PT Avia Avian Tbk (AVIA)
Q3 2024 Earnings Call Q&A Summary
Friday, 1st of November 2024

Panelists:

Mr. Ruslan Tanoko	: Vice President Director
Mr. Robert Christian Tanoko	: Operations & Development Director
Mr. Kurnia Hadi Sinanto	: Finance Director
Mr. Andreas Timothy Hadikrisno	: Head of Investor Relations

1. Questions from Divya Kothiyal, Morgan Stanley

1) How is the volume growth in October? Is it as strong as the 12% seen in Q3?
2) Why is sales value growth of 5% slower than volume growth? Is there a downtrading or a change in the category mix? Which categories are growing faster?
3) Why are margins for Architectural Solutions lower despite stable raw material costs? What is the margin outlook for Q4?
4) Regarding the higher advertising spend in Q3, could you comment on where competition is more aggressive? How much do we expect to spend on A&P in the next two quarters?

Answer:

1) We just concluded the month of October, so it is a bit too early to comment on the performances.
2) The gap between volume and value growth is primarily due to the stronger sales performance in the wall segment. In Q3, the wall segment achieved a high double-digit volume growth, the highest among all segments. Meanwhile, waterproofing and wood & metal, which are the other top sales contributors, only delivered a high single-digit volume growth. The average selling price per liter in the wall segment tends to be much lower compared to other segments like waterproofing or wood & metal. As a result, even though the volume recorded double-digit growth in Q3, the value growth was relatively lower.
3) The decline in gross margin for the architectural solutions segment is attributable to the increase in our below-the-line (BTL) marketing expenses compared to the previous period.
4) Regarding the A&P, we aim to maintain the same level of marketing expenses as in Q3 in response to the more aggressive competition, which has been increasingly intense over the past 2–3 years. Nevertheless, we are taking a cost-conscious approach to be as efficient as possible. With our 123 wholly-owned DCs across the nation, we can easily adjust our budget based on the actions of competitors in each region.

2. Questions from Yuan Long Loh, Avanda Investment Management

1) The Architectural Solutions segment grew by 5% year-over-year this quarter. A simple volume/price breakdown indicates that volume grew by 12%, suggesting that ASP per metric ton may have declined by around 7%. Is this accurate for the quarter? Is there a higher mix of lower-ASP products?
2) Regarding Trading Goods, there has been significant margin improvement here. What is driving this, and how sustainable is it?

3) The full-year guidance is still for 6-10% sales value growth, yet I believe we are tracking at 5% year-over-year for 9M24. What is the confidence level for Q4? Can we share any trends for October?

Answer:

1) The first question has already been answered earlier.
2) The margin improvement in the trading goods segment came from a one-time bonus that was awarded for the segment's strong results. The bonus for the first nine months was recognized in Q3, thereby contributing to the significant rise in gross profit for the quarter. For the full year, gross margins for the trading goods segment should settle around 19%.
3) We basically did a lot of things right in Q3, and we will continue to duplicate this strategy in Q4. We are committed to analyzing the competitive dynamics in each region and adjusting our strategies accordingly. Overall, we are feeling quite confident about hitting our sales target for the full year.

3. Questions from Calvin K, Gate3 Capital

Are there any plans to increase the buyback program? Considering the current valuation, it seems more value-accretive compared to acquiring competitors at premium valuations.

Answer:

We will continue the buyback program as we planned. We still have time until June next year, so we will stick to our initial schedule.

4. Questions from Tian Q Chen, HSBC Asset Management

1) Robert just mentioned that the company is confident about meeting the low end of the guidance range. Is this a slight tone-down? Any updates on EBITDA margin and gross margin guidance?
2) No new DCs were added in Q3. Does this indicate any rethinking of the expansion strategy for now?
3) Regarding potential M&A, is there an opportunity related to asset disposal by a foreign paint brand exiting Indonesia? Any further insights, such as on products or geography, would be appreciated.

Answer:

1) The question regarding the sales guidance has been discussed earlier. As for margins, the decline in EBITDA and net profit margins in Q3 is attributable to the company's intensified marketing efforts in response to the challenging market conditions and more aggressive competition. Our target for EBITDA and net profit margins is around 26% and 21%, respectively, which represents our comfort range. For the first nine months of 2024, we maintained an EBITDA margin of 26.5% and a net profit margin of 21.5%, both still aligning with our established range. We continue to carefully manage our operating expenses to sustain our target margins through the end of 2024.
2) Correct. While we are adding one more distribution center in Q4 and a few more next year, the slower market conditions have led us to reassess further expansion. However, please note that even without additional distribution centers, we are already everywhere in the country, and our current distribution network has far outpaced those of other competitors.

3) When it comes to M&A, acquiring assets is not the main focus for us because the most valuable aspect of an M&A is the brand itself. We believe that just acquiring tangible assets would not be very beneficial as we can always procure similar assets from our suppliers. Additionally, the specifications might not align with what we envision for our factories. We are not particularly interested in acquiring the assets of other companies unless they are offered at a very low price.

5. **Questions from Andree Siantoro, Maybank Asset Management**

    1) Why focus on a higher A&P budget rather than discounts to gain market share?
    2) We have observed Chinese producers entering other industries. Do you see any new competition from Chinese producers in your market?

    Answer:

    1) We believe discounts do not always work for gaining market share. As a company, we have been pretty creative in our approach. About 15-18 years ago, we introduced gold coins to incentivize customers, shifting from typical giveaways like t-shirts or electronics. This approach has worked well for us over the past 15+ years. Discounts, on the other hand, can lead to price erosion as competitors may respond by further lowering their prices.
    2) While Chinese products are entering the Indonesian market, they primarily consist of items that are adjacencies to paints. In this case, the competition from the Chinese companies is not in the paint sector. Due to the high number of SKUs and shipping costs, we believe it will not be worthwhile to import paints from China. Even if Chinese competitors are to set up factories locally in the future, our 46 years of local presence and longstanding market knowledge will allow us to maintain a strong position.

6. **Questions from Selviana Aripin, HSBC Global Research**

    Could you discuss the potential ASP from the housing project? Should we expect a lower margin from the housing project segment, given the increased sales from this division?

    Answer:

    Currently, the contribution from our project division is still in the low single digits. As for margins, we have very extensive product lines, ranging from economical to premium segments. Even in the lowest-tier product category, we still maintain pretty good margins. But we are always careful regarding the account receivables, which is a common problem in project sales. We are prioritizing payment reliability over project size to avoid issues with delayed payments that can negatively impact the company.

7. **Questions from Danif Esfandiari, Mandiri Sekuritas**

    What is the strategy moving forward if market or macro conditions remain unsupportive?

    Answer:

    The market for building materials in Indonesia has not been great in the past 2-3 years. Even when the market is not supportive, the company continues to execute its sustainable growth strategies. We will continue with our innovation side. Beyond this, the company is focusing on gaining market share from other competitors, especially from smaller paint companies, by strategically attacking them in areas or regions where they are weak. We believe this is one of the key factors that led to our positive results in Q3, and we will continue to do this going forward.

8. **Questions from Axel Bramantyo, Retail Investor**
    1) Does the company plan to be more aggressive with the ATL budget to boost brand awareness and brand equity through viral or guerilla marketing campaigns?
    2) Based on my research, due to the economic slowdown, many retailers, especially key accounts, are currently holding high inventory levels. What is Avia's strategic plan to address their sell-out issues?
    3) Any updates on M&A activities?
    4) If acquiring a paint company is challenging, is the company open to other segments aligned with Tirtakencana's distribution channels?

    Answer:
    1) We are not going to be extremely aggressive on our above-the-line (ATL) budget because we are also taking a cost-conscious approach. We are closely monitoring the market trends in Q4 to adjust our strategies.
    2) It is true that retailers are sitting on higher inventory levels right now. Many retailers are commenting that the traffic to their shops is definitely lower than what it used to be. In this case, the company is providing extra support for its retailers. This does not only include speedy delivery, but we also give them an almost guaranteed product return, so retailers feel comfortable carrying our products. We want them to see us as a responsible company committed to being their long-term partner.
    3) We have not seen any M&As within the paint industry in Indonesia. The sentimental value attached to family-owned businesses here is much higher compared to other countries. We will continue to explore the M&A opportunity, and hopefully, we can announce one in the coming months.
    4) We always want to leverage our distribution network. But at the same time, we are also quite careful. The last thing we want is to sell something that will jeopardize or impact our paint sales. We generally avoid acting as a distributor for external brands unless there is a clear exit strategy and long-term benefits that align with our business. Our priority remains on protecting and growing our core business.

9. **Questions from Handiman S, Mirae Asset Sekuritas**
    1) When entering the project market, particularly government projects, how do you expect it to impact AR days and margins? Can these be sustained at the current level?
    2) How significant will the contribution be to overall sales?

    Answer:
    1) As mentioned earlier, when evaluating government and other projects, our main concerns are always the on-time collections and AR days, along with margins. Generally, we work with third parties who are experienced in supplying projects. We provide various technical support and build brand awareness among the project developers, but the supply would come from the third parties. We carefully select these third parties to ensure we can manage our AR effectively. Additionally, it is really not our intention to engage in unprofitable projects.
    2) Project contributions to overall sales are still in the low single digits. In the last nine months, our project sales have grown by around 30%. However, there is still a lot of work to do, and we are being selective about the projects to maintain our AR and protect our margins.

10. **Questions from Theodorus Melvin, Stockbit Sekuritas**

1) From a paint market perspective, is this volume growth driven by an overall increase in paint demand, a gain in market share, or a combination of both? If comfortable, could you indicate which competitors might be experiencing a decline in market share?
2) Given the current trend of downtrading across consumer sectors, can you provide insights into the sources of value growth?
3) Are there any updates on the inorganic growth initiatives mentioned last quarter?

Answer:

1) For Q3 volume growth, we believe most of our gains came from other players. We have observed that several competitors are suffering with their sales growth. This reinforces our view that our Q3 performance is largely due to market share gains rather than an overall increase in paint demand.
2) We see these challenging market conditions as an opportunity to grow sustainably. When the market improves, we plan to continue our approach, aiming to grow faster than competitors through our innovation capability, superior service quality, and strong relationships with customers.
3) We are still in the process of refining the agreement, and we will announce it when we are ready.

11. **Questions from Anuttri Kaewkiew, NTAsset**

Apart from M&A opportunities, are there other aspects of industry consolidation that you find particularly evident? When might these positively impact the company's performance?

Answer:

Consolidation in Indonesia is inevitable, though the timeline remains uncertain. Please be assured that we continue to be aggressive in acquiring market share from other competitors, especially the smaller paint companies.