



Overview of the Indonesian Animal Feed Industry 2012

Summary

Contact:

Bayu Prasetyawan
Manager - Analyst
Corporate Ratings
+62 21 576 1516
bayu.prasetyawan@icraindonesia.com

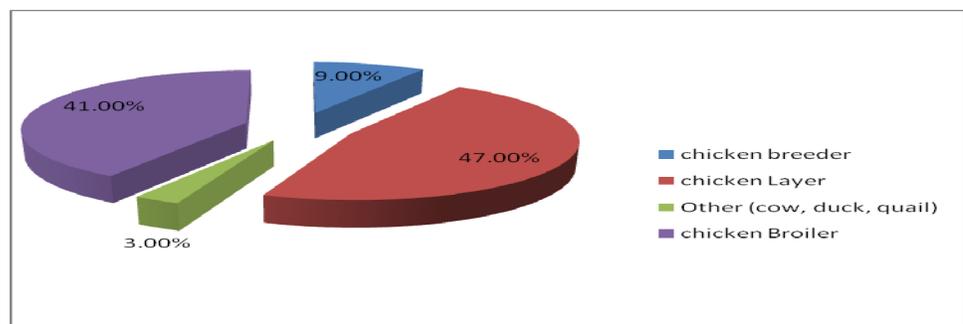
- Animal feed industry in Indonesia is still attractive as the level of per capita consumption of chicken and eggs is still very low
- More than 90% of animal feed consumption is attributable to poultry industry
- Fluctuation in the US dollar's (USD) exchange rates against the Indonesian rupiah (IDR) could have a significant bearing on the performance of animal feed industry
- Integrated companies with a large scale of business will be more efficient and thus have a better credit profile against the non-integrated and small players
- Scale of production will also play a key role to determine the market position, another important competitive factor in the industry
- Other key success factors for the industry include diversification in terms of suppliers, locations, markets, and customers, and operating management to control cost and expenditures

Animal feed consumption

Animal feed industry has an important role in supporting the animal husbandry industry (including poultry) to provide meat and meat products for the community as an additional source of protein. Feed accounts for around 70% of total cost of poultry production, quite a significant number showing its critical role. Judging from the level of production, animal feed industry has recorded an average annual growth rate of 11% in the last five years.

To synergize the business activities, major animal feed producers are vertically integrated from upstream sector (animal feed production) to downstream sectors which include farm, slaughterhouses, processing of livestock, medicine, vitamin livestock, and so on.

Figure 1: Animal Feed Consumption 2010.



Source: Association of Animal Feed Producers (GPMT)

Poultry business which consists of chicken layer, broilers and chicken breeder has been the main consumers of animal feed, accounting for 97% of the total consumption in 2010 (figure 1). This is supported by the fact that the consumption level of chicken and eggs for Indonesian community is much higher compared to others (figure 3). Thus, the growth rate of animal feed consumption is strongly linked to the growth in demand for chicken and eggs. We believe there have been no significant shifts in the consumption profile in the last two years after 2010, and thus expect the same profile to appear in 2012.

Dominated by a few big players

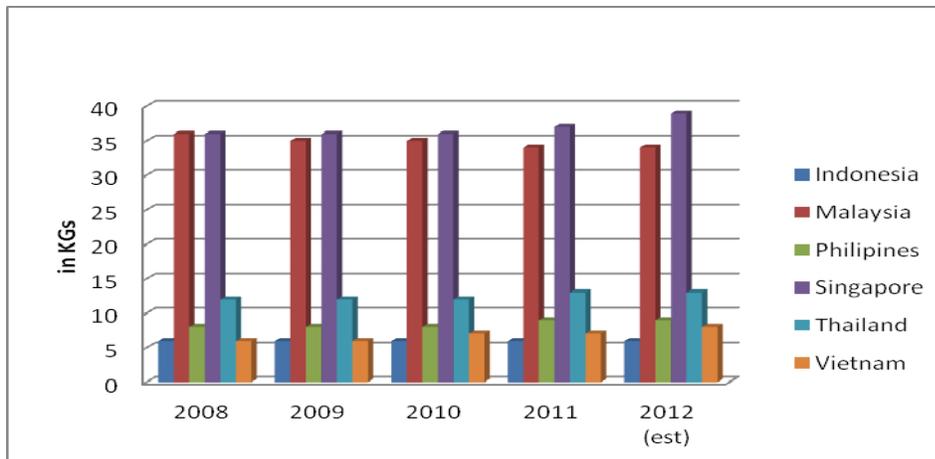
This industry is dominated by a few big players who control more than 60% market share. In general, they vertically integrate their business activities to optimize the value addition. And 40% market share of the remaining is contested by about 80 registered companies and a lot of traditional breeders. Therefore, it would become difficult for new players to stand at par with the market leaders.

The industry is also characterized by homogenous products, making it difficult to differentiate prices, except for the more value-added products such as nugget and sausage in the downstream.

Demand and growth potential

With the country's chicken consumption of 6 kg per capita per year, the lowest in the Southeast Asia region, the industry should have a strong growth potential. Similarly, Indonesia has a very low consumption of eggs. Currently, the consumption of 80 eggs per capita per year is inferior compared to Malaysia's (311) or Thailand's (93).

Figure 2: Chicken Consumption per Capita per Year (in Kg)



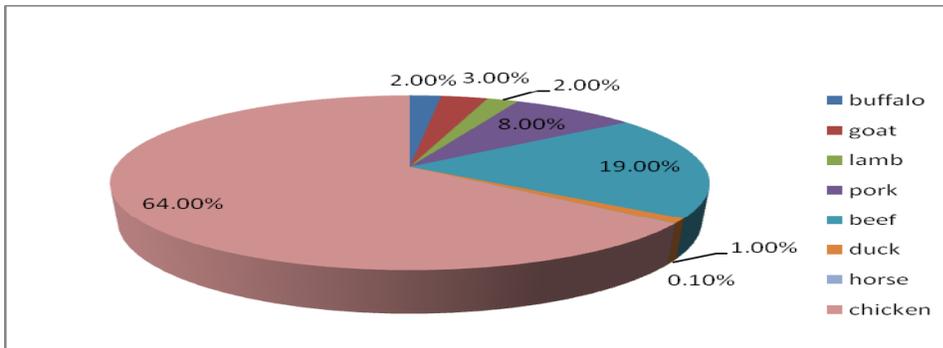
Source: <http://www.indexmundi.com>

Additionally, the demand growth for poultry has been positively correlated to population growth. As the most populous country in Southeast Asia, it is understandable that demand should be abundant. With an average population growth of 1% per year, Indonesia's population is estimated to reach 242.4 million in 2012. Assuming the level of per capita consumption is stable, the consumption of chicken will increase by 14.4 million kg (equivalent to 9.6 million chickens), still much larger compared to Malaysia and Thailand which will increase by 9.8 million kg (6.5 million chicken) and 9 million kg (6 million chickens) in 2012, respectively under the same assumptions.

Other factors for the potential growth include the increase in preference of chicken over other animal proteins due to factors such as rising prices of beef, and the growing health consciousness that believes white meat is healthier than red meat.

The levels of fondness for chicken are illustrated in figure 3. We expect the level of 64% to be stable this year despite the escalating beef prices, partially as the chicken prices may also get adjusted.

Figure 3: Meat Consumption 2010

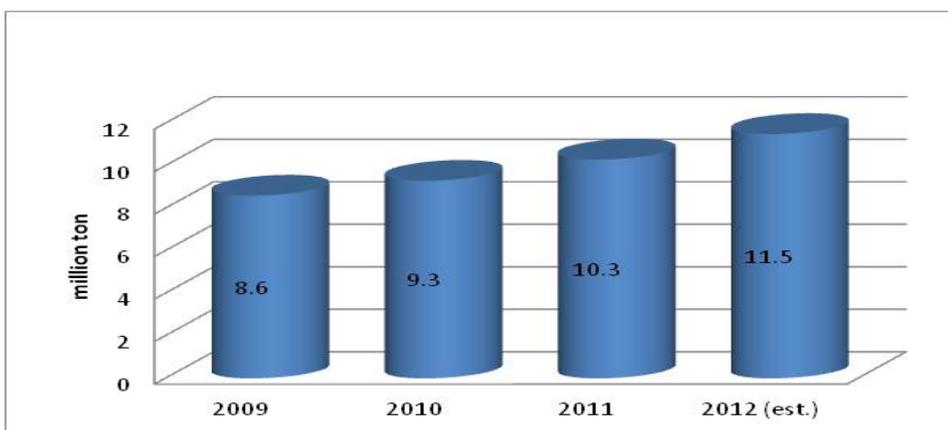


Source: Indonesia Statistics Office (BPS)

Production increased in line with the rising chicken demand.

In 2012, it is estimated that animal feed production will be up by about 12% taking into account the rising population and the growth of middle class income category. This has been evident in the increased demand for broilers. Animal feed companies also have anticipated such an increase by building new feed factories. Aside from responding to the hikes in demand, the new factories were intended to support the integration of their business activities, which in turn would improve the margins.

Figure 4: Animal Feed Production in Indonesia

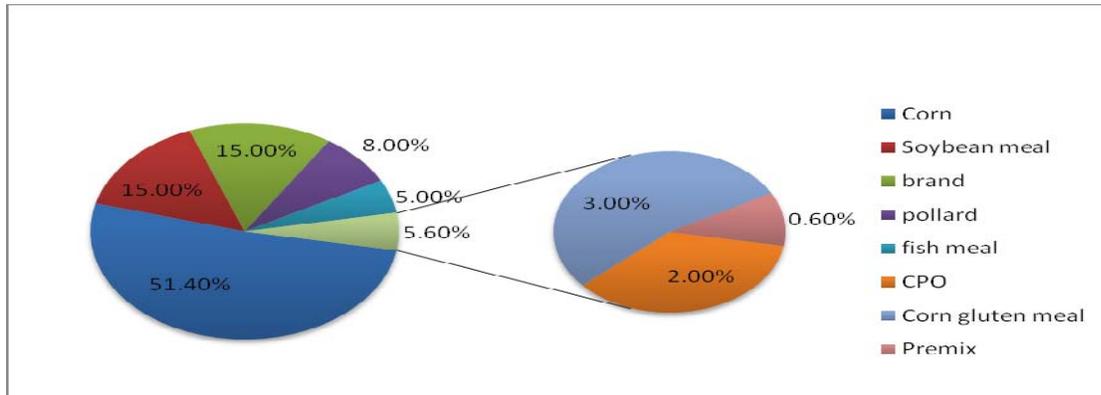


Source: Ministry of Industry and Trade

Majority of raw materials are still imported

Approximately 85% of the animal feed cost is attributed to raw material cost, and corn alone contributes 50-55% of it. It is then followed by soybean meal, meat bone meal (MBM) and poultry meat meal (PMM) as shown in figure 5.

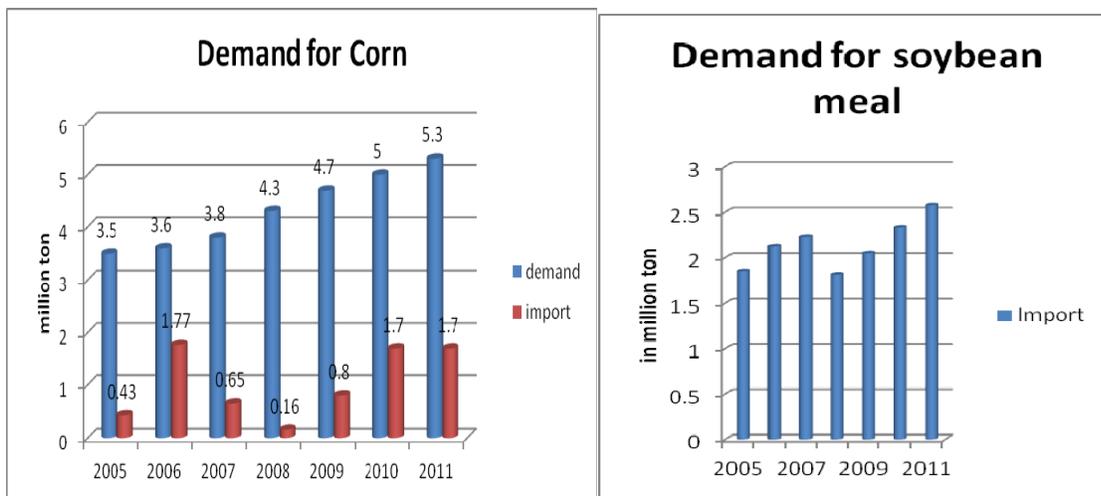
Figure 5: Animal Feed Raw Material Consumption 2010



Source: Association of Animal Feed Producers (GPMT)

Indonesia currently still imports more than 30-35% of corn required by animal feed industry. For soybean, the import level is 100%. In 2005, the country only imported about 0.4 million tons of corn and the number grew to 1.7 million tons in 2011. Similarly for soybean, it imported 1.9 million tons in 2005 and 2.5 million tons in 2011. Apparently, the domestic corn and soybean producers have never been able to provide continuous supply of the materials to the animal feed companies. Imports are expected to continue rising going forward in line with the increasing consumption of chicken.

Figure 6: Demand for Animal Feed Raw Materials in Indonesia



Source: Association of Animal Feed Producers (GPMT)

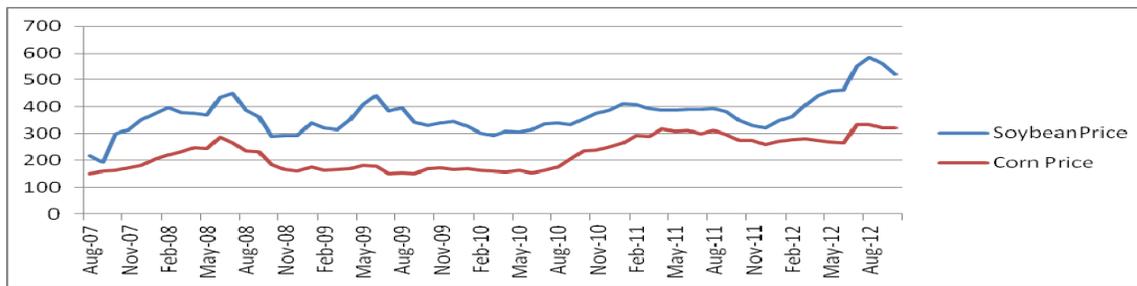
Raw material prices have increased recently

This year, the prices of raw materials for animal feed, including corn, soybean meal, and MBM have escalated. In particular, the escalation has been triggered by the drought that hit the United States (US), the major supplier of corn and soybean -- key commodities. Other causes shall include the mad cow case in the US in the beginning of this year. MBM, a major source of protein in animal feed, is produced from beef cattle, so a case of mad cow caused the animal feed industry to avoid the use of MBM as a raw material and instead they replaced it with corn or soybean.

If we look at the chart below, the price of soybean has more than doubled to USD 661/metric ton (MT) in 2012 (until August) from USD 309/MT in 2007 or with a compounded annual growth rate (CAGR) of 16.5%. During the same period, the price of corn has jumped to USD 320/MT from USD 151/MT (CAGR of 16.2%). The share of these two main raw materials to production costs is 80%, meaning there has been an increase in the cost of production at a CAGR of around 13% over the same period.

In fact, during the last 6 months until August 2012, the soybean and corn prices have been up by 13.2% and 19.7%, respectively.

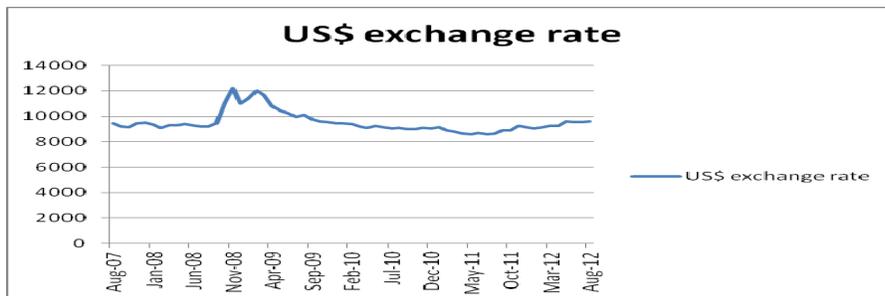
Figure 7: Soybean and Corn Price Trend (USD/MT)



Source : www.indexmundi.com

Exposed to currency fluctuation and event risks

Figure 8: USD Exchange Rate Trend



Source : www.bi.go.id

Another area of concern for the animal feed industry is the exchange rate fluctuation. As roughly 70% of raw materials come from imports, the depreciation of IDR against USD will adversely impact the industry's costs. As shown in the figure 8 above, IDR seems to have depreciated against USD by 11.5% year-on-year in August 2012.

We expect the industry to increase the selling price of their products by 5%-10% in the 2H2012 to maintain their margins. This price adjustment would also indirectly affect the pace of growth in the level of chicken consumption. As such, we believe that the chicken consumption per capita will remain stable at 6 kg.

Major players in brief

This industry is occupied by over 80 registered companies and a lot of traditional breeders. The listed PT Charoen Pokphand Indonesia Tbk (CPIN), PT Japfa Comfeed Indonesia Tbk (JPFA), PT Sierad produce Tbk (SIPD), and PT Malindo Feedmill Tbk (MAIN) are the market leaders, controlling almost 60% of market shares. All of them are vertically integrated. Related to poultry, they have business activities of feed, day old chicken (DOC) breeding farms, poultry feed plants, and chicken processing plants. Only MAIN does not have slaughter house and food processing facilities. Farmers usually purchase the DOC as well as poultry feed from the integrated players. The non-integrated players normally do business solely in breeding farms such as PT Cibadak Indah Sari Farm, or in poultry feed factories such as PT Sinta Prima Feedmill. The more the company is integrated, the better the business profile for its more efficient in operation, better diversification and higher barriers to entry.

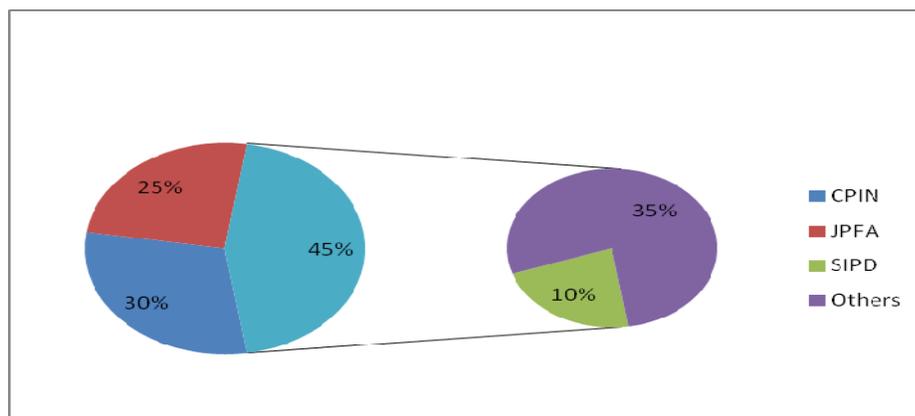
Figure 9: Poultry-related Business Activities of Listed Animal Feed Companies

Business line	CPIN	JPFA	SIPD	MAIN
Poultry feed	√	√	√	√
DOC breeding	√	√	√	√
Chicken breeding	√	√	√	√
Chicken trading	√	√	√	√
Slaughter house	√	√	√	-
Food processing	√	√	√	-

Source: Companies' Annual Report

As to poultry feed segment, CPIN has controlled the biggest market share of 30% based on sales volume in 2011, followed by JPFA (25%) and SIPD (10%). In DOC breeding business, CPIN also is ahead of the market, followed by JPFA and MAIN.

Figure 10: Animal Feed Market Share 2011



Source: Association of Animal Feed Producers (GPMT)

Operating Margin Fluctuation

The industry is characterized by a fluctuation in operating margins --measured by operating profit before depreciation, interest, taxes and amortization (OPBDITA)/Revenue ratio. For the listed companies, the margins have been hovering at 9-13% over the last 3 years until 2011. After expanding by 3.5% on average in 2010, operating margin weakened by 1.8% in 2011, mainly due to the increased raw material costs. In 2012, we expect the operating margin to decline compared to last year. Although there was an increase of 2.6% on average for all listed animal feed companies in 1H2012, the operating margin is believed to go down towards end of 2012 to compensate the rising raw material prices in 2H2012.

Figure 11: Operating Margins

Company	1H2012	2011	2010	2009
CPIN	21.6%	17.7%	19.7%	15.0%
JPFA	11.2%	8.5%	12.6%	10.7%
SIPD	5.3%	4.9%	5.2%	3.4%
MAIN	16.5%	13.4%	14.2%	8.6%
average	13.6%	11.1%	12.9%	9.4%
% increase	-	-1.8ppt	3.5 ppt	-

Source: Companies Financial Reports

A point to note is that SIPD has steadily recorded quite low operating margins as compared to those of other players. One of the contributing factors is most probably its low capacity utilization. SIPD's asset turnover ratio of 1.5-1.9x has been inferior against 1.8-2.7x of its competitors.

Favorable ROCE

Animal feed industry should be attractive referring to, albeit fluctuating, the high level of Return on Capital Employed (ROCE) ranging from 30% to 40% in the last three years until 2011. Last year, the industry's ROCE, as represented by those of listed players, declined by 8.4%. This is caused by the shrinking operating margin coupled with the increased capital (net worth and debt). Looking at the achievement in the 1H2012, we believe the ROCE in 2012 will be better than 2011. This is on the basis that while operating margin would be modest, there would be some deleveraging by the major players.

Among the large companies, only SIPD has booked quite low ROCE which partially is attributable to its low operating margin as discussed above. Other factors may include the extensive use debt taking into account its weak margin generation.

Figure 12: Return on Capital Employed (ROCE)

Company	1H2012	2011	2010	2009
CPIN	67.6%	53.2%	65.8%	60.5%
JPFA	24.0%	19.2%	31.4%	30.3%
SIPD	8.0%	7.2%	9.0%	11.8%
MAIN	63.5%	39.3%	46.1%	5.9%
average listed company	40.8%	29.7%	38.1%	27.1%
% increase	-	-8.4 ppt	11.0ppt	-

Source: Companies Financial Reports

Moderate Leverage

As seen from the figure 13, most of the listed companies have used debt as part of the funding sources to expand their businesses. This trend is predicted to continue looking ahead as they need the funds to further integrate their businesses. However, we expect leverage of this industry as measured by debt-to-equity ratio (DER) to improve in 2012 as a result of the significant increment in sales combined with the less significant increase in debt. MAIN's DER has been the highest until 2011 indicating its heavier reliance on debt to support its operations. The company issued IDR 300 billion bonds in 2008 to acquire land and animal feed plants. JPFA also issued bonds in 2012 amounting to IDR1,500 billion to set up animal feed factories and corn drying units, as well as for refinancing purposes.

Figure 13: Debt/Equity Ratios

Company	1H2012	2011	2010	2009
CPIN	0.2	0.2	0.2	0.4
JPFA	1.1	0.9	0.7	1.1
SIPD	0.9	0.8	0.5	0.2
MAIN	0.6	1.4	1.8	3.8
Average	0.7	0.8	0.8	1.4

Source: Companies Financial Reports

From other point of view, Debt/OPBDITA ratios have been hovering at 1.6-2.5x over the past three years and 1H2012. Similar to the DER, we expect the ratio to improve in 2012 for enhancement in OPBDITA and only minor addition in debt. As can be seen in figure 14, Debt/OPBDITA ratios have improved in 1H2012 for all listed companies except SIPD. Aside from the low margin generation as discussed above, there was a significant increase in total debt for SIPD in 1H2012.

Figure 14: Debt/OPBDITA Ratios

Company	1H2012	2011	2010	2009
CPIN	0.3	0.4	0.2	0.6
JPFA	2.5	2.7	1.4	1.7
SIPD	5.5	5.4	3.1	2.6
MAIN	0.6	1.7	1.6	2.8
average	2.3	2.5	1.6	1.9

Source: Companies Financial Reports

Good Interest Coverage

The industry, as represented by listed players, has booked a good interest coverage as measured by OPBDITA/(Interest & Finance Charges) ratios of around 6-18x on average for the last three years until 2011 and 1H2012. As the biggest company, CPIN showed significant improvement in interest coverage in 2010 resulting from its ability to reduce financing costs.

In 2011, most of the companies showed a decline in coverage indicators. This was due to the high interest expenses arising from additional debt used for their investments. In 2012, we expect this coverage to continue weakening for the same reason as in 2011, coupled with the modest operating margins.

Figure 15: OPBDITA/(Interest & Finance Charges) Ratios

Company	1H2012	2011	2010	2009
CPIN	34.2	50.5	54.3	10.9
JPFA	4.3	4.0	8.3	6.6
SIPD	1.8	1.9	3.9	5.1
MAIN	9.7	6.8	6.6	3.3
Average	12.5	15.8	18.3	6.5

Source: Companies Financial Reports

Referring to figure 16 below, most of the listed animal feed companies were able to pay their financial obligations as evident in their debt service coverage ratios (DSCR) in the last three years until 2011 and 1H2012. However, despite the rising operating income, a significant hike in interest payments on debt obligations led to a decline in the DSCR in 1H2012. We expect this to continue for the full year of 2012.

Figure 16: Debt Service Coverage Ratio

Company	1H2012	2011	2010	2009
CPIN	3.4	5.2	2.7	9.7
JPFA	0.3	1.9	2.8	5.6
SIPD	1.2	1.3	3.0	4.5
MAIN	5.7	5.0	4.8	3.1
average	2.6	3.3	3.3	5.7

Source: Companies Financial Reports

© Copyright, 2012, ICRA Indonesia. All Rights Reserved.

All information contained herein has been obtained by ICRA Indonesia from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided 'as is' without any warranty of any kind, and ICRA Indonesia in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion and ICRA Indonesia shall not be liable for any losses incurred by users from any use of this publication or its contents.