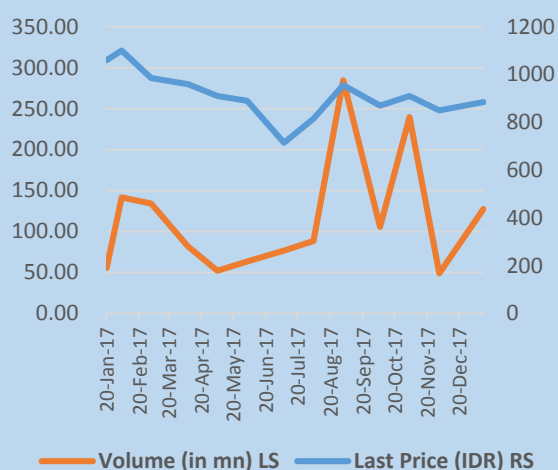


26 January 2018  
Integrated Steel industry, Equity

Price IDR. 520  
Target Price IDR. 720  
JKSE Index 6615.328



Stock Code  
Bloomberg code KRAS IJ  
Market cap (IDR.bn) 2,671.3  
52-Week High (IDR) 785  
52-Week Low (IDR) 334  
6-m Avg Daily. Val (IDR) 500  
Free Float (%) 20

Major Shareholders (%)  
Government 80%  
Public 20%

USD/IDR-YE  
2017A 13548  
2018F(Avg) 13,439

Key Indicators 2018F  
ROE (%) 2.30  
Debt/ Equity (x) 1.43  
Current ratio (x) 0.79

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### Investment Consideration

#### 63% increase in Hot steel mill capacity

PT Krakatau Steel (Persero) Tbk (KRAS), the largest integrated steel producer in Indonesia plans to dominate in the domestic market by expanding its Hot Steel Mill (HSM) # 2 with additional capacity of HRC of 1.5 mn tons. As of 9M17, KRAS has completed the detailed engineering mechanical equipment for HSM#2 and physical development has reached 35.93%. KRAS is targeting completion by 1H19. After the expansion, total hot steel mill capacity will be 3.9 mn tons or increase 63% and in total rolling mill capacity will increase from 3.15mn tons to 4.65mn tons or 48% by 2019. As of 2016, the portion of steel imports reached 54% while as of 1H17 KRAS has a market share for its products including HRC of 35.85%, CRC 25.37% and WR 3.92%. We believe increasing its steel production capacity would limit steel imports, cover the local supply shortage, and increase domestic market share.

#### Expects better margin

KRAS is targeting better margins in 2018 from an increase in top line due to higher average selling price of all steel products and also through an efficiency program in 2018 which includes a blast furnace complex which as of 9M17 reached 99.43% completion and will be finished this year. KRAS is targeting "first blow in" of blast furnace starting 1Q18. Efficiency also come from the procurement of raw materials and energy at a lower cost, overhead cost efficiency, and a reduced financial expenses program. KRAS also plans to conduct bond issuance this year as part of capital restructuring. We are targeting within 2017-2018 EBITDA margin of KRAS will average 17% with 2018 net profit margin of 2.55% compared to net loss in 2017.

#### Valuation: 38% upside

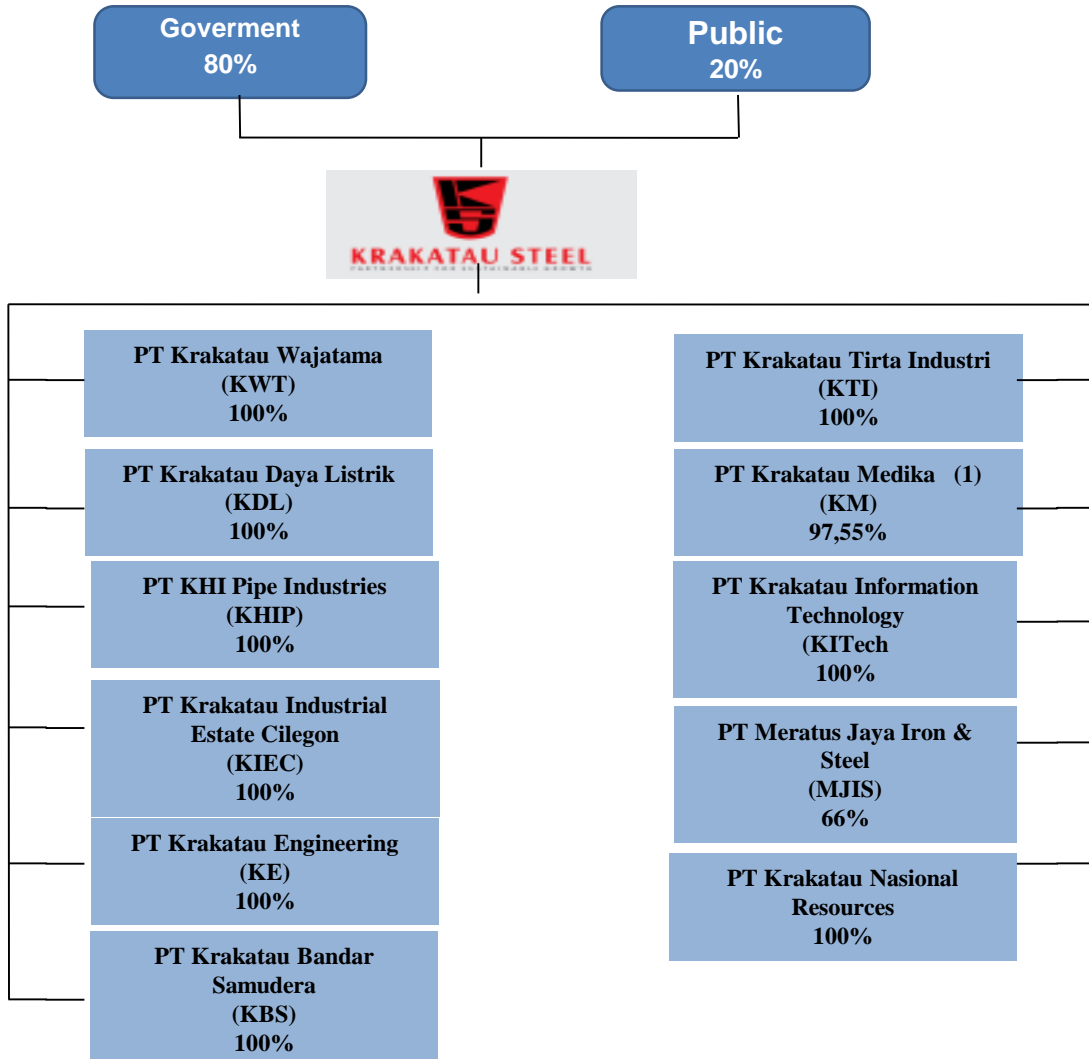
Based on DCF, with WACC 9.0%, we are targeting within one year KRAS target price of IDR. 720/share or trade at 22.7x PER. An increase of 38% upside potential, we give recommendation to BUY.

Profit and Loss (US\$.mn)	2014A	2015A	2016A	2017F	2018F	2019F
<b>Revenues</b>	<b>1868.85</b>	<b>1321.82</b>	<b>1344.72</b>	<b>1351.49</b>	<b>1777.18</b>	<b>2090.19</b>
Cost of revenues	(1827.51)	(1358.26)	(1189.49)	(1170.61)	(1362.27)	(1637.13)
<b>Gross Profit</b>	<b>41.33</b>	<b>(36.43)</b>	<b>155.23</b>	<b>180.88</b>	<b>414.91</b>	<b>453.06</b>
Operating expense	(112.19)	(147.12)	(150.84)	(175.69)	(195.49)	(229.92)
<b>Operating Profit</b>	<b>(70.85)</b>	<b>(183.55)</b>	<b>4.39</b>	<b>5.19</b>	<b>219.42</b>	<b>223.14</b>
Other income	(112.13)	(143.91)	(196.09)	(135.15)	(177.72)	(167.21)
<b>Pretax income(PBT)</b>	<b>(182.99)</b>	<b>(327.46)</b>	<b>(191.70)</b>	<b>(129.96)</b>	<b>41.70</b>	<b>55.92</b>
taxes	28.80	0.94	10.98	7.80	(2.50)	(3.36)
Non-Controlling interest	7.07	6.49	9.03	4.60	6.04	7.11
<b>Net Profit</b>	<b>(147.11)</b>	<b>(320.03)</b>	<b>(171.69)</b>	<b>(117.57)</b>	<b>45.24</b>	<b>59.67</b>
EPS	(0.0093)	(0.0203)	(0.0101)	(0.0061)	0.0023	0.0031
<b>EBITDA</b>	<b>(0.22)</b>	<b>(109.41)</b>	<b>98.32</b>	<b>159.30</b>	<b>388.06</b>	<b>413.42</b>

**Company Profile**

PT Krakatau Steel (Persero) Tbk (KRAS) was founded in 1970 with its headquarter located in Cilegon. The company along with its subsidiaries, engages in the production and trading of iron and steel products in Indonesia and internationally. KRAS operates in five segments including Steel products, real Estate and Hotels, Engineering and Construction, Port Services, and Other Services. The steel products segment is primarily involved in production and sale of steel products such as HRC (hot rolled coils), CRC (cold rolled coils), Wire Rod, Steel Bar, Steel Section, and Steel pipes (Spiral and ERW) as well as the provision of services related to steel, including coating and tolling services. The Real estate and Hotels segment develops and sells industrial estates, and hotels and sport facilities. The engineering and Construction segment is involved in the construction, industrial engineering, planning, and contracting of various types of buildings; export and import of goods; and provision of services and software related to the aforementioned activities. The Port Services Provider segment offers pier services for berthing, loading, and unloading goods and containers; and sea port support, warehousing, and transport services. The Other Services segment provides information technology, medical, electricity, and water distribution services for industrial and residence needs. In terms of supply sector projects, KRAS mainly supplies its products to Infrastructure (Roads & Bridges) and Energy (Gas & oil pipes and electricity towers) sectors.

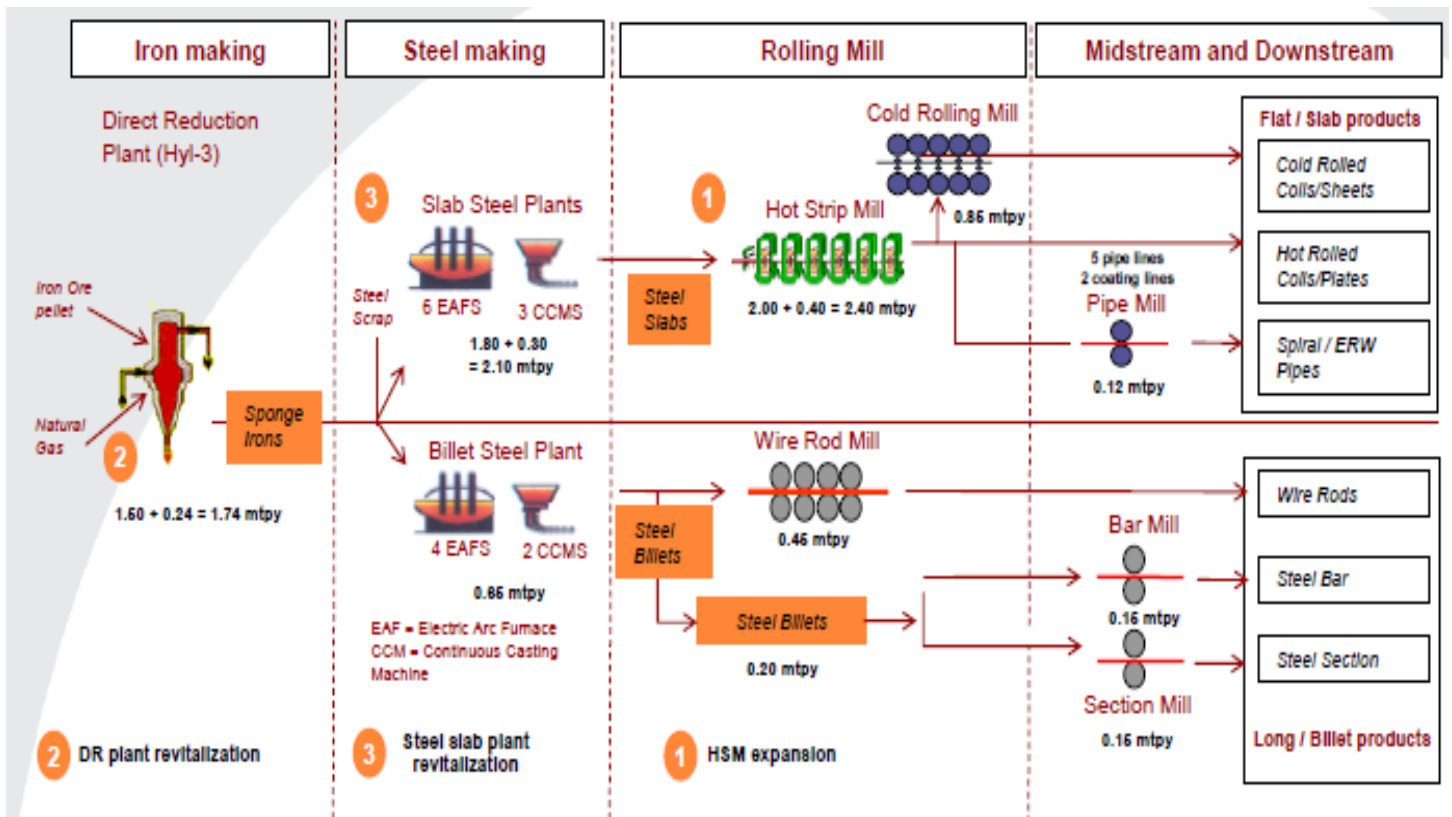
**Company Structure**



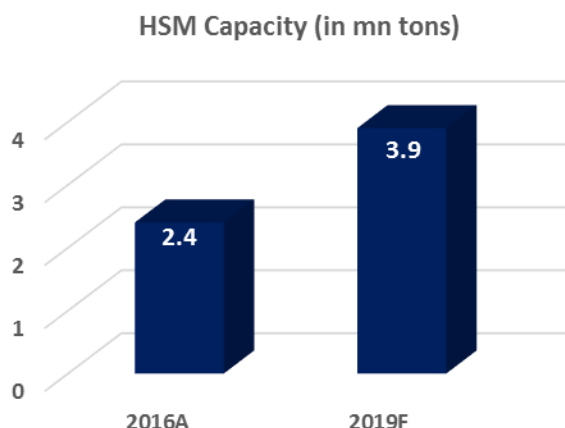
**Steel price outlook 2017-2018**

In 2018, the Worldsteel Association expects global growth to moderate mainly due to slower growth in China while in the rest of the world, steel demand will continue to maintain its current momentum. Chinese supply is a wildcard for prices, Since November 2017 until March 2018, the Chinese Government decided to cut back steel production 50%. The production cuts are part of a series of production suspensions in China's rust belt that will take effect within months as environmental authorities chase public commitments to lower the concentration of particulate matter by 22%. The measures have already reduced cooking coal production where as the result cooking coal prices also have risen. Domestically, demand for steel is strengthening amid fluctuation in global steel prices. In term of KRAS' prices, the rally in Krakatau Steel's HRC selling price stalled in mid June 2017 and price began its downward move since then. HRC price regained footing and reached US\$599/ton as of 30 September 2017 after bottoming out at US\$577 early in August. In terms of average price, the company's HRC average selling price grew 33.33% YoY to US\$583/ton in 9M 2017 from US\$437/ton in 9M 2016. The strengthening steel prices is triggered by restocking inventory and strong demand from the housing construction sector in China. We believe, China's government plan for reducing steel production of 100-150 million tons in the next 5 years also gave a positive sentiment to strengthen global steel prices in foreseeable future.

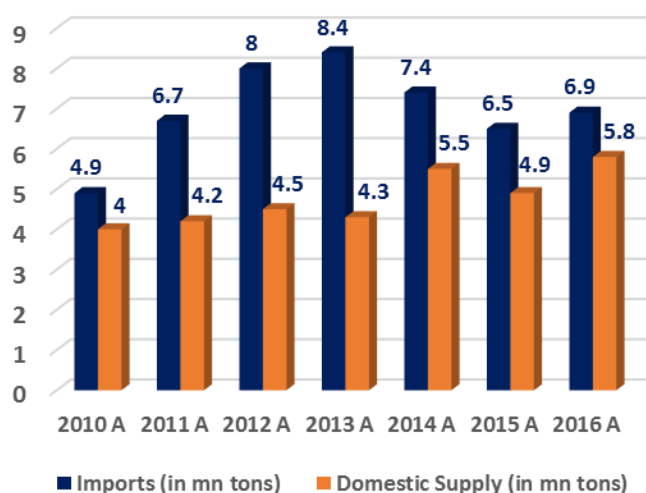
**Steel production process**



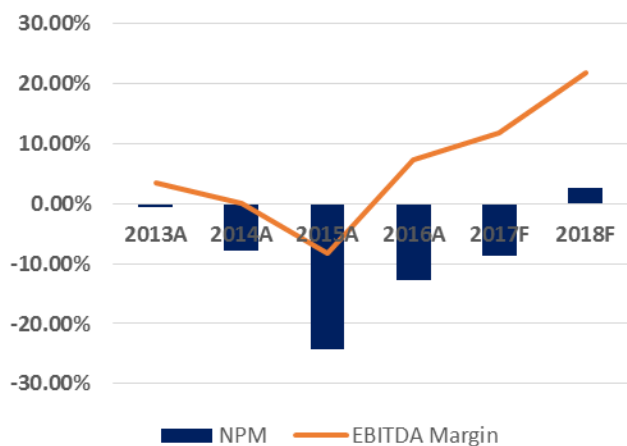
**Chart: HSM capacity yoy capacity (in mn tons)**



**Chart: Gap between domestic supply and imports (in mn tons) yoy**



**Chart: NPM vs EBITDA margin yoy (%)**



**63% increase in Hot steel mill capacity**

PT Krakatau Steel (Persero) Tbk (KRAS) as the largest integrated steel producer in Indonesia plans to dominate in domestic market share by taking advantage of the local supply shortage and expanding its Hot Steel Mill (HSM) # 2 capacity by 1.5 mn tons. As of 9M17, KRAS has completed the detailed engineering and physical development has reached 35.93%. KRAS is targeting completion of HSM#2 by 1H19. After the expansion, total hot steel mill capacity will be 3.9 mn tons or increase 63% in 2019 and in total rolling mill capacity (HRC, WR, steel bar, steel section) will increase from 3.15mn tons to 4.65mn tons or 48% in 2019. In terms of expansion of their other rolling mill product, Wire rod, Krakatau Steel and Sango Corporation signed an agreement to cooperate in the automotive industry in December as part of diversification which will create high-grade wire rod for automotive which is still 100% imported. Currently, the agreement is still in the study stage. As of 2016, steel imports reached 54% while as of 1H17 KRAS markets share was HRC 35.85%, CRC 25.37% and WR 3.92%. We believe by increasing its steel production capacity KRAS can limit the amount of steel imports, cover the local supply shortage, and increase domestic market share. Going forward, SEAISI (South East Asia Iron and Steel institute) says Indonesian steel consumption will increase from 45Kg/capita in 2015 to 84 kg/capita by 2020, giving strong growth opportunities.

**Expects better margin**

KRAS is targeting better margins in 2018 from an increase in top line due to higher average selling prices of all steel products and also through an efficiency program including a blast furnace complex which as of 9M17 reached 99.43% completion and will be completed by 2018. KRAS is targeting “first blow in” of blast furnace starting 1Q18. Efficiency also comes from the procurement of raw materials and energy at a lower cost, overhead cost efficiency, and a reduced financial expenses program. KRAS also plans to conduct bond issuance this year as part of capital restructuring. We are targeting within 2017-2018 EBITDA margin of KRAS will average 17% while 2018 net profit with margin will be 2.55% compared to net loss in 2017.

## Balance Sheet (US\$.mn)

Balance sheet (US\$. In mn)	2013A	2014A	2015A	2016A	2017F	2018F	2019F
Cash and cash equivalent	190.23	236.69	132.59	264.95	180.99	383.08	167.19
STI & Restricted cash & time deposits	7.84	20.17	40.10	1.09	2.43	3.20	3.76
Trade Account Receivable	276.17	248.83	211.25	182.54	270.30	279.33	341.09
inventory	519.09	480.87	408.62	473.96	486.54	533.15	627.06
Other current asset	101.90	72.07	99.73	74.79	98.66	124.40	146.31
<b>Current Asset</b>	<b>1095.22</b>	<b>1058.62</b>	<b>892.29</b>	<b>997.32</b>	<b>1038.92</b>	<b>1323.17</b>	<b>1285.41</b>
Net Fixed Asset	857.74	1097.41	2356.41	2454.39	2677.46	2925.21	3195.89
Intangible assets	0.00	0.00	1.23	37.45	33.30	29.97	26.98
Estimated claims for tax refund	54.45	58.42	42.34	32.00	25.97	25.97	25.97
other long term asset	375.80	389.90	409.88	415.55	418.96	550.93	647.96
<b>Total non current Asset</b>	<b>1287.99</b>	<b>1545.73</b>	<b>2809.85</b>	<b>2939.39</b>	<b>3155.70</b>	<b>3532.08</b>	<b>3896.79</b>
<b>Total Asset</b>	<b>2383.21</b>	<b>2604.36</b>	<b>3702.14</b>	<b>3936.71</b>	<b>4194.61</b>	<b>4855.25</b>	<b>5182.20</b>
Trade Account Payable	179.90	202.88	152.06	184.86	270.30	355.44	438.94
Short Term bank loans	800.48	1037.15	1143.89	894.13	922.61	992.61	1042.61
Other Short term liabilities	157.77	173.26	169.38	145.51	243.27	319.89	376.23
<b>Total current liabilities</b>	<b>1138.15</b>	<b>1413.30</b>	<b>1465.33</b>	<b>1224.50</b>	<b>1436.18</b>	<b>1667.94</b>	<b>1857.79</b>
Long term bank loans	146.03	247.83	405.49	802.29	782.71	1032.71	1082.71
Other Long term liabilities	52.06	57.30	43.30	70.25	125.69	159.95	188.12
<b>Total long term/ non current liabilities</b>	<b>198.08</b>	<b>305.13</b>	<b>448.79</b>	<b>872.54</b>	<b>908.39</b>	<b>1192.65</b>	<b>1270.82</b>
<b>Total Liabilities</b>	<b>1336.23</b>	<b>1718.42</b>	<b>1914.12</b>	<b>2097.04</b>	<b>2344.57</b>	<b>2860.59</b>	<b>3128.61</b>
<b>Total Equities</b>	<b>1046.98</b>	<b>885.93</b>	<b>1788.03</b>	<b>1839.68</b>	<b>1850.04</b>	<b>1994.66</b>	<b>2053.59</b>
<b>Total Liabilities and equity</b>	<b>2383.21</b>	<b>2604.36</b>	<b>3702.14</b>	<b>3936.71</b>	<b>4194.61</b>	<b>4855.25</b>	<b>5182.20</b>

**Profit and Loss (US\$.mn)**

<b>Profit and Loss (US\$.mn)</b>	<b>2013A</b>	<b>2014A</b>	<b>2015A</b>	<b>2016A</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
<b>Revenues</b>	<b>2,084</b>	<b>1868.85</b>	<b>1321.82</b>	<b>1344.72</b>	<b>1351.49</b>	<b>1777.18</b>	<b>2090.19</b>
Cost of revenues	(1,989)	(1827.51)	(1358.26)	(1189.49)	(1170.61)	(1362.27)	(1637.13)
<b>Gross Profit</b>	<b>96</b>	<b>41.33</b>	<b>(36.43)</b>	<b>155.23</b>	<b>180.88</b>	<b>414.91</b>	<b>453.06</b>
Operating expense	(97)	(112.19)	(147.12)	(150.84)	(175.69)	(195.49)	(229.92)
<b>Operating Profit</b>	<b>(1)</b>	<b>(70.85)</b>	<b>(183.55)</b>	<b>4.39</b>	<b>5.19</b>	<b>219.42</b>	<b>223.14</b>
Other income	(14)	(112.13)	(143.91)	(196.09)	(135.15)	(177.72)	(167.21)
<b>Pretax income(PBT)</b>	<b>(15)</b>	<b>(182.99)</b>	<b>(327.46)</b>	<b>(191.70)</b>	<b>(129.96)</b>	<b>41.70</b>	<b>55.92</b>
taxes	1	28.80	0.94	10.98	7.80	(2.50)	(3.36)
Non-controlling interests	(0.39)	7.07	6.49	9.03	4.60	6.04	7.11
<b>Net Profit</b>	<b>(14)</b>	<b>(147.11)</b>	<b>(320.03)</b>	<b>(171.69)</b>	<b>(117.57)</b>	<b>45.24</b>	<b>59.67</b>
EPS	-0.0009	(0.0093)	(0.0203)	(0.0101)	(0.0061)	0.0023	0.0031
<b>EBITDA</b>	<b>73</b>	<b>(0.22)</b>	<b>(109.41)</b>	<b>98.32</b>	<b>159.30</b>	<b>388.06</b>	<b>413.42</b>

**Cash flow (US\$.mn)**

<b>Cash Flow (In US\$ mn)</b>	<b>2013A</b>	<b>2014A</b>	<b>2015A</b>	<b>2016A</b>	<b>2017F</b>	<b>2018F</b>	<b>2019F</b>
Current Assets	904.99	821.93	759.70	732.37	857.93	940.09	1118.22
Current Liabilities	1138.15	1413.30	1465.33	1224.50	1436.18	1667.94	1857.79
WC	(233.16)	(591.36)	(705.63)	(492.13)	(578.25)	(727.85)	(739.57)
<b>Cash From Operating Activities</b>	<b>177.96</b>	<b>281.73</b>	<b>(131.90)</b>	<b>(311.45)</b>	<b>44.64</b>	<b>277.84</b>	<b>162.07</b>
capex	(182.64)	(310.31)	(1332.86)	(171.73)	(299.15)	(330.75)	(361.36)
Intangible assets	0.00	0.00	(1.23)	(36.23)	4.15	3.33	3.00
Estimated claims for tax refund	(54.45)	(3.98)	16.08	10.34	6.03	0.00	0.00
other long term asset	37.56	(14.10)	(19.98)	(5.67)	(3.42)	(131.96)	(97.03)
<b>cash from investing activities</b>	<b>(199.53)</b>	<b>(328.38)</b>	<b>(1337.98)</b>	<b>(203.28)</b>	<b>(292.39)</b>	<b>(459.39)</b>	<b>(455.39)</b>
Long term loans	(8.77)	101.80	157.66	396.80	(19.58)	250.00	50.00
other long term liabilities	5.32	5.25	(14.00)	26.95	55.44	34.26	28.17
Equity	(55.02)	(13.93)	1222.13	223.34	127.93	99.38	(0.74)
<b>cash from financing activities</b>	<b>(58.47)</b>	<b>93.12</b>	<b>1365.78</b>	<b>647.09</b>	<b>163.79</b>	<b>383.63</b>	<b>77.43</b>
Net Changes in Cash	(80.04)	46.46	(104.10)	132.37	(83.97)	202.09	(215.89)
<b>Beginning Balance</b>	<b>270.27</b>	<b>190.23</b>	<b>236.69</b>	<b>132.59</b>	<b>264.95</b>	<b>180.99</b>	<b>383.08</b>
<b>Ending balance</b>	<b>190.23</b>	<b>236.69</b>	<b>132.59</b>	<b>264.95</b>	<b>180.99</b>	<b>383.08</b>	<b>167.19</b>

**Ratio Highlights**

	2013A	2014A	2015A	2016A	2017F	2018F	2019F
<b>Growth (% YoY)</b>							
Sales	-8.9%	-10.3%	-29.3%	1.7%	0.5%	31.5%	17.6%
OP	-106.7%	6540.5%	159.1%	-102.4%	18.1%	4131.3%	1.7%
EBITDA	8.8%	-100.3%	50552.3%	-189.9%	62.0%	143.6%	6.5%
NP	-31.6%	951.9%	117.5%	-46.4%	-31.5%	-138.5%	31.9%
EPS	-31.6%	951.9%	117.5%	-50.1%	-40.0%	-138.5%	31.9%
<b>Profitability (%)</b>							
Operating Margin	-0.1%	-3.8%	-13.9%	0.3%	0.4%	12.3%	10.7%
EBITDA margin	3.5%	0.0%	-8.3%	7.3%	11.8%	21.8%	19.8%
NET Profit margin	-0.7%	-7.9%	-24.2%	-12.8%	-8.7%	2.5%	2.9%
ROA	-0.6%	-5.6%	-8.6%	-4.4%	-2.8%	0.9%	1.2%
ROE	-1.3%	-16.6%	-17.9%	-9.3%	-6.4%	2.3%	2.9%
<b>Solvability</b>							
Debt/ equity (x)	1.28	1.94	1.07	1.14	1.27	1.43	1.52
Debt ratio (x)	0.56	0.66	0.52	0.53	0.56	0.59	0.60
<b>Liquidity</b>							
Current Ratio (X)	0.96	0.75	0.61	0.81	0.72	0.79	0.69
<b>Per Share data (US\$)</b>							
EPS	(0.0009)	(0.0093)	(0.0203)	(0.0101)	(0.0061)	0.0023	0.0031
BVS	0.0664	0.0562	0.1133	0.0951	0.0956	0.1031	0.1061

**Stock Ratings:**

Buy: a recommendation to purchase the security with upside potential of 20% or greater

Hold: a recommendation to neither buy nor sell a security with upside potential of 0-20%.

Sell: a recommendation to close out a long position in a security with upside potential below 0% or negative.

**RESEARCH TEAM  
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