17 May 2016

Property | Real Estate

Mega Manunggal Property

Poised For Growth

Buy

Target Price:	IDR950
Price:	IDR705
Market Cap:	USD303m
Bloomberg Ticker:	MMLP IJ

We initiate coverage on Mega Manunggal with a BUY call and DCF-derived IDR950 TP (35% upside). As the largest publicly-listed modern logistics property developer, it is poised for an earnings growth CAGR of 37% in 2015-2018. This is backed by growing demand, greater efficiency, a high operating leverage and the tripling of capacity in four years' time. The firm's flexible corporate structure should enable it to achieve a scalable size and sufficient cash flow to sustain its growth.

Solid business model. Mega Manunggal Property (Mega Manunggal) builds and leases two types of warehouses:

i. Multi-tenant;
ii. Built-to-suit (BTS) – this is its main focus going forward.

With a 10-year lease term, the BTS business ought to ensure the initial 8- to 9-year payback period target is achieved, while balancing the need to reset rental rates at the end of a term. BTS warehouses currently account for 68% of Mega Manunggal's total net leasable area (NLA). The segment also yields 80-85% EBITDA margins on a project basis, generating stable recurring cash flow. That aside, mitigating business risks include a 10% initial yield to the cost of each new project and focus towards first-tier clients.

Funding is the key. Amid Mega Manunggal's IPO proceeds of IDR987.7bn, the tripling of its capacity to a NLA of 500,000 sqm would still require further financing – be it through a rights issue, REITS or a strategic partnership. So far, we are positive on the company's partnership with Daiwa House Industry (DHI), which was signed in Nov 2015, as well as the agreement inked with GIC Real Estate Pte Ltd (GIC Real Estate) a Singaporean sovereign wealth fund in April. We believe these deals would definitely bring significant value add, such as a lower cost of funds and technical know-how. These would enable Mega Manunggal to achieve its target NLA, or perhaps more, by 2018.

Timely execution a key risk, initiate coverage with a BUY call and DCF-based TP of IDR950. Mega Manunggal said that an advance payment had been made for 42.5ha of landbank. The key risk is for the company being able to execute development on a timely basis. Obtaining suitable landbank and funding would still continue to be major risks for Mega Manunggal, going forward.

We used DCF methodology (assuming 10.3% WACC and a cap rate of 5% to determine long-term value) to derive our TP of IDR950. This implies FY16F-17F P/Es of 31.8-21.1x and EV/EBITDA of 45.6-25.5x. Admittedly expensive, but it is justified by Mega Manunggal's:

i. Potential growth;
ii. Stable operating cash flow;
iii. Earnings qualities.

Share Data

AvgDaily Turnover (IDR/USD)	9,609m/0.73m
52-wk Price low/high (IDR)	585 - 900
Free Float (%)	24
Shares outstanding (m)	5,714714
Estimated Return	35%

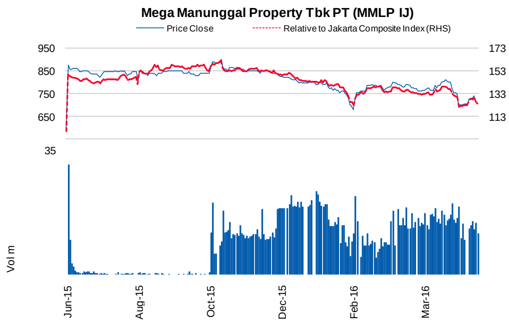
Shareholders (%)

Mega Mandiri Properti	69.3
Vasanta Investment Ltd	5.8
Hungkang Sutedja	0.7

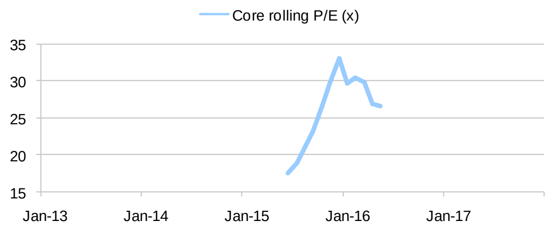
Share Performance (%)

	YTD	1m	3m	6m	12m
Absolute	(11.9)	(11.9)	(10.2)	(17.1)	
Relative	(14.9)	(10.0)	(9.9)	(23.6)	

Source: Bloomberg



Source: Bloomberg



Source: Bloomberg

Forecasts and Valuations	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover (IDRbn)	142	163	172	285	454
Reported net profit (IDRbn)	287	117	171	257	293
Recurring net profit (IDRbn)	287	117	171	257	293
Recurring net profit growth (%)	216.4	(59.1)	45.4	50.8	14.0
Recurring EPS (IDR)	71.7	24.1	29.8	45.0	51.3
Recurring P/E (x)	9.8	29.2	23.6	15.7	13.7
P/B (x)	1.95	1.58	1.48	1.35	1.23
Return on average equity (%)	24.8	5.9	6.5	9.0	9.4
Return on average assets (%)	14.4	4.4	3.9	4.0	3.9
Net debt to equity (%)	40.4	8.0	8.3	1.6	6.0
Our vs consensus EPS (adjusted) (%)			(6.7)	11.8	(0.7)

Source: Company data, RHB

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Financial Exhibits

Financial model updated on:2016-04-21

Asia
Indonesia
Property
Mega Manunggal Property Tbk PT
Bloomberg MMLP IJ
Buy

Valuation basis

We use a DCF approach, given the company's stable recurring cash flow, assuming WACC of 10.3% for our forecasted 10-year earnings. Meanwhile, our long-term value is determined by using a capitalisation rate of 5%. Our rationale for using the cap rate is to reflect its asset value at the end of 10 years.

Key drivers

The warehouse business is all about volume growth and efficiency, focusing on long-term stable cash flow while keeping operating risks low.

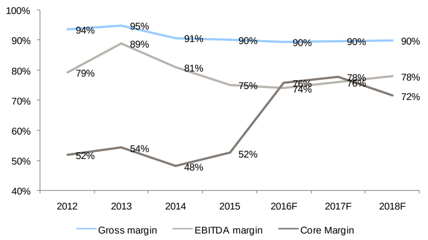
Key risks

Executing developments in a timely manner, obtaining suitable landbank and funding.

Company Profile

Mega Manunggal Property (Mega Manunggal) is a warehouse provider that supports industrial property needs in Indonesia by focusing on providing ready-built office buildings and logistics warehouses locally.

Margin trends



Financial summary	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Recurring EPS (IDR)	71.7	24.1	29.8	45.0	51.3
EPS (IDR)	71.7	24.1	29.8	45.0	51.3
BVPS (IDR)	361	446	476	521	572
Weighted avg adjusted shares (m)	4,000	4,857	5,714	5,714	5,714

Valuation metrics	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Recurring P/E (x)	9.8	29.2	23.6	15.7	13.7
P/E (x)	9.8	29.2	23.6	15.7	13.7
P/B (x)	1.95	1.58	1.48	1.35	1.23
FCF Yield (%)	(0.7)	2.3	52.9	31.2	15.0
EV/EBITDA (x)	11.9	12.8	10.8	5.1	2.3
EV/EBIT (x)	12.0	12.9	10.9	5.2	2.3

Income statement (IDRbn)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total turnover	142	163	172	285	454
Gross profit	129	147	154	256	409
EBITDA	115	123	127	217	354
Depreciation and amortisation	(1)	(1)	(1)	(1)	(1)
Operating profit	114	122	126	215	354
Net interest	(43)	(24)	4	6	(28)
Income from associates & JVs	(8)	0	0	0	0
Pre-tax profit	310	134	199	404	534
Taxation	(14)	(16)	(17)	(28)	(45)
Minority interests	(9)	(0)	(11)	(119)	(195)
Recurring net profit	287	117	171	257	293

Cash flow (IDRbn)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Change in working capital	(310)	(40)	21	(1)	(1)
Cash flow from operations	(20)	79	2,133	1,257	606
Cash flow from investing activities	(306)	(631)	(2,310)	(971)	(911)
Proceeds from issue of shares	290	986	0	0	0
Cash flow from financing activities	621	1,970	263	278	96

Balance sheet (IDRbn)	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Total cash and equivalents	11	383	469	1,033	824
Tangible fixed assets	2	13	12	11	11
Total investments	2,037	2,388	4,982	5,953	6,864
Total other assets	17	284	0	0	0
Total assets	2,139	3,204	5,612	7,195	7,969
Short-term debt	56	125	0	0	0
Other liabilities	13	17	14	20	30
Total liabilities	691	653	949	1,276	1,443
Shareholders' equity	1,445	2,548	2,719	2,976	3,269
Minority interests	3	3	1,944	2,944	3,257
Total equity	1,448	2,551	4,662	5,919	6,526
Net debt	586	203	386	94	390
Total liabilities & equity	2,139	3,204	5,612	7,195	7,969

Key metrics	Dec-14	Dec-15	Dec-16F	Dec-17F	Dec-18F
Revenue growth (%)	18.8	15.2	5.3	65.4	59.6
Recurrent EPS growth (%)	216.4	(66.3)	23.6	50.8	14.0
Gross margin (%)	90.8	90.2	89.6	89.8	89.9
Operating EBITDA margin (%)	81.1	75.1	74.0	76.1	78.0
Net profit margin (%)	202.2	71.7	99.1	90.3	64.5
Interest cover (x)	2.60	2.35	2.97	3.26	4.11

Source: Company data, RHB

Investment Thesis

Solid business model – a focus on cash flow and earnings quality. Mega Manunggal's business model focuses on recurring cash flow, a strategy that fits well in the current volatile market conditions. The company's BTS warehouses – currently 68% of a total NLA of 163,757 sqm (and likely to increase to 73% by end-2016) – help mitigate the risk of a low utilisation rate. With a 10-year lease term, Mega Manunggal's focus towards the BTS business ought to ensure that an initial 8- to 9-year payback period is achieved. This is while balancing the need to reset the rental rate at the end of the lease term. BTS warehouses yield EBITDA margins of 80-85% on a project basis. This is thanks to low operating costs incurred and the ability to generate stable recurring cash flow.

Early in the industry cycle, potential growth inevitable. Mega Manunggal's NLA target of 500,000 sqm over the next 3-4 years – tripling its current capacity from a mere 163,757 sqm – is possible, in our view. This is given:

i. Expensive logistics costs locally;

ii. Indonesia's rising e-commerce demand; and

iii. Potential from strengthening its existing market position via capacity expansion.

The company guided that it has already made advance payments for 42.5ha of landbank, which should be sufficient to add another 255,000 sqm of NLA over the next 3-4 years. If well executed, this 42.5ha of land should generate IDR182bn-195bn of EBITDA pa, or 1.6x the current EBITDA.

Mega Manunggal's distinct competitive advantages include:

i. The ability to find landbank that suits to customers' needs. This is supported by its founder's 25-year experience in landbanking, which gives the company an edge with regards to finding landbank;

ii. A 5-year track record in building modern logistics properties that are efficient and offer tenants an international standard of quality;

iii. Its partnership with one of the largest logistics companies in Japan, DHI, which could help improve its design, technical know-how and expertise in handling low-cost funding; and

iv. Its partnership with a leading global investment firm, GIC Real Estate, which should help boost its progress towards achieving 500,000sqm in NLA in the next three years.

Flexible corporate structure. Mega Manunggal has established a new company, PT Mega Tridaya Properti (MTP). All of its future expansionary activities would be done via a MTP subsidiary or through PT Mega Khatulistiwa Properti (MKP), a sub-subsidiary (Figure 24). If funding is insufficient, Mega Manunggal would have another option to initiate a rights issue at MKP level in an attempt to bring in potential investors. With each project placed under a company, the company may be preparing to inject assets into REITS in the future, if such a move is necessary. Meanwhile, since all four of its warehouses are to remain under its full control – and as most of its capex has been spent – recurring cash flow from these assets could be used to pay dividends in the future.

Initiate coverage with BUY. We initiate coverage on Mega Manunggal with BUY and a DCF-derived TP of IDR950 (35% upside) based on a 10.3% WACC and cap rate of 5% on determining long-term value. Earnings are set to grow at a 3-year CAGR of 37% due to:

i. Growing demand;

ii. Greater efficiency;

iii. High operating leverage; and

iv. An estimated tripling of capacity in three years.

Operating cash flow is sustainably positive, thanks to its positive working capital. As the company is now focused on building logistics properties that cater to specific customer needs, this should ensure that the cost of investment is returned within an 8- to 9-year timeframe.

Forecasts And Valuation

Earnings to double in three years

We expect the company's earnings to grow by a CAGR of 37% over 2015-2018, driven by:

i. Completion of Lazada's phase 1 (30,000 sqm NLA) warehouse with a 100% utilisation rate;

ii. Its rental rate increasing by 15%.

We expect Mega Manunggal to achieve 30,000 sqm, 120,000 sqm and 30,000 sqm of NLAs in FY16-18 respectively, with average monthly rental of IDR74,000-110,000 per sqm during this period. Most of the increase in rental rates would come from newly-developed warehouses and the resetting of rental rates at its Intirub Business Park (IBP) warehouses. We assume new projects to have at least a 10% yield-to-cost ratio, with an EBITDA margin of around 80-85% for BTS warehouses.

Figure 1: Assumptions for total capacity and monthly rental for FY16F-120F

Description	2014	2015	2016F	2017F	2018F	2019F	2020F
Net Leasable Area (NLA), Sqm	163,757	163,757	193,757	313,757	343,757	493,757	643,757
Additional NLA, Sqm			30,000	120,000	30,000	150,000	150,000
Rental rate/Sqm/Month (IDR)	72,220	83,198	74,037	75,614	110,145	102,524	107,061

Source: RHB

We expect operating costs to increase by 9%, 48% and 37% annually in FY16F-18F respectively, assuming:

i. A 7.5% pa increase in employees' salaries. However, we estimate that each new project would still require more employees to help monitor its progress;

ii. Around IDR2,400 per sqm would need repair and maintenance expenses each month (28% of total cost of revenue);

iii. 15% of construction cost would go towards insurance expenses, while 10% of land cost may be equivalent to the land tax that the company has to pay.

Since 65% of its costs are actually fixed, any increase of 10% in revenue ought to lead to a 1-2ppt increase in EBITDA margins. Conversely, a decline of 10% in revenue would result in a 2ppt lower EBITDA margin.

Figure 2: Scenario analysis – impact of higher/lower revenue on EBITDA margins

Base case	**FY16F**	**FY17F**	**FY18F**
Revenue (IDRbn)	172	285	454
EBITDA (IDRbn)	127	217	354
EBITDA margin	**74%**	**76%**	**78%**
Base case +10%	**FY16F**	**FY17F**	**FY18F**
Revenue (IDRbn)	189	313	500
EBITDA (IDRbn)	145	245	400
EBITDA margin	**76%**	**78%**	**80%**
Base case -10%	**FY16F**	**FY17F**	**FY18F**
Revenue (IDRbn)	155	256	409
EBITDA (IDRbn)	110	188	309
EBITDA margin	**71%**	**73%**	**76%**

Source: RHB

Figure 3: 65% of Mega Manunggal's costs are fixed

	Type	FY15	
Cost of revenue			
Insurance	Fixed	2.4	
Representation	Variable	0.3	
Office supplies and printing	Variable	0.0	
Repair and maintenance	Variable	3.9	
Securities	Fixed	2.2	
Utilities	Variable	6.9	
Others	Variable	0.3	
Subtotal		**16.1**	
Operating costs			
Salary	Fixed	15.3	
Representation	Variable	0.7	
Insurance	Fixed	0.5	
Employee benefits	Fixed	0.9	
Depreciation	Fixed	0.9	
Taxes and licenses	Fixed	3.4	
Rental	Fixed	0.4	
Office supplies and printing	Variable	0.4	
Repair and maintenance	Variable	0.5	
Marketing expenses	Variable	0.4	
Professional fee	Fixed	1.1	
Transportation	Variable	0.3	
Telecommunication	Variable	0.1	
Business trip	Variable	0.6	
Others	Variable	0.2	
Subtotal		**25.8**	
Total		**41.8**	
Fixed cost		**27.1**	**65%**
Variable cost		**14.7**	**35%**

Source: RHB

Marked-to-market asset and debt structure of the balance sheet

Under international financial reporting standards (IFRS), the company is allowed to conduct a fair value measurement of its assets on a yearly basis. This is given the nature of its business, ie leased warehouses. It justifies the need for such accounting practices for internal purposes, especially if Mega Manunggal looks to determine the value of each asset should it decide to go down the REIT path.

In our forecasts, we have estimated the value of its assets to grow 3.5% pa (2015 assets growth: 3.2%). This has led to significantly smaller changes in the fair value of its assets for 2016-2018, vis-à-vis 2014's 16%.

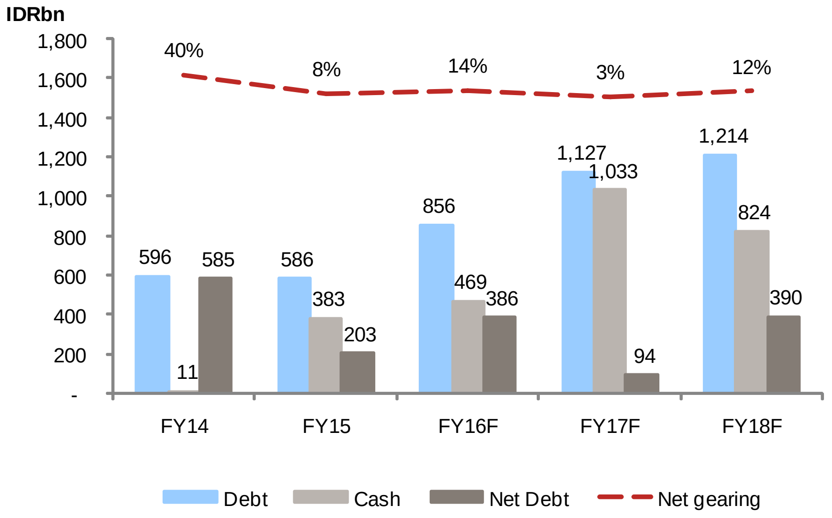
Figure 4: Changes in the fair value of assets

	FY12	FY13	FY14	FY15	FY16F	FY17F	FY18F
Investment properties (IDRbn)	1,409	1,748	2,037	2,103	2,176	2,253	2,331
Changes		24.1%	16.5%	3.2%	3.5%	3.5%	3.5%

Source: RHB

Mega Manunggal has a total of IDR586bn in debt as of last year, of which almost half is denominated in USD. This is a legacy debt, which it took over in 2011 at a (deemed) low interest rate of 5.75%. Its principal and interest have been hedged up until September. With the company capping the gearing for each of its future projects to around 50% of construction costs, we expect its debt level to double over the next three years. Yet, despite the expected higher debt level, we estimate that net gearing is likely to remain at a low 12%, due to its sustainable operating cash flow.

Figure 5: Low net gearing although debt is expected to double over the next three years



Source: RHB

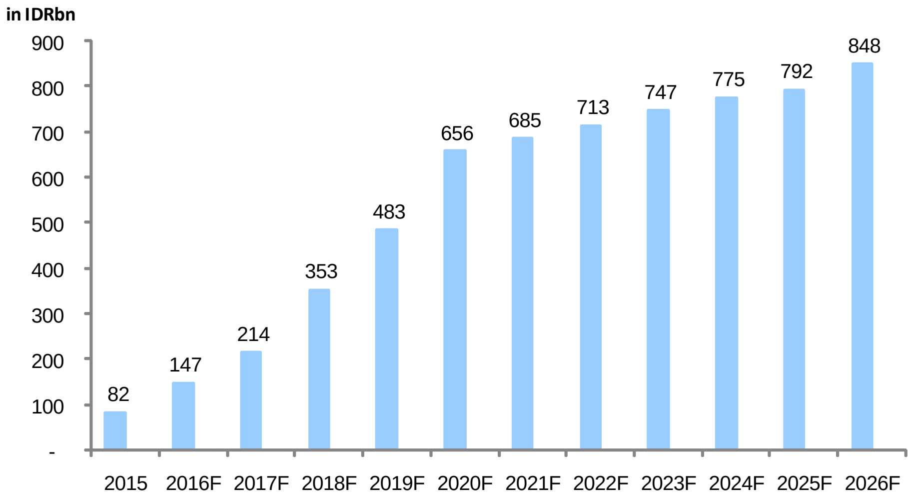
Sustainable operating cash flow

Based on our calculation, Mega Manunggal should be able to sustain its positive operating cash flow, which averages a yield of around 26% pa, over the next 10 years. Focusing on developing BTS warehouses would also help it keep its working capital positive – since BTS tenants usually pay rental a year in advance.

The company spends the most on capex, which we estimate to reach around IDR4trn in total over the next three years. Of this, IDR2.2trn would go towards construction costs and the remaining IDR1.8trn would be allocated for land acquisition. Given that such acquisitions would be settled proportionately with Mega Manunggal's strategic investors, this should once again alleviate the pressure on the company's cash spending.

If needed, additional capex could easily be funded by a strategic partner, or through the issuing of new shares.

Figure 6: Likely to sustain its positive operating cash flow…



Source: RHB

Figure 7: …thanks to its positive working capital

	2012	2013	2014	2015	2016F	2017F	2018F
Accounts receivable turnover (days)	2	8	9	148	36	25	17
Accounts payable turnover (days)	1,747	1,282	610	230	610	610	610
Cash conversion cycle (days)	(1,745)	(1,274)	(602)	(82)	(574)	(585)	(593)

Source: RHB

Valuation And Recommendation

We assume that its existing landbank (7.9ha existing landbank and 42.5ha of land area that it has already made advanced payments for) is to be developed over the next five years.

We also adopt a DCF-based valuation, given the company's stable recurring cash flow. We assume a WACC of 10.3% for our forecasted 10 years of earnings. Meanwhile, our long-term value is determined by using a capitalisation rate of 5%. Our rationale for using the cap rate is to reflect Mega Manunggal's asset value at the end of 10 years. The cap rate is based on the existing rate of its warehouses adjusted for market value. Given the lack of benchmarking on the cap rate, we used the existing yields from Unilever Indonesia's (UNVR IJ, NEUTRAL, TP: IDR42,500) warehouse. According to management, this warehouse currently offers a yield of around 5% based on its recent appraisal (according to market value) – and this is just only five years after it commenced operations.

In our valuation, we factored in the developer's partnerships with DHI and GIC Real Estate, backed by its confidence in achieving its target of 500,000 sqm NLA within three years. After deducting IDR1.9trn of an increasing minority interest portion, this results in a total equity value (EV) by end-FY16 of IDR5.4trn, or EV per share of IDR950.

Under our sensitivity analysis (Figure 8), for every 0.25ppt increase or decrease in our WACC assumption (currently at 10.3%), Mega Manunggal's EV per share should decrease or increase by 3.3%, respectively. Meanwhile, for every 0.5ppt increase or decrease of our 5% cap rate, the company's EV per share should decrease or increase by 11% or 13% respectively.

Figure 8: Sensitivity analysis

		Capitalisation rate						
		3.5%	4.0%	4.5%	5.0%	5.5%	6.0%	6.5%
	9.6%	1,570	1,352	1,182	1,046	935	843	764
	9.8%	1,525	1,312	1,146	1,013	904	814	737
WACC	10.1%	1,481	1,272	1,110	980	874	786	711
	10.3%	1,438	1,234	1,075	949	845	758	685
	10.6%	1,396	1,197	1,042	918	816	732	660
	10.8%	1,355	1,160	1,009	887	788	706	636
	11.1%	1,315	1,125	976	858	761	680	612

Source: RHB

Figure 9: Mega Manunggal's DCF valuation

		2016F	2017F	2018F	2019F	2020F	2021F	2022F	2023F	2024F	2025F	2026F
Period		0	1	2	3	4	5	6	7	8	9	10
Revenues (IDRbn)		172	285	454	607	827	845	879	898	935	956	1,028
EBITDA (IDRbn)		126	215	354	485	672	686	733	748	778	793	853
Tax expenses (IDRbn)		(17)	(28)	(45)	(61)	(83)	(84)	(88)	(90)	(94)	(96)	(103)
Changes in working capital (IDRbn)		21	(1)	(1)	(2)	(16)	(1)	(20)	(1)	(2)	(1)	(5)
Capex (IDRbn)		(2,494)	(797)	(703)	(665)	(33)	-	-	-	-	-	-
FCFF (IDRbn		(2,365)	(611)	(396)	(243)	540	601	625	657	682	697	746
PV FCFF (IDRbn)	1,228		(554)	(325)	(181)	365	368	347	330	311	288	279
PV of Terminal value (IDRbn)	6,522											
Total PV	**7,751**											
+ Cash FY16F	469											
- Debt FY16F	(856)											
- Minority Interest FY16F	(1,944)											
Equity Value (EV)	**5,421**											
No of shares, bn	5.71											
EV/Share	**949**											
Target Price	**950**											

Source: RHB

Regional comparison

Based on Figure 10, Mega Manunggal's valuation is quite premium, with P/Es for FY16F-18F nevertheless still at a 12%-45% discount to its most expensive peer, Mitsubishi Logistics Corp. Nonetheless, given its relatively higher EPS growth and ROE of 49% and 6.5% respectively for FY16F, this should warrant its premium valuation when compared with its regional peers.

Figure 10: Regional peer comparison

Regional comparison	Ticker	Price	Mkt Cap		Target	EPS growth			P/E			P/BV			ROAE	ROAA
		(lcl ccy)	(USDm)	Rating	Price	FY16F	FY17F	FY18F	FY16F	FY17F	FY18F	FY16F	FY17F	FY18F	FY16F	FY16F
Mega Manunggal*	MMLP IJ	800	347	BUY	950	49.0	48.0	13.9	24.8	16.4	14.4	0.9	0.7	0.6	6.5	3.9
Global Logistic Properties	GLP SP	1.8	6,086	NR	N/A	25.1	22.7	12.6	24.7	19.7	17.3	0.7	0.7	0.7	4.8	2.9
Mapletree Logistics Trust	MLT SP	1.0	1,766	Neutral	0.89	2.7	(8.2)	15.8	12.9	13.9	12.0	0.9	0.9	0.9	7.1	4.3
Mitsubishi Logistics Corp	9301 JP	1,443	2,337	NR	N/A	2.4	2.7	4.2	28.1	27.1	26.2	N/A	1.0	0.9	3.4	N/A
Kerry Logistics Network	636 HK	10.5	2,302	NR	N/A	9.5	9.8	6.4	15.3	13.9	13.1	1.1	1.0	0.9	8.2	5.2
Goodman Group	GMG AU	7.1	9,324	NR	N/A	7.4	6.5	5.9	17.9	16.8	15.9	1.6	1.6	1.5	9.4	6.2
Ticon Industrial Connection*	TICON TB	14.2	443	Sell	10.8	7.9	(6.7)	1.8	18.7	20.0	19.7	1.3	1.3	1.3	6.3	2.8
Avg						**9.2**	**4.4**	**7.8**	**19.6**	**18.6**	**17.4**	**1.1**	**1.1**	**1.0**	**6.6**	**4.3**
Weighted avg						**11.6**	**9.4**	**8.3**	**20.2**	**18.2**	**16.8**	**1.1**	**1.1**	**1.1**	**7.2**	**4.3**

Note: Data as at 11 May
*Note: * RHB estimates, averages exclude Mega Manunggal*
Source: Bloomberg, RHB

Focusing On Cash Flow And Earnings Quality

Mega Manunggal's business model focuses on recurring cash flow, which is a strategy that works in the current volatile market conditions. Its warehouses are divided into two types: BTS and multi-tenanted. BTS warehouses currently account for 68% of its total 163,757 sqm of NLA and are expected to increase to 73% by the end of 2016. This, we believe, should help mitigate the risks of their utilisation rates dropping to low levels. With 10-year leasing terms, Mega Manunggal's focus on developing BTS warehouses should help ensure that it meets its target of an around nine years payback period while balancing the need to reset rental rates at the end of every lease term. BTS warehouses have EBITDA margins of around 85% (on a per project basis), as their low cost of operations also helps to generate stable recurring cash flow.

Figure 11: The differences between BTS and multi-tenant warehouses

BTS	Multi-tenant
High EBITDA margins – up to 90%	Modest EBITDA margins – around 70-75%
Low operating costs: insurance, land tax and some maintenance	High operating costs: security, cleanliness, land tax, insurance, utilities and high maintenance
Long-term contract of 5-10 years	Short-term contract of 1-5 years
Stable cash flow with a typical 5% rental increase every two years	Cash flow depends on the contract, with a frequent resetting of rental rates that are higher than in the BTS segment
High occupancy level with minimal tenancy turnover	Current high occupancy rate runs risk of tenancy turnover
High probability of tenant retention	Low probability of tenant retention, unless in a prime location

Source: RHB

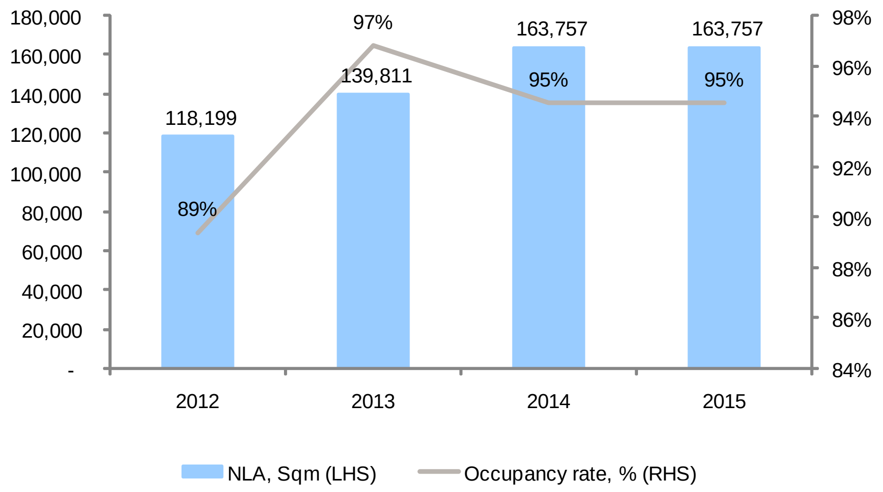
The company's warehouses currently span over c.163,757 sqm. Two of the warehouses are BTS warehouses, which cater to Unilever's and Li & Fung Ltd's needs, with a total NLA of 111,900 sqm. There is also a 5,920 sqm facility rented to Yusen with two years of rental paid in advance. In addition to this, Mega Manunggal is currently building its fifth BTS warehouse in Cibinong for one of the largest e-commerce companies in Indonesia, Lazada. Lazada's warehouse sits on 9ha of land, where the development of 60,000 sqm NLA in total is to be divided into two phases. The first phase of 30,000 sqm is expected to be delivered in 4Q16. Meanwhile, Lazada has the right of first refusal for the remaining 30,000 sqm under the second phase, which is expected to be delivered in 2018.

Figure 12: Details of Mega Manunggal's existing warehouses

Project	Land area (sqm)	NLA (sqm)	Date of contract	Months to develop	Delivery date
Built-to-suit					
Unilever Mega DC	194,297	90,288	15 Dec 2010	16 months	25 Apr 2012
Li & Fung	34,637	21,612	9 Jul 2012	11 months	15 May 2013
Lazada	90,180	30,100 (Phase 1)	8 Oct 2015	12 months	8 Oct 2016
Multi-tenant					
Intirub Business Park I	28,195	23,397 (warehouse) + 4,639 (office)	9 months		
Intirub Business Park II	32,380	13,709 (warehouse) + 4,646 (office)	18 months		
Selayar	9,164	5,620	12 months		

Source: RHB

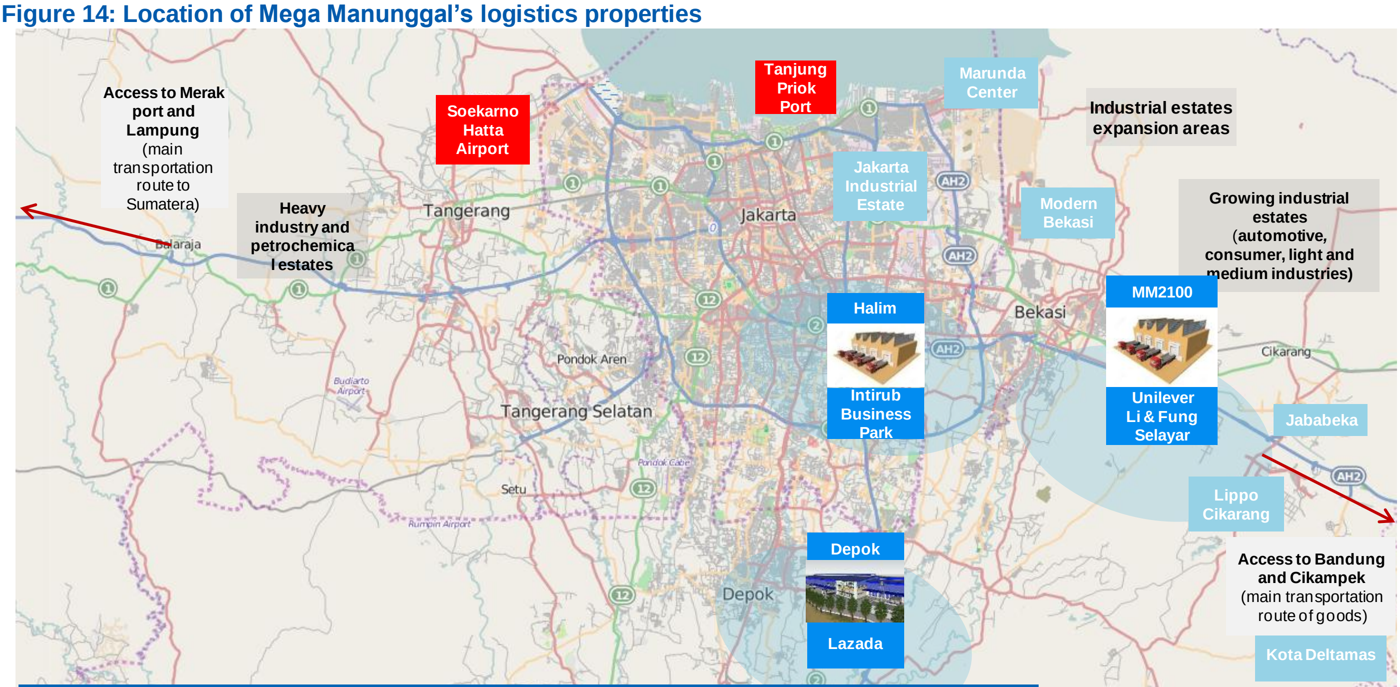
Figure 13: NLA and occupancy rates (2012-2015)



Source: RHB

As for multi-tenant warehouses, the current total NLA is c.51,857 sqm. They are located close to the Halim Perdana Kusuma Airport at the IBP. They are currently fully occupied by 23 tenants, with rental rates 21% higher than BTS warehouses' average rental rates of IDR77,237 as at Dec 2015. Given its superb location, some of Mega Manunggal's existing tenants have asked for more space, which the company cannot provide at this time, unfortunately.

Figure 14: Location of Mega Manunggal's logistics properties



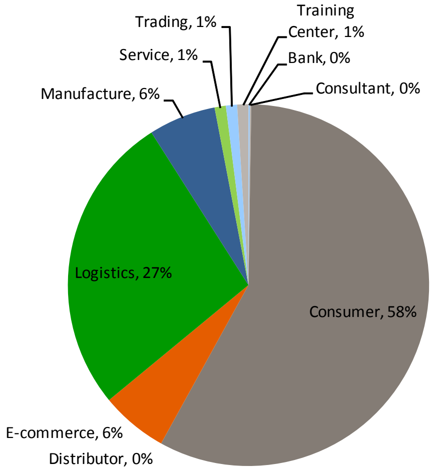
(in km)	Intirub Business Park	Unilever Mega DC	Li & Fung	Selayar	Lazada
Distance to Jakarta	0	35	35	35	22
Distance to Tanjung Priok port	22	48	48	48	43
Distance to International Airport	39	68	68	68	60

Source: Company

In our view, the prime location of multi-tenant warehouses is crucial in order to avoid the risk of a low tenant retention ratio. Amid the lower margins of this business, it still provides revenue growth, even if there are no other warehouses to be built. This is given the frequent resetting of the rental rate of 5-7% each year vis-à-vis the rental rate adjustment of the BTS segment's 5% every two years. Other actions undertaken by Mega Manunggal to mitigate its operational risks include:

i. **Making sure that all tenants are first tier clients,** or at least the largest in their respective sectors. Such a strategy reduces the risk of defaults by the tenants or the sustainability of the lease terms with the company. All new potential tenants would have undergone a due diligence process on their businesses and backgrounds;

Figure 15: Mega Manunggal's tenant profile as at 2015



Source: RHB

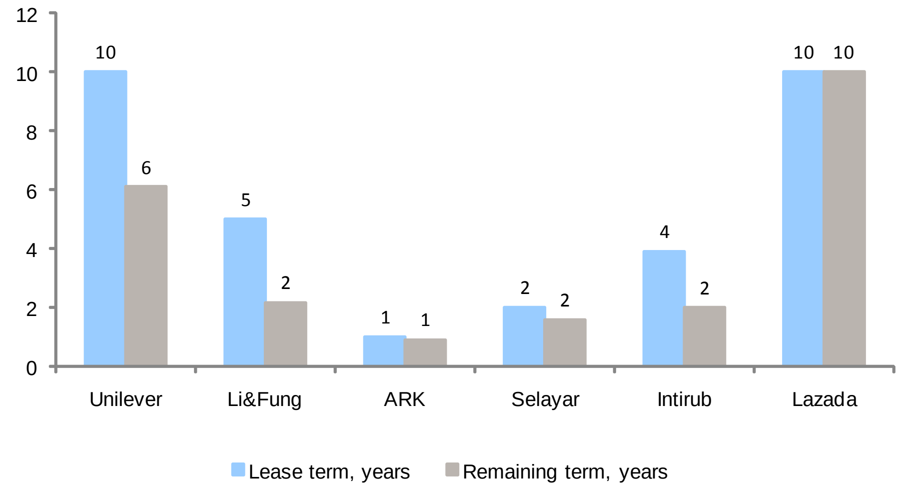
Figure 16: Mega Manunggal's clients

Source: Company

ii. **Focusing on BTS warehouse development.** All BTS warehouses have contracts of at least 5-10 years, with a 5% rental rate escalation every two years. Two benefits attached to long-term contracts are security and cash flow certainty (ensuring that investment costs are returned), and the high probability of tenancy retention;

iii. **Tenants exiting to another BTS warehouse at the end of a 5- to 10-year lease would probably not get as competitive a rental rate as Mega Manunggal's.** This is given that most of the company's capex has been incurred since the start of the lease and that investment costs have been fully returned, if not partially. Besides, the cost of new BTS warehouses to be built at the end of the lease term could never be as competitive as if they were built 5-10 years ago;

Figure 17: Lease term and remaining contract tenure



Source: RHB

iv. **But, just in case tenants were to exit,** Mega Manunggal's modern warehouses – whose specifications match those of international standards for efficiency and high throughput/turnover for first tier clients – would be suitable for similar potential tenants. They are also suitable for clients looking to improve efficiencies. Note that the option to extend the lease lies with the respective tenant; and

v. **Finally, there are terms on its contracts that we think mitigate cash flow risk.** With all BTS contracts, any tenants breaching their agreements within the lease term would have to pay the remaining balance of the terms. They also have the option to sub-lease their space to other parties, subject to Mega Manunggal's approval. This, and the 1-year advance rental payment – plus the 3-month deposit – help ensure that working capital remains positive (Figures 6 and 7).

An Inevitable Potential Growth

We believe the warehouse business is all about volume growth and efficiency, focusing on long-term stable cash flow while keeping operating risks low. While the former is attributed to the early stage in the development of modern logistics properties, the latter can be achieved through the early acquisition of landbank and effective logistics designs.

Mega Manunggal's target of 500,000 sqm in NLA over the next 3-4 years – tripling its current capacity from a mere 163,757 sqm – is possible, in our view. This is given:

i. **The expensive cost of logistics in Indonesia,** at 24% of GDP (IDR1,820trn pa), according to the Indonesian Chamber of Commerce and Industry (KADIN). By comparison, it is 15% for Malaysia and 10% each for the US and Japan. This necessitates the need for efficiency. Inevitably, the country's geographical and infrastructure challenges have resulted in costs of IDR546trn for storage/warehouses and a whopping IDR1,092trn in transportation costs pa. From a tenants' perspective, shifting warehousing costs to Mega Manunggal makes sense, in our view. This is particularly when such strategies yield a higher return on investment, creates cost efficiencies and leads to effective allocation of resources;

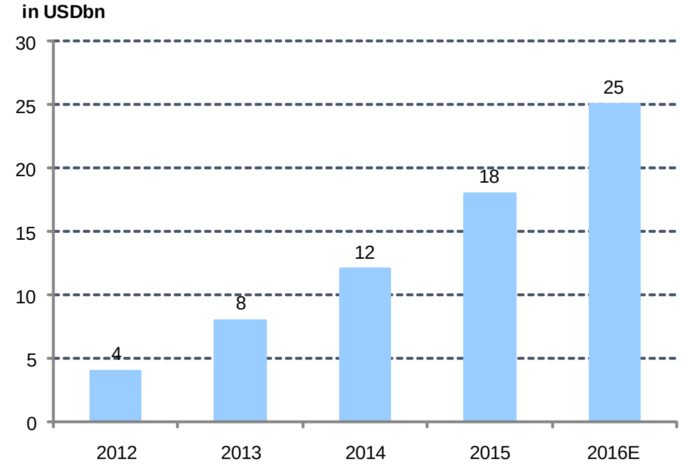
Figure 18: ROIC for FMCG companies increases if they are to lease their warehouses to third-party players

	20,000 sqm warehouse		
	Own	**Third party**	**Assumptions**
Sales, IDRbn	1,000	1,000	
Gross profit, IDRbn	500	500	Assuming a typical FMCG gross margin of 50%
Gross margin, %	*50%*	*50%*	
EBIT, IDRbn	250	234	After rental expenses are deducted
EBIT margin, %	*25%*	*23%*	
Fixed asset	100	100	Existing fixed asset
Warehouse	147		The cost of building own warehouse
Land	67		
Building	80		
Total fixed asset	247	100	
AR days	30	30	
AP days	30	30	
Inventory days	60	60	
AR	83	83	Assuming a typical FMCG AR of 30 days
AP	42	42	Assuming a typical FMCG AR of 30 days
Inventory	83	83	Assuming a typical FMCG AR of 60 days
Work cap	125	125	
Annual rental, IDRbn		16	Assuming a IDR65,000/sqm/month
ROIC	67%	104%	

Source: RHB

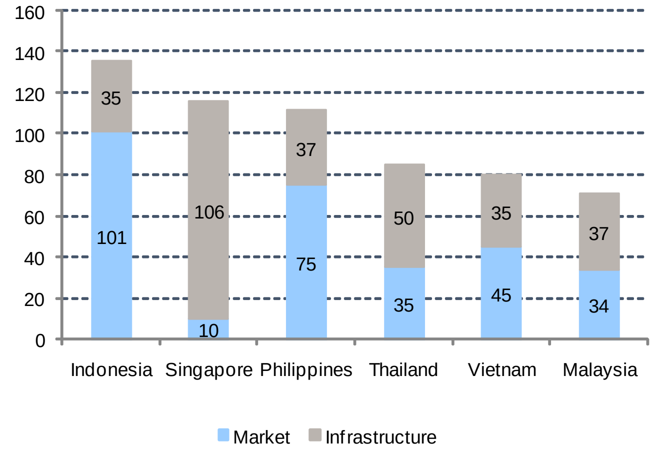
ii. **Indonesia's rising e-commerce demand.** This was a USD8bn market in 2013 and is likely to triple this year, according to Vela Asia Research. Delivering products to customers is already a big challenge in this country, what more the speed of delivery, which is as important as product quality. Arguably, this requires e-commerce players having warehouses located closed to customers.

Figure 19: Local e-commerce market size to triple from 2013



Source: Vela Asia Research

Figure 20: Indonesia the most e-commerce ready country in ASEAN



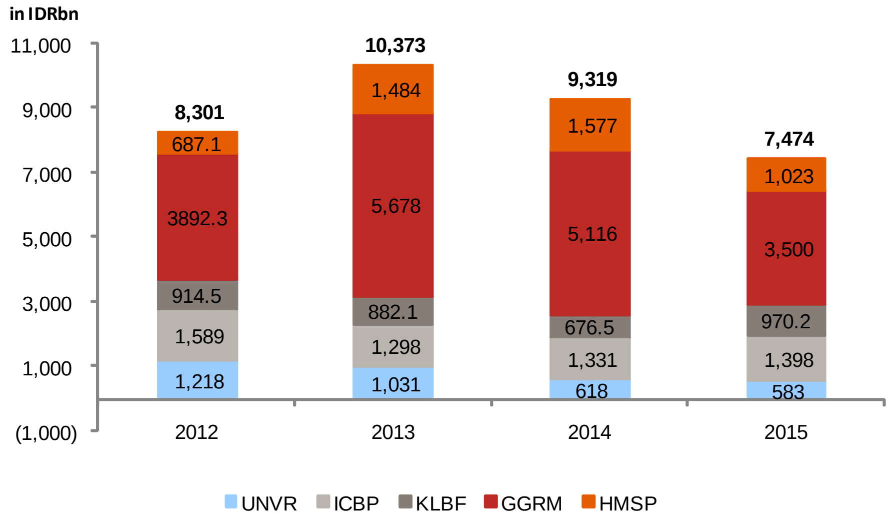
Source: Vela Asia Research, World Economic Outlook 2013, eMarketer (2013), Association of Internet Service Providers survey (Jul 2012)

For Mega Manunggal, some of its e-commerce tenants, eg aCommerce, MatahariMall.com and Singapore Post (SingPost), have already occupied 12,000 sqm at its IBP warehouses. These tenants have, in fact, asked for more space at the same location – a request that the company has not been able to be meet at this time. The latest addition of 30,000 sqm for Lazada's warehouse is likely to increase Mega Manunggal's e-commerce tenants' contributions to overall revenue to 32% from 6% currently (Figure 15). This should be higher (c.36%) if Lazada exercises its option to have another 30,000 sqm in the same location by 2018. This would place e-commerce tenants as the second-largest contributor to the company's topline.

The key here is Mega Manunggal's flexibility in searching for landbank, which caters to the location needs and specifications of potential tenants. In our view, this allows it to stand out amongst its competitors, if any. This is particularly so when it comes to building logistics properties for e-commerce businesses, which need to strengthen their market position through capacity expansion. This is to ensure that market share is sustained, if not increase.

The point is that these existing multi-national companies need to increase their penetration rate to reach all customers amidst a scenario of geographical limitation. This is via an efficient and effective distribution system, in our view. As such, we have seen consumer companies spend around IDR27.2trn in total for capex over the past three years. With that in mind, warehouses would have to keep up with such production expansions as well.

Figure 21: Total capital spent by consumer firms over the past three years



Source: Companies data

Different distribution strategies have also been adopted. Previously, most manufacturers sent their products to buyers' warehouses on the outer islands at the expense of a slow turnover, ie an around 5.5-day gap for goods to be cleared at ports on top of 2-3 weeks of shipment time. Now, most of the large multinational manufacturers have sought out Mega Manunggal to build warehouses on Indonesia's outer islands to help them expedite their deliveries and to maximise distribution whilst reducing their own working capital. The key question, however, is whether the company has the capability to locate land outside Java on a timely basis.

Regardless, now that Mega Manunggal has already made an advance payment for 42.5ha of landbank (mostly in the Bekasi area), this should be sufficient to add another 255,000 sqm of NLA over the next 3-4 years. Assuming a market rental rate of IDR70,000-75,000 per sqm per month, an EBITDA margin of 80% and yield-to-cost of at least 10%, this landbank – if well executed – could add an additional IDR171bn-184bn of EBITDA annually. This 1.4-1.5x its current EBITDA levels. With an 8-year payback period, this 42.5ha of land ought to lead to total cash of IDR859bn-966bn by the eighth year. This could be sufficient to add another 28-31ha of landbank, assuming land prices increase by 5% pa.

Figure 22: Mega Manunggal's 42.5ha landbank could add another IDR171bn-184bn to EBITDA

	Rental price, IDR/sqm/month		
	Low	**High**	**Assumptions**
Land bank, sqm		425,000	Down payment for land price already made – excluding Lazada
Building, sqm		255,000	Assuming 60% building coefficient
Rental, IDR/sqm/month	70,000	75,000	Market rental is based on 10% yield-to-cost
Revenues, IDRbn	214	230	
EBITDA, IDRbn	171	184	Assuming 80% EBITDA margin
Debt, IDRbn	574	574	Assuming 50% of construction cost
Interest, IDRbn	63	63	Assuming 11% interest cost
Total debt + interest, IDRbn	637	637	
Cash flow in 8th year, IDRbn	1,496	1,603	Assuming 5% rental increase every two years
Net cash flow after debt repayment, IDRbn	859	966	

Source: RHB

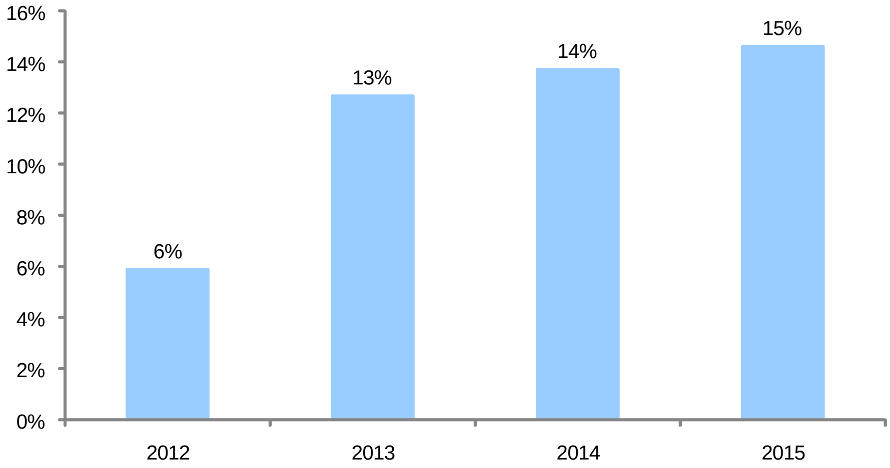
Volume aside, cost efficiency is another of Mega Manunggal's focus in sustaining its yield-to-cost level. While the running level is currently around 15%, new projects would be targeted to have at least 9-10% yield-to-cost initially, depending on client and location. These yields appear to be modest, but increasing them is more likely, given:

i. **Mega Manunggal's early acquisition of land,** which contributes around 40% of total development costs. These early-acquired landbank would have generated an additional 1-2% additional yield if developed in 2-3 years, thanks to the higher market rental rate;

ii. **Its high operating leverage,** with 65% of its operating cost basically fixed (Figure 3). Of this fixed cost, 57% is for employee salaries. So long as greater volume is attained, we believe EBITDA margins could reach 75-85% at least. Since its IPO, we have seen Mega Manunggal's salary costs increase. This has been attributed to the establishment of its marketing team. This year, the company plans to add senior people to its engineer team, ie the team that has been the backbone for Mega Manunggal's efficient warehouse designs; and

iii. **Its better construction design.** Around 70% of total construction cost is based on the structure, with the remaining costs related to the foundation on which the structure is built upon. Construction efficiency, therefore, is dependent on land quality, the flow of goods and the materials used in construction.

Figure 23: Mega Manunggal's running yield-to-cost from four existing assets



Source: Company data

Distinctive Competitive Advantages

We believe Mega Manunggal's distinctive competitive advantages include:

i. **Its ability to find landbank that suits its customers' needs.** Unlike industrial estate players – which bring tenants to their respective estates – the company has greater flexibility in providing landbank to its clients in various locations. Mega Manunggal's founder has 25 years in landbanking, and this experience gives the company an edge when it comes to finding landbank;

ii. **It has a track record in building modern logistics properties** despite being a young company (it has only been five years since it was established). Its efficient designs provide clients with properties that meet with international standards of quality. Mega Manunggal has the ability to design warehouses that maximise tenants' throughput, which generates savings for such clients. This is particularly notable when you consider that each tenant has different input as to the way they handle their respective products;

iii. **Its partnership with one of Japan**'s **largest logistics companies.** Mega Manunggal's partnership with DHI is an advantage, in that the latter can help the company to improve its design, garner technical know-how and secure low-cost funding provisions;

iv. **Its recent partnering with GIC Real Estate** ought to also bring value-add. This is in terms of the latter's knowledge and experience investing in the logistics business in Asia and other global markets.

Tripling Capacity: The Art Of Funding And Cash Recycling

Mega Manunggal operates a high capex business, with the company estimated to require around IDR6.2m-9.7m for each sqm of NLA, depending on the location. For example, to develop its 42.5 ha landbank, it would require around IDR1.1bn-1.3bn in capex. This is aside from the probable c.IDR765bn-935bn in terms of the cost of buying the land. So the key question is, how would Mega Manunggal fund all its expansion?

We believe the company's flexible corporate structure has its own advantages when it comes to raising the initial funding needed. This is until it reaches economies of scale, or 3-4 years' time, in our estimate. This is because this is period where cash generated would be sufficient to roll out further expansion.

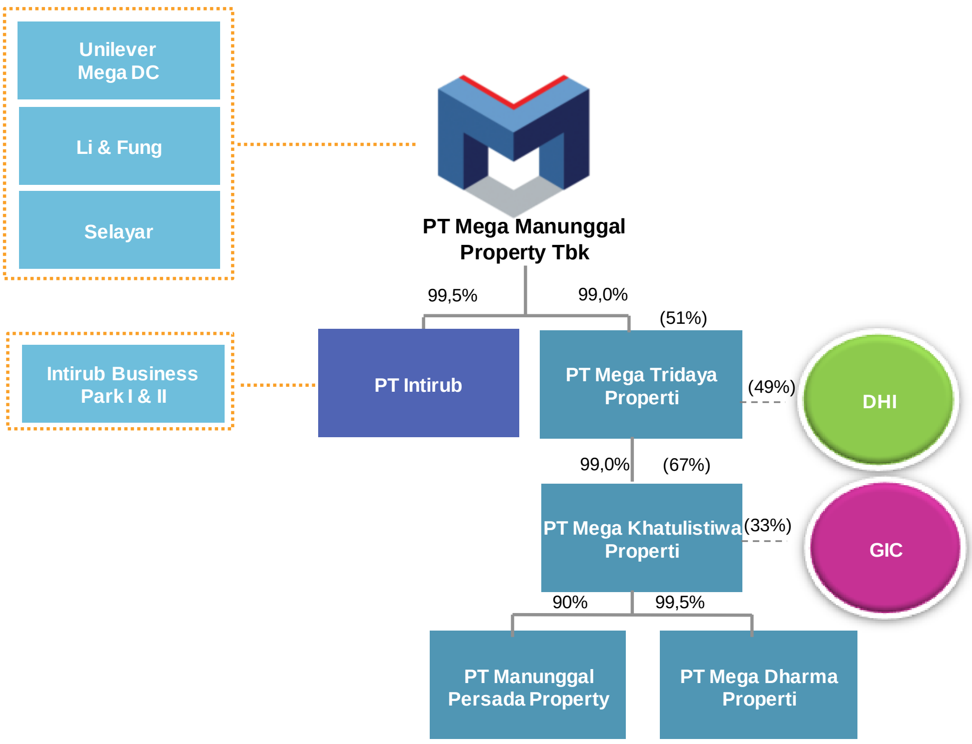
Management said it has established a new company, MTP, in which it would have a partnership with DHI for up to a 49% stake. The idea is for Mega Manunggal to have lower cost of funds, gain technical know-how and bring initial growth to achieve a scalable size of 365,000 sqm of NLA – by which time the company should have sufficient cash flow to sustain its growth.

All of this future expansion would be done under another subsidiary of MTP or by MKP, a sub-subsidiary. Note that Mega Manunggal has also signed an agreement with GIC Real Estate for a 33% stake in MKP.

If funding is not sufficient, the company has the option to undertake a rights issue at MKP level, which would bring in other potential investors. With each project placed under a company, Mega Manunggal is preparing for a future REITS option, if need be. This is aside from monitoring the cash flow and performance of each individual project.

What is interesting is the fact that all four of the company's existing warehouses are to remain under its full control. And, given that most of its capex has been spent, recurring cash flow from these assets could be used for future dividend payments. These assets are currently generating IDR123bn in EBITDA pa and are likely to increase to around IDR673bn, going forward.

Figure 24: Mega Manunggal's corporate structure allows for flexible funding



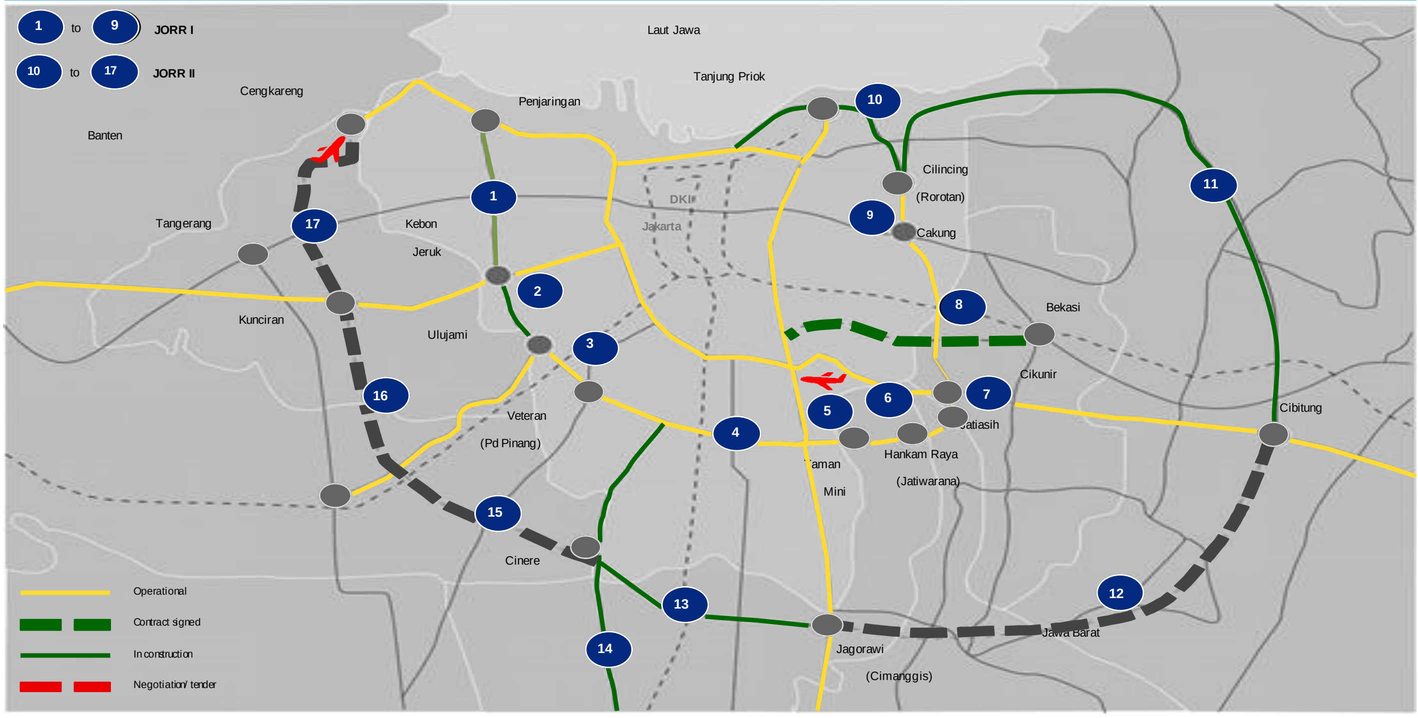
Source: Company

Strategies

Mega Manunggal is to continue to look for available landbank in good locations. The landbank acquisition strategy would differ from location to location. For example, management shared that it is willing to pay a down payment for land located in Bekasi. This is because the land is at the junction of where the road network connects the ports, inner city and east side of the city, where almost 60% of manufacturing facilities in the country are based.

Figure 25: Mega Manunggal's properties are located closer to consumers

Located in Java Island that is the centre for industries with the largest industrial estates in Indonesia



Source: Company

Any other land acquired outside of the Bekasi area would be dependent on the commitment of Mega Manunggal's potential clients. This strategy is to reduce the risk of having to own the land without being able to monetise it. For now, the focus is to remain on Java Island before any thoughts of venturing into Indonesia's outer islands.

All land acquired is to be free and clear. This means that such land should meet the regulated zoning requirements, and all documentation should be clear of mortgages and conflicts before payment is settled. Due diligence is likely to take six months, during which time Mega Manunggal's marketing team is to search for potential tenants. Soil tests are also an important factor for every land acquisition. This is because it could effectively save construction costs, particularly on the foundation.

To mitigate the risk of losing tenants that look for immediate space, the company is to build a 35,000 sqm NLA double-decker sheltered warehouse in 1H16. The idea is for these potential tenants to temporarily utilise this warehouse until their BTS warehouses are ready.

To achieve volume and efficiency, Mega Manunggal is to continue to strengthen its marketing and engineering teams. Most of the hiring for the marketing team was completed late last year. This year's focus is on building its engineering team to improve design and construction efficiency.

The company continues to match its cash flow for further expansion amidst partnerships with DHI and GIC Real Estate. This should be more than sufficient to achieve the target of 500,000 sqm in NLA, in our estimates, within the next 2-3 years.

Key Risks

We believe key risks for Mega Manunggal are:

i. **Timely execution.** It takes roughly around 9-18 months of construction before earnings are realised. Any delays to construction could lead to lower earnings and possibility cost overruns;

ii. **Availability of landbank.** As much as the company has greater flexibility in getting land in any location, it runs the risk of losing tenants if it takes time to secure the needed landbank. Even if there is available landbank, it takes time for Mega Manunggal to do a complete due diligence;

iii. **Funding.** The ability for Mega Manunggal to increase its yields would depend on its ability to secure funding, either for land or construction, on a timely basis;

iv. **Loss of potential clients.** The company said it has lost several tenants due to unavailability of space or long waiting times. To mitigate such risks, Mega Manunggal is to build a 35,000 sqm sheltered warehouse that potential tenants can lease temporarily while their needed warehouses are being built. The building of the company's sixth warehouse is to start next month;

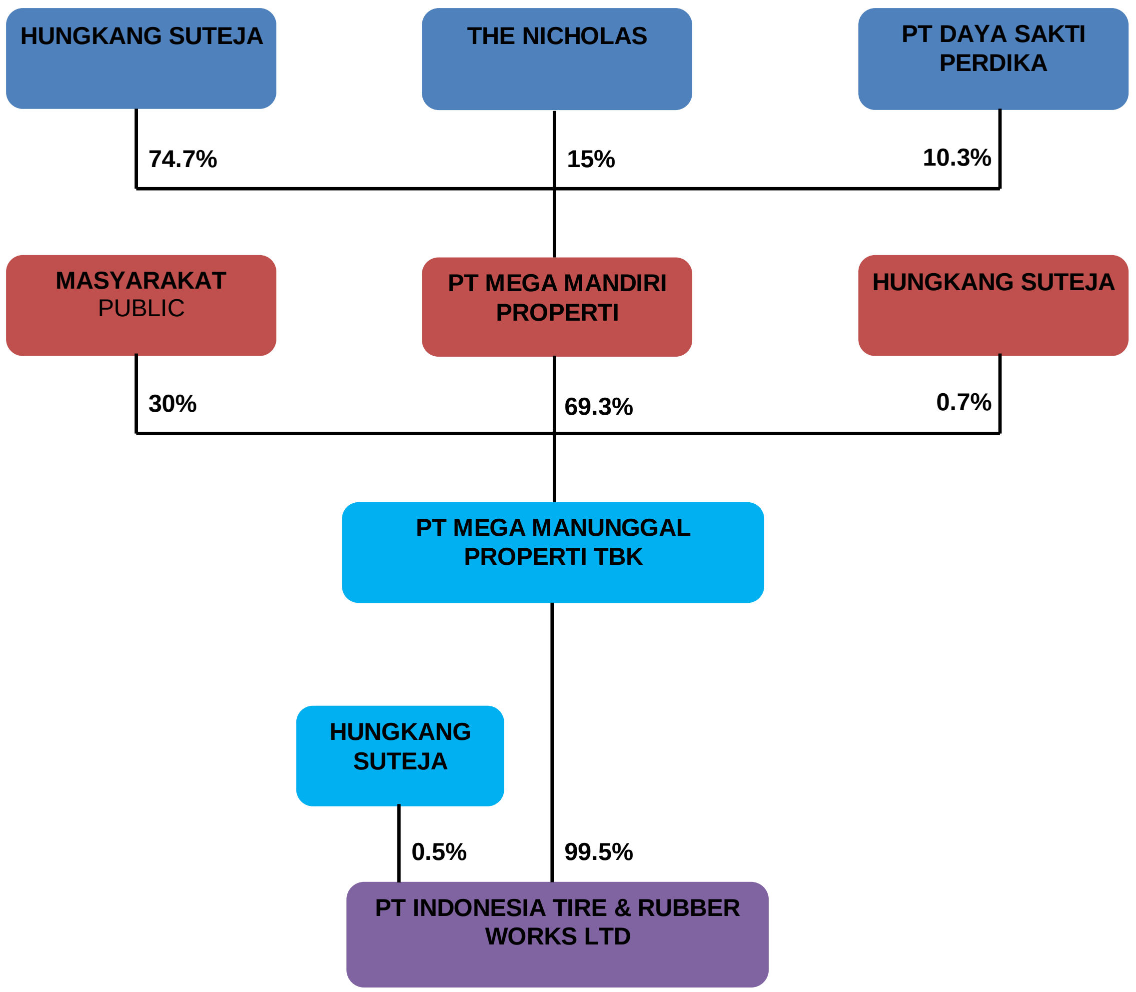
v. **Tenancy turnover.** While Mega Manunggal has long-term contracts for its BTS warehouses, it still runs risks of losing tenants at the end of the lease term. This possibility would further increase for its multi-tenant warehouses; and

vi. **High operating cost, particularly repair and maintenance.** While most of the repair and maintenance is borne by the BTS tenant, particularly when damages are due to their operational activities, Mega Manunggal would still need to incur additional repair and maintenance cost when it comes to structural damages to its warehouse assets.

Appendix

Mega Manunggal's majority shareholder – as at 26 Apr – is PT Mega Mandiri Properti. Its ultimate owners are Mr Hungkang Suteja, Mr The Nicholas and PT Daya Sakti Perdika. The company owns a subsidiary, Indonesia Tire & Rubber Works Ltd, that operates in the property developing and real estate business.

Figure 26: MMLP's shareholder structure



Source: Company data

Figure 27: Mega Manunggal's management board

Name	Position	Description
Mr Fernandus Chamsi	President director	Mr Chamsi has served as a director since 2015. He is responsible for the activities of the company as a whole. He graduated with a degree in Economics from the University of Pancasila, Jakarta, in 1994. Mr Chamsi previously served as senior manager of the pulp & paper division of the Sinar Mas Group (1997-2002); general manager at Agro Manunggal Group (2002-2003); vice president, head of commercial division at Petronusa Interindo (2003-2004); senior vice president, corporate finance at Indika Energy (2003-2010); group managing director at Uresources (2011); and a member of the audit committee of Bekasi Fajar Industrial Estate (2012-Mar 2015).
Mr Johny Johan	Director	Mr Johan has served as a director since 2010 and was reappointed to this role in 2015. He graduated from Trisakti University in 1981 and graduated with a Master of Engineering from the Asian Institute of Technology, Bangkok, Thailand in 1989. Mr Johan also has a Master of Management (MM) from Prasetya Mulya, Jakarta (1995); and a PhD in the field of project management from Tarumanagara University, Jakarta (2011). He previously served as an advisor to the Agung Sedayu Group and Great Podomoro Group (2001-2007), and development director at Danayasa Arthatama (1998-2007). Mr Johan also works as a part-time lecturer at Tarumanagara University (1990-present), and previously worked at Trisakti University (1983-1987), Atma Jaya University Yogyakarta (1995-2010), and the Asian Institute of Technology Vietnam Chapter on Project Management, Hanoi (2007-2012).
Mr Bonny Budi Setiawan	Independent director	Mr Setiawan was appointed as an independent director in 2015. He is in charge of finance and operations. Mr Setiawan holds a Bachelor of Business Administration in Accounting and Finance from Simon Fraser University, Canada (1997). He previously served as executive director at UBS Securities Indonesia (2011-2015), senior vice president at Danareksa (2010-2011), vice president of research at Danareksa (2009-2010), vice president of research at Merrill Lynch (2007-2008), vice president of research at CIMB-GK Securities (2007-2008), assistant vice president of research at Danareksa (2005-2007), supervisor consultant in financial advisory services (FAS) in Prijohandojo Boentoro & Co (2003-2005), research analyst at Panin Securities (2002-2003), and export supervisor at Tjiwi Chemical Plant Paper (1998-2000).

Source: RHB

Figure 28: Mega Manunggal's board of commissioners

Name	Position	Description
Mr Hungkang Sutedja	President commissioners	Mr Sutedja has been president director since 2010 and was reappointed to this role in 2015. He graduated from the University of Missouri, Columbia, to the Department of Finance in 1993. Mr Sutedja currently serves as president director of Bekasi Fajar Industrial Estate (since 2003), Bekasi Matra Industrial Estate (since 2011), commissioner of Putra Manunggal Energy (since 2008), commissioner of Delta Mega Persada (since 2007), director of Manunggal Prime Development (since 2007), director of Daya Sakti Perdika (since 1999), and director of Megalopolis Manunggal Industrial Development (since 1996).
Mr The Nicholas	Commissioner	Mr The has served as commissioner since 2015. He earned his Bachelor of Arts while majoring in international marketing from the University of Missouri, Columbia (1991). Mr The currently serves as commissioner of Alam Sutera Realty (since 2015), vice president commissioner of China Taiping Insurance Indonesia (since 2013), president commissioner of Agro Manunggal Land Development (since 2013), director of Agro Manunggal Triasta (since 2013), president commissioner of Poultry Mangosteen (since 2005), and commissioner of Variety Metal Industrial (since 1993).
Mr Abdul Rahim Tahir	Independent commissioner	Mr Tahir has been appointed as an independent commissioner since 2015. He holds an MBA in Strategic Marketing from the University of Hull (2002). Mr Tahir previously served as vice president at DHL Supply Chain Asia Pacific – certified supply chain specialist (CSCS) programme (2014-2015), managing director at DHL Supply Chain Indonesia (2006-2014), chief operating officer at Rapex Wahana (RPX) Group Indonesia (2002-2006), managing director – supply chain services, South Pacific Region at Federal Express Pacific Inc (1999-2001), general manager – supply chain services, South Pacific Region at Federal Express Pacific (1996-1999), and director of business planning in Concord Express International (1994-1996)
Mrs Debbie Ana Sumargo	Independent commissioner	Mrs Sumargo was appointed as independent commissioner in 2015. She graduated with a Bachelor of Science in Accounting with Honours from California State University, Long Beach, California in 1987. She also graduated with an MBA in Finance from Loyola Marymount University Graduate School of Business, Los Angeles, California, US in 1990. Mrs Sumargo previously served as financial controller at Kedoya Adyaraya (2009-2013), advisor at Bekasi Fajar Industrial Estate (2011-2015), chief financial officer at Usahatama Mandiri Nusantara (2009-2011), general manager finance & accounting division at Bekasi Fajar Industrial Estate (2009-2011), general manager of the accounting division at Polyprima Karyareksa (1996-2009), general manager of the accounting division at Polypet KaryaPersada (1996-2009), and accounting manager at Black & Veatch International Indonesia (1994-1996).

Source: RHB

SWOT Analysis

S

- Its ability to find landbank that suits customers' needs, backed by the founder's landbanking experience, while its track record in building modern logistics properties – with international standards of quality – provides efficiency to its tenants
- Partnership with Daiwa House Industry (DHI) and GIC Real Estate

W

- The warehouse business is about volume growth, thus, limited funding may hold back potential growth

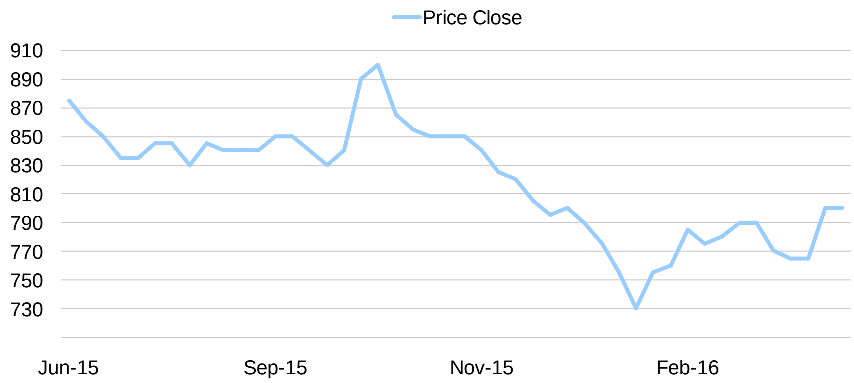
O

- Indonesia's rising e-commerce demand
- Indonesia's expensive logistics costs result in the demand for warehouses to creates cost efficiencies as well as effective allocation of resources

T

- Timely execution
- Availability of landbank
- Loss of potential client
- Tenancy turnover
- Macroeconomic downturn

Recommendation Chart



Source: RHB, Bloomberg

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