking at the discrepancy versus peers. PBRX's mid-to-high single digit EBITDA margin is significantly below that of other garment ODMs. As we have argued, closing the gap is going to be a function of better utilizing the existing plant and labour force to produce higher value goods – a polo-shirt or tank-top may only sell for US$3-5 per piece compared to US$150-200 per piece for a Gortex ski jacket, for instance.

Fig 15 - Pan Brothers' margins are currently the lowest in their peer group

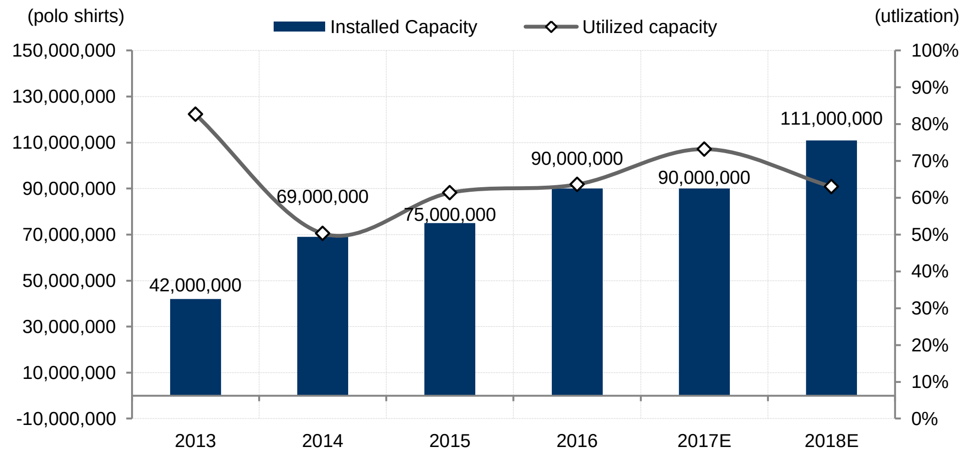
Ticker	Name	Gross margin (%)		EBITDA margin (%)		Net margin (%)		SG&A as % of sales		ROE (%)	
		FY15	FY16	FY15	FY16	FY15	FY16	FY15	FY16	FY17E	FY18E
PBRX IJ	**PAN BROTHERS TEX**	**12.8**	**13.5**	**6.4**	**8.6**	**2.2**	**3.0**	**8.7**	**9.0**	**7.9**	**7.9**
3402 JT	TORAY INDUSTRIES	19.9	21.0	10.6	12.1	3.5	4.3	13.7	13.7	9.8	10.0
3405 JT	KURARAY CO LTD	31.9	34.5	21.1	22.5	6.9	8.3	19.3	20.5	8.0	7.9
2313 HK	SHENZHOU INTL GP	30.5	32.5	26.7	29.1	18.6	19.5	9.8	9.7	20.8	20.5
1382 HK	PACIFIC TEXTILE	17.1	18.8	18.4	19.0	15.6	16.2	2.6	3.7	31.4	33.0
321 HK	TEXWINCA HLDG	34.1	34.0	10.2	15.8	8.3	11.2	27.9	22.0	10.3	11.0
2111 HK	BEST PACIFIC INT	33.2	N.A.	25.8	N.A.	16.7	18.5	14.1	N.A.	23.9	23.1
2678 HK	TEXHONG TEXTILE	18.0	19.4	16.2	18.0	5.6	8.7	7.1	7.6	21.0	20.3
1476 TT	ECLAT TEXTILE	28.0	28.4	21.9	22.1	16.4	14.9	9.1	9.6	27.9	28.2
1477 TT	MAKALOT	23.6	20.4	12.6	10.4	9.2	6.9	12.2	11.6	18.6	21.0

Source: RCML Research, Bloomberg, Company

Opportunities for further expansion

In 2011, PBRX began doing business with Mitsubishi, which is a buying agent for major brands in Japan, such as Fast Retailing (*Uniqlo)*. Mitsubishi has rapidly grown to become PBRX's largest customer, reaching 28% of their sales in 2016. In 2014, as Mitsubishi's proportion of PBRX's total sales grew beyond 20%, they elected to enter into a direct partnership to grow the business through a 3-stage expansion project, making a US$15m equity investment for 15% of new venture ESGI, which will grow overall capacity by 23% to 110mn polo shirt equivalent by 2018. PBRX completed a Rp1tn (US$87mn) rights issue in January 2014, with 60% of the proceeds earmarked for the ESGI expansion.

Fig 16 - PBRX's capacity expansion will continue through FY18



Source: RCML Research, Company

Fast Retailing's move to grow its footprint in Indonesia with PBRX versus other manufacturers in China, Vietnam and Bangladesh serves as important validation of the company's positioning. While PBRX's business with Mitsubishi only makes up a fraction of the total garment market, another customer of this scale would be transformational for the company, offering a low-risk avenue to growth.

Shifts in trade agreements favour Indonesia

The textile and garment sector is politically sensitive in emerging economies because of the huge labor force it employs. Governments use subsidies and grants to improve the economics for corporations operating in their country and to disincentivize them from relocating to lower cost markets. Similarly, importing countries (typically developed markets) use tariffs and trade barriers as a bargaining tool with producer countries, knowing free trade agreements (FTA) with destination markets such as the US, EU and Japan are highly attractive to manufacturers when competing for business.

Indonesia has been a laggard in establishing trade agreements beyond ASEAN. As the incumbent manufacturing power, China is offering large grants and subsidies to manufacturers to relocate to lower cost regions to preserve their competitiveness. Vietnam is leading the emerging producers and has established a bilateral trade agreement with the US and more recently an FTA with the EU. Changes to the status quo such as Indonesia establishing an FTA with the EU and the recently scrapped Trans-Pacific Partnership (TPP) are incrementally positive for PBRX.

Fig 17 - Three trade deals under negotiation will benefit Indonesian manufacturers

	Trans-Pacific Partnership (TPP)	Regional Comprehensive Economic Partnership (RCEP)	Free Trade Area of the Asia Pacific (FTAAP)
Countries	US (exited as of 23rd Jan), Canada, Japan, Singapore, Malaysia, Vietnam, Brunei, Australia, New Zealand, Mexico, Chile, Peru	ASEAN + 6 (China, Japan, Korea, India, Australia, New Zealand)	APEC members
Textile sector	Vietnam prefers the more flexible "cut and sew" rule, requiring only the assembly of garment to take place in a TPP country, while yarn/fabrics can be sourced outside	Details of tariff concessions/industries to be open are still under negotiations News reported that India would like to keep textiles out of the initial offer for RCEP	Negotiations are ongoing

Source: RCML Research

Free trade agreement with the EU

The EU currently imposes a 6.3-12.0% tariff on garment imports from Indonesia. Vietnam entered an FTA with the EU during 2016 and most tariffs were immediately lifted, with the remainder will be lifted progressively over the next seven years. Indonesia began talks with the EU in 2014, and entered a partnership and cooperation agreement in May. Two rounds of discussions took place in 2016 with industry sources tipping a final agreement to be reached by 2018. Once an Indonesia-EU FTA is in place, textile and garment exporters will regain their cost advantage vis-à-vis Vietnam and other low cost producing countries which don't have an FTA with Europe, such as Cambodia and Myanmar.

Fig 18 - Non-FTA tariffs on textile products with major economies

(%)	HS Chapter/subheading	US	EU	Japan
Yarn				
-Silk	5003-5006	0 - 2.5	0 - 5	0 - 6.9
-Wool	5105-5110	0 - 6	2 - 5	0 - 2.7
-Cotton	5204-5207	0 - 12	4 - 5	1.9 - 5.6
-Man-made fibers	5401-5406/5501-5511	0 - 13.2	3.8 - 5	0 - 6.6
Woven fabrics				
-Silk	5007	0 - 3.9	3 - 7.5	10 - 12.5
-Wool	5111-5113	0 - 25	5.3 - 8	5.3 - 7.9
-Cotton	5208-5212	0 - 16.5	8	3.7 - 7.4
-Man-made fibers	5407-5408/5512/5516	0 - 25	8	4 - 10
Knit fabrics	60	6.6 - 18.5	6.5 - 8	4 - 9.8
Apparel	61-62	0 - 32	6.3 - 12	4.4 - 12.8

Source: RCML Research, Company

America's exit from the TPP is a boon for Indonesia

The Trans-Pacific Partnership (TPP), a mega-trade deal with 12 member countries (of which Indonesia was not one), was scuttled in October following the election of Donald Trump, who declared the United States would no longer participate in the trade pact. Vietnam as a member country would have significantly benefitted versus Indonesia, as it would have been able to trade with the US, Japan and Australia tariff-free.

In addition to its EU-FTA, the TPP would have made Vietnam the obvious choice for major Chinese, Taiwanese and Korean manufacturers looking to build offshore capacity to serve these major Western markets. Scrapping the partnership is a positive outcome for the Indonesian textile and garment industry which would otherwise have been placed at a further disadvantage to Vietnam and serves as an opportunity for Indonesia to catch-up and participate in any amended trade deal.

Anti-China sentiment from the United States

In addition to scrapping the TPP, President Trump has expressed anti-China sentiment on various occasions during the US presidential campaign and now while in office, labeling the country as a currency manipulator and attacking its protectionist trade policies.

Customers of most of the Chinese mega-manufacturers are American brands or brands which have a large market in the US. We expect these MNCs will seek to mitigate supply chain risk by diversifying production away from China to Vietnam, Bangladesh and Indonesia. This is an opportunity for a leading garment manufacturer such as PBRX, which is already seeing increased interest from new customers and to take on new product lines from existing customers. The overall market scale relative to PBRX is an advantage for the company as only a small diversion of trade towards Indonesia would make a major difference to the company.

Fig 19 - End customers are driving production base diversification

Company	Ticker	Related OEM/ODM
Fast Retailing	9983 JT	Shenzhou, Makalot, Pan Brothers
GAP	GPS US	Makalot, Eclat
Inditex	ITX SM	Makalot
Nike	NKE US	Eclat, Shenzhou
Adidas	ADS GR	Shenzhou, Eclat
The North Face	N/A	Pan Brothers
Under Armour	UA US	Makalot, Eclat
Lululemon	LULU US	Eclat
2XU	N/A	Eclat
A&F	ANF US	Makalot
Puma	PUMG IX	Shenzhou
Ralph Lauren	RL US	Makalot

Source: RCML Research, Bloomberg, Company

Business in Indonesia's textile sector set to boom

The Indonesian government is playing catch-up to support the manufacturing sector now that the economy cannot rely solely on natural resources. Indonesia's FTA with the EU will be the country's first pact with a major economic region outside of ASEAN. Importantly, these are destinations for textile exports and will be incrementally positive to regaining competitiveness versus Vietnam. Similarly, the sidelined TPP gives Indonesia the opportunity to enter a revised trade pact that will undoubtedly be formed in the future. In both cases, this should attract investment and new business to the Indonesian textile sector while incrementally benefitting the margins of garment manufacturers.

Inflection in earnings will drive returns

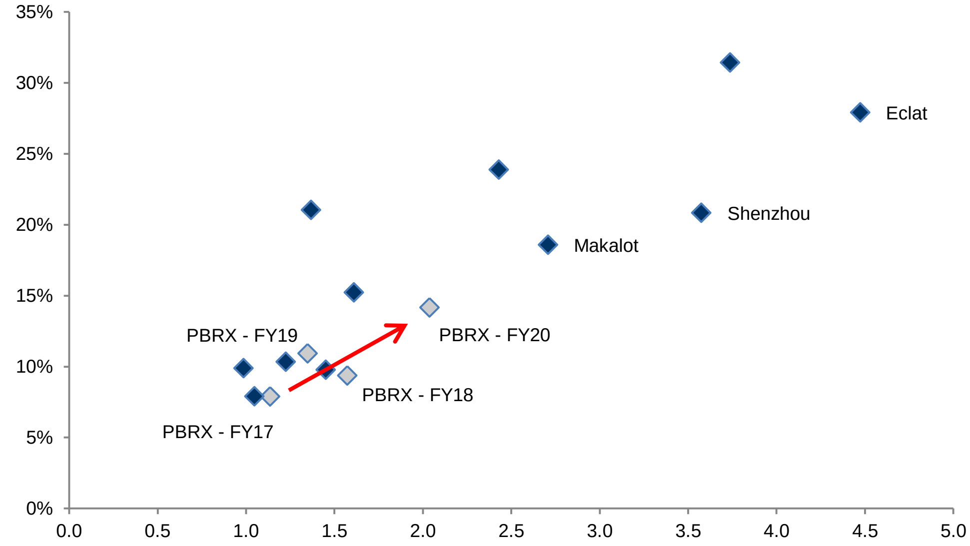
On a PE basis, PBRX trades at a slight premium of 14.4x FY17E and in line with peers at 10.9x FY18E. Notably, the company trades at a lower PB to its peer group, which is explained by its low ROE. However, as margins and ROE increase over the coming years, we expect the implied P/B to re-rate to 1.4x in FY18 and 2.0x by FY20. This would still place PBRX toward the low-end of the valuation range compared with large, integrated Chinese and Taiwanese peers such as Shenzhou Intl (FY18E PB 3.1x), Eclat Textile (3.9x) and Makalot (2.9x). Our FY18 price target of IDR720 implies a PE of 14.7x and 35% upside. Initiate coverage with BUY.

Fig 20 - Pan Brothers' PB and ROE is at the low-end of its peer group…

Ticker	Name	Market Cap (US$)	PER (x)		PB (x)		EV/EBITDA (x)		Dividend yield (%)		ROE (%)	
			FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E	FY17E	FY18E
PBRX IJ	**PAN BROTHERS**	**260**	**14.4**	**10.9**	**1.1**	**1.0**	**7.5**	**6.6**	**0.0**	**0.0**	**7.9**	**9.4**
3402 JT	TORAY INDUSTRIES	14,467	14.8	13.5	1.5	1.3	8.4	7.7	1.5	1.7	9.8	10.0
3405 JT	KURARAY CO LTD	5,381	13.3	12.6	1.0	1.0	4.7	4.3	2.6	2.7	7.9	7.9
2313 HK	SHENZHOU INTL GP	8,830	17.2	14.9	3.6	3.1	10.4	8.9	3.2	3.7	20.8	20.6
1382 HK	PACIFIC TEXTILE	1,601	11.9	11.3	3.7	3.7	8.8	8.9	8.4	8.8	31.4	33.0
321 HK	TEXWINCA HLDG	930	11.9	11.1	1.2	1.2	5.9	5.6	9.0	8.9	10.3	11.0
2111 HK	BEST PACIFIC INT	825	10.2	8.5	2.4	2.0	7.0	5.7	3.7	4.6	23.9	23.1
2678 HK	TEXHONG TEXTILE	1,222	6.5	5.9	1.4	1.2	4.2	3.7	4.6	5.1	21.0	20.3
1476 TT	ECLAT TEXTILE	2,694	16.0	13.7	4.5	3.9	10.5	9.1	4.2	4.8	27.9	28.2
1477 TT	MAKALOT	848	14.6	12.1	2.7	2.5	9.1	7.4	5.4	7.2	18.6	21.0

Source: RCML Research, Bloomberg

Fig 21 - …but is positioned for a re-rating as efficiency drives higher returns



Source: RCML Research, Company

Fig 22 - Target upside of 35% on re-rating

	FY17E	FY18E	FY19E	FY20E
Return On Equity	7.9%	9.4%	10.9%	14.2%
Δ		*18.7%*	*38.4%*	*79.4%*
Implied P/B (x)	1.2	1.4	1.6	2.1
Implied Equity Vale (USD)	265.0	348.9	459.9	699.4
Implied Price (IDR/share)	**547**	**720**	**949**	**1,444**

Source: RCML Research, Company

Income Statement

Y/E 31 Dec (USD mln)	FY14A	FY15A	FY16A	FY17F	FY18F
Total revenue	**338.5**	**418.6**	**482.2**	**568.7**	**705.2**
EBITDA	22.1	26.7	41.6	52.1	60.9
EBIT	13.9	15.3	24.6	34.3	43.1
Net interest income/(expense)	(0.9)	(3.8)	(6.3)	(10.0)	(9.7)
Other income/(expense)	0.4	(1.8)	2.6	2.6	2.6
EBT	12.9	11.5	18.3	24.4	33.4
Income taxes	(3.6)	(2.9)	(5.0)	(6.1)	(8.4)
Min. Int./Inc. from associates	0.2	0.8	1.3	(0.2)	(1.2)
Reported net profit	**9.6**	**9.4**	**14.6**	**18.1**	**23.8**
Adjustments/non-recurring	0.0	0.0	0.0	0.0	0.0
Adjusted net profit	**9.6**	**9.4**	**14.6**	**18.1**	**23.8**

Balance Sheet

Y/E 31 Dec (USD mln)	FY14A	FY15A	FY16A	FY17F	FY18F
Cash and cash equivalents	127.8	73.6	78.4	88.2	79.7
Short-term Investments	0.0	0.0	0.0	0.0	0.0
Receivables	51.9	65.7	80.5	85.3	105.8
Inventories	67.4	88.6	101.6	113.7	141.0
Other current assets	37.1	82.6	126.1	126.1	126.1
Total Current Assets	**284.2**	**310.6**	**386.6**	**413.4**	**452.6**
Long term receivables	0.0	0.0	0.0	0.0	0.0
Net PPE	75.8	122.9	123.4	126.6	129.8
Other assets	7.3	9.4	9.5	9.5	9.5
Total non-current assets	**83.0**	**132.3**	**132.9**	**136.1**	**139.4**
Total assets	**367.3**	**442.8**	**519.5**	**549.5**	**592.0**
Short-term debt	12.7	6.0	23.3	23.3	23.3
Accounts payable	48.9	60.4	66.1	78.0	96.7
Other current liabilities	12.8	19.9	13.3	13.3	13.3
Total Current Liabilities	**74.4**	**86.3**	**102.8**	**114.7**	**133.3**
Long-term debt	83.1	135.0	182.4	182.4	182.4
Other long term liabilities	8.3	5.7	6.7	6.7	6.7
Total long-term liabilities	**91.5**	**140.7**	**189.1**	**189.1**	**189.1**
Total liabilities	**165.9**	**227.0**	**291.9**	**303.8**	**322.4**
Minority interest	15.3	18.9	16.9	16.7	15.5
Stockholder's equities	**186.2**	**197.0**	**210.8**	**229.0**	**254.1**
Total liabilities & equities	**367.3**	**442.8**	**519.5**	**549.5**	**592.0**

Cash Flow Statement

Y/E 31 Dec (USD mln)	FY14A	FY15A	FY16A	FY17F	FY18F
Profit before tax	**9.6**	**9.4**	**14.6**	**18.1**	**23.8**
Depreciation & Amortization	8.2	11.3	16.9	17.8	17.8
Changes in net working capital	0.8	(47.6)	(67.4)	(5.0)	(29.2)
Other items	0.0	0.0	0.0	0.0	0.0
Cash flow from operations	**18.6**	**(26.9)**	**(35.8)**	**30.9**	**12.4**
Capital expenditures	(22.5)	(61.9)	(18.6)	(21.0)	(21.0)
Other items	(9.1)	(1.1)	(2.3)	0.0	0.0
Cash flow from investing	**(31.5)**	**(63.0)**	**(20.9)**	**(21.0)**	**(21.0)**
Debt raised repaid	17.3	35.5	64.7	0.0	0.0
Share issued/repurchased	83.0	0.0	0.6	0.0	0.0
Dividend paid	(0.5)	(0.5)	(1.0)	0.0	0.0
Other items	2.7	0.7	0.0	0.0	0.0
Cash flow from financing	**102.4**	**35.7**	**64.4**	**0.0**	**0.0**
Changes in cash	**89.5**	**(54.2)**	**7.7**	**9.9**	**(8.6)**

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