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# Indofood Sukses Makmur and First Pacific: Financial Risks from Upstream Investments

PT Indofood Sukses Makmur Tbk. (Indofood SM), listed on the Indonesia Stock Exchange, is the country's largest food company and the market leader in instant noodles, flour, cooking oils, margarine and fats. Its largest shareholder is First Pacific Co. Ltd., a Hong Kong-listed conglomerate with interests in food, telecom, construction, and natural resources. The Indonesian Salim family controls First Pacific. Both Indofood SM and First Pacific face financial risks from their upstream investments. These material risks include contested land and labor risks associated with their supply chains and reputation risks from their investments in their Singapore-listed oil palm plantation subsidiary Indofood Agri Resources.

## Key Findings

- **42 percent of Indofood Agri Resources' 549,287 ha total landbank is contested.** Indofood Agri Resources (Indofood Agri) controls 63 concessions**.** Six plantations (7 percent of its total landbank) allegedly have community conflicts and labor controversies. Four plantations (9 percent of its undeveloped landbank) are located on peat and/or forest areas, potentially prohibited from development given Indonesian government regulations. Approximately 5,900 ha of peatland burned in 2015 on Indofood concessions. 16 plantation companies (29 percent of its total landbank) do not publish concession maps.

- **A RSPO complaint was recently filed accusing Indofood Agri of employing child labor and exhibiting poor labor practices.** The company has allegedly undermined job security for workers and the freedom of association in trade unions. It is allegedly paying employees below the minimum wage and setting individual quotas for workers unrealistically high. Also, the company allegedly employs children to assist with harvesting.

- **36 percent of the CPO processed in Indofood Agri's refineries comes from undisclosed sources, creating both supply chain and reputation risks for buyers and investors.** Simultaneously, various private oil palm plantation companies indirectly controlled by Anthoni Salim are developing supply chain and reputation risks by their deforestation activities for their current and future CPO buyers.

- **Indofood Sukses Makmur: Indofood Agri's ESG risks could negatively impact the share price of its parent company.** A stock price decline of 16 percent could materialize if banks and equity investors with ESG policies avoid Indofood Sukses Makmur because of concerns about deforestation and labor issues at its 74.5 percent controlled subsidiary Indofood Agri.

- **First Pacific: Indofood Agri's ESG risks could also negatively impact First Pacific's share price.** The Hong Kong-listed conglomerate First Pacific has a controlling 50.1 percent stake in Indofood Sukses Makmur and derives 38 percent of its revenues from this investment. Because of these strong links, banks and equity investors could avoid this ultimate parent company as well.

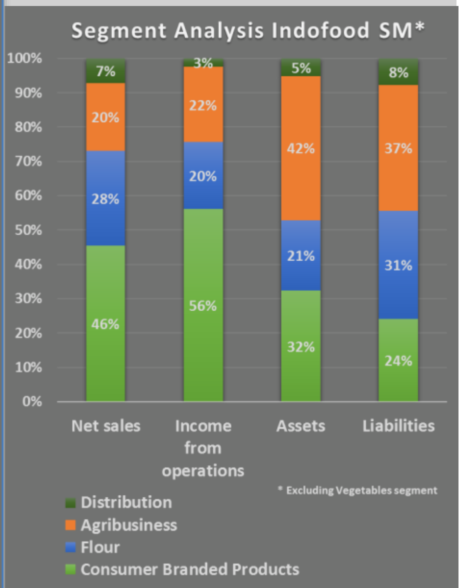
| PT Indofood Sukses Makmur Tbk | | |
|---|---|---|
| Bloomberg ticker | INDF:JK | |
| No. of shares outstanding | 11,662 billion | |
| | IDR | USD |
| Present share price | 8,000 | 0.6 |
| 52Week Low | 9,200 | 0.69 |
| 52Week High | 5525 | 0.41 |
| Market Cap | 70,243 b | 5.27 b |

| Main shareholders | Country | % |
|---|---|---|
| CAB Holdings | Seychelles | 50.07% |
| Dimensional Fund Advisors | United States | 1.63% |
| Vanguard Group | United States | 1.46% |
| BlackRock Institutional | United States | 1.26% |

| IDR billion | 2015 | *F 2016* | *F 2017* | *F 2018* |
|---|---|---|---|---|
| Revenue | 64,062 | 68,309 | 74,076 | 79,768 |
| EBITDA | 9,230 | 10,517 | 11,635 | 12,923 |
| EBIT | 7,363 | 8,048 | 9,078 | 9,924 |
| Net Income | 2,572 | 4,035 | 4,463 | 5,011 |
| EPS | 293.00 | 469.74 | 507.26 | 567.54 |
| Net Debt | 13,439 | 11,892 | 12,279 | 10,231 |
| Net Debt/ EBITDA | 1.46 | 1.13 | 1.06 | 0.79 |

| Returns | INDF | JKSE |
|---|---|---|
| 3M Return | 7.25% | -1.53% |
| 1Y Return | 37% | 15% |
| 2Y Return | 6.39% | 0.77% |

## Indofood Sukses Makmur: Products and Segments



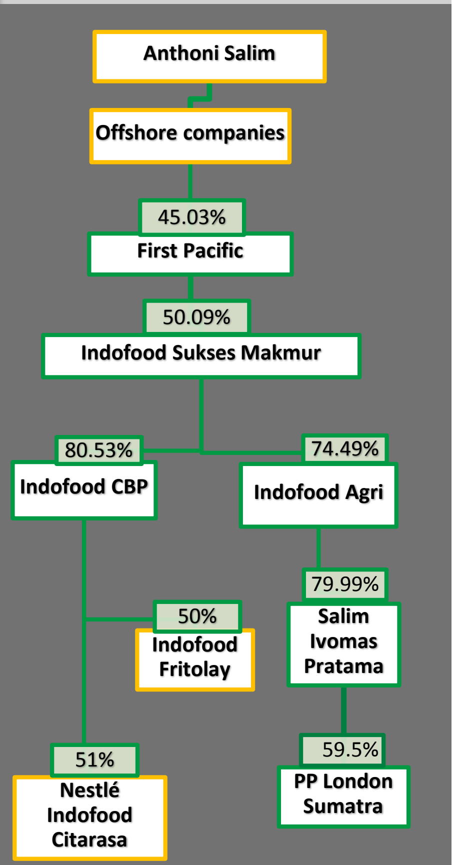

PT Indofood Sukses Makmur Tbk. (Indofood SM) is the largest food company in Indonesia with a market cap of USD 4.8 billion (IDR 65.4 trillion). The company dominates the Indonesian instant noodles and flour markets. It is also a significant producer of baby foods, snack foods, sauces, seasonings and biscuits. Moreover, Indofood SM is the Indonesian market leader for branded cooking oils, margarine and fats - products mostly made from palm oil. The company operates a national distribution network to supply these products to shops across Indonesia.

In fiscal year 2015, Indofood SM total revenue was USD 4,789 million (IDR 64,062 billion), resulting in operating income of USD 531 million (IDR 7,108 billion). Their net profit amounted to USD 222 million (IDR 4,524 billion), equaling a 4 percent net profit margin. Indofood SM generates 92 percent of its revenues from the Indonesian market. It generated smaller export revenues from other Asian markets.

Indofood SM has grouped its business activities in five segments:

- **Consumer Branded Products:** This segment produces a diverse range of consumer branded products including noodles, dairy, snack foods, food seasonings, nutrition and special foods and beverages. Brand names include Pepsi, Maggi, Indomie, Indomilk and Chitato. The holding company for this segment, PT Indofood CBP Sukses Makmur Tbk., is listed separately on the Indonesia Stock Exchange.
- **Bogasari***:* This segment produces wheat flour and pasta.
- **Agribusiness:** The holding company for this segment is Singapore-listed Indofood Agri Resources Ltd., which operates oil palm plantations in Indonesia with a total planted area of 246,359 ha and 24 palm oil mills producing one million tons of CPO per year. Its five Indonesian palm oil refineries have a total annual CPO processing capacity of 1.4 million tons. Indofood Agri has a leading position in the Indonesian branded cooking oil, shortening and margarine markets. Its brands include Bimoli, Delima, Happy, Palmia and Amanda. It also operates rubber and sugar plantations.
- **Distribution***:* This segment operates an extensive distribution network in Indonesia, distributing the majority of its own consumer products, as well as third-party products. It includes more than 1,100 distribution points to retail outlets across Indonesia.
- **Cultivation and Processed Vegetables:** Singapore-listed China Minzhong Food Corporation (CMFC) operates this segment. It produces and processes vegetables in China. Indofood SM has announced that it is selling its majority position in CMFC. Marvellous Glory Holdings, controlled by Anthoni Salim, purchased 99.57 percent of CMFC for a total sum of SGD 783 million in November and December 2016.

The Consumer Branded Products (CBP) segment accounted for 46 percent of Indofood SM's net sales (IDR 63,594 billion) in 2015, excluding its Cultivation and Processed Vegetables segment. The CBP segment is more profitable than the other segments. It contributed 56 percent to income from operations. Return on assets (ROA) for this segment are high given that it accounts for only 32 percent of total assets and its leverage is low at 24 percent of total liabilities. The oil palm plantations and palm oil refineries in the Agribusiness segment account for 20 percent of net sales and 22 percent of operational income, while using 42 percent of total assets and 37 percent of total liabilities. This segment is less profitable and more leveraged than the CBP segment.




Market capitalization and enterprise value of Salim companies (million USD, January 2017)

| Company | Market cap | EV |
|---|---|---|
| First Pacific | 3,197 | 12,940 |
| Indofood Sukses Makmur | 5,204 | 8,110 |
| Indofood CBP | 7, 483 | 7,152 |
| Indofood Agri Resources | 548 | 1,874 |
| Salim Ivomas Pratama | 595 | 1,441 |
| PP London Sumatra | 860 | 810 |

## Salim Family Businesses: History

Anthoni Salim inherited the family business from his father Sudono Salim. Sudono Salim was a close friend and business partner of ex-President Suharto. In the 1990s, the Salim family businesses accounted for 5 percent of Indonesia's economic output with interests in food processing and marketing, automotive, chemicals, construction and building materials, real estate, telecommunications, financial services and trading. In the 1990s, via a web of offshore companies, the group acquired concessions to develop 1.1 million ha of land into oil palm plantations.

When the Asian financial crisis occurred in 1998, non-performing debts almost bankrupted Bank Central Asia. The Salim family controlled Bank Central Asia. At the time, it was the largest private bank in Indonesia. The Indonesian Bank Restructuring Agency (IBRA) saved the bank from collapse because of its non-performing debts. The Salim family was forced to transfer its 25 oil palm plantations, with a total planted area of 260,000 ha, together with its oleochemical businesses to IBRA as compensatory payment. IBRA sold these 25 plantations to the Malaysian company Kumpulan Guthrie. Kumpulan Guthrie later merged with Sime Darby.

During this period, the Salim family succeeded in maintaining control over its profitable flagship company PT Indofood Sukses Makmur. As a producer of instant noodles, cooking oil, margarine and other food products, this company was the largest Indonesian domestic buyer of palm oil. Indofood SM started to rebuild its oil palm plantation activities to secure upstream supply. It acquired a majority stake in the Indonesia Stock Exchange-listed plantation company PP London Sumatra Indonesia. To attract foreign investors, these plantations where then grouped together with the Indofood palm oil refineries under Indofood Agri Resources. Indofood Agri Resources was listed on the Singapore Exchange in 2006 through a reverse take-over.

## Salim Family Businesses: Structure and Governance

To maintain control over its diversified companies while seeking foreign investors, the Salim family created a complicated structure including many listed and unlisted onshore and offshore companies. On the left is shown a simplified overview of the group structure, focusing on Indofood SM and some of the subsidiaries related to the palm oil business, and leaving out many other businesses and intermediate vehicles.

Indofood SM and two Salim offshore companies own 74.49 percent of Singapore-listed Indofood Agri Resources Ltd, which is the holding company for the oil palm plantations and palm oil refineries. Indofood Agri itself controls two plantation holding companies, which are both listed on the Indonesia Stock Exchange. PT Salim Ivomas Pratama Tbk, which is 79.99 percent owned by Indofood Agri and its parent company, manages almost all activities of Indofood Agri. The company has a market value of USD 595 million (IDR 8.07 trillion).

In turn, Salim Ivomas Pratama owns 59.5 percent of PT PP London Sumatra Indonesia Tbk. This is one of the oldest plantation companies in Indonesia. Its market value is USD 873 million (IDR 11.8 trillion). Aidenvironment calculations estimate the total landbank of Indofood Agri at 549,287 ha, of which 34 percent are owned by PT PP London Sumatra and 52 percent by PT Salim Ivomas Pratama. The ownership of the remaining 14 percent is unknown.

**First Pacific Subsidiaries**

| Company | Country | Industry |
|---|---|---|
| Indofood SM | Indonesia | Food |
| Goodman Fielder | Hong Kong/ Singapore | Food |
| Philex Mining | Philippines | Mining |
| Roxas Holdings | Philippines | Mining |
| Metro Pacific | Philippines | Infrastructure |
| PLTD | Philippines | Telecom |
| Global Business Power | Philippines | Infrastructure |
| Meralco | Philippines | Infrastructure |

**Main Salim family offshore holding companies**

| Company | Country |
|---|---|
| Asian Capital Finance | British Virgin Islands |
| CAB Holding | Seychelles |
| First Pacific | Bermuda |
| First Pacific Investments | Liberia |
| First Pacific Investments (B.V.I.) | British Virgin Islands |
| Indofood Singapore Holdings | Singapore |
| Salerni International | British Virgin Islands |

**CPO sales Indofood Agri Resources**

| Market | Tons | Revenue (IDR bln) | Price (IDR mln/ton) |
|---|---|---|---|
| External | 441,900 | 5,419 | 12.3 |
| Internal | 540,100 | 3,730 | 6.9 |
| **Total sales** | **982,000** | **9,149** | **9.3** |

Indofood SM also owns 80.53 percent of Indonesia Stock Exchange-listed Indofood CBP Sukses Makmur. Indofood CBP Sukses Makmur controls the Consumer Branded Products segment of the group. It has joint ventures with major foreign food companies. PT Nestlé Indofood Citarasa Indonesia is a joint venture between Indofood CBP and Nestlé SA, producing culinary products. With the snacks and beverages giant PepsiCo, Indofood CBP has the snack foods joint venture PT Indofood Frito-Lay.

First Pacific owns 50.07 percent of Indofood SM. First Pacific is a Bermuda-registered conglomerate listed on the Stock Exchange of Hong Kong. First Pacific market value is USD 2.9 billion. Its business interests range from telecommunications to food, infrastructure and mining across the Asia-Pacific region. Indofood Sukses Makmur accounts for 38 percent of First Pacific's turnover. Anthoni Salim owns 45.03 percent of First Pacific through various offshore vehicles.

The ownership structure of the Salim family businesses, with its many listed subsidiaries, aims to optimize the family's interests. The structure focuses on attracting outside financing without losing control. A small group of managers controls these companies, which derive their sales and market values to a large extent from the same assets. This creates an imbalance of information between the dominant shareholder – the Salim family – and other investors as well as potential conflicts of interests, exacerbated by frequent "related party" transactions.

## Indofood Agri Resources: Palm Oil Supply Chain Risks

Indofood SM describes its subsidiary Indofood Agri Resources as "one of the largest diversified and integrated agribusiness groups in Indonesia". Indofood Agri Resources operates oil palm plantations, CPO mills and refineries. But in reality the vertical integration is less strong than suggested. According to Indofood Agri, the *Plantations* segment sells 55 percent of its CPO to the *Edible Oils and Fats* segment and 45 percent to external customers. As a result, the refineries source a 36 percent of their CPO supply from undisclosed third party suppliers.

The segment revenues reported by the company seem to suggest that the company's refineries actually rely even more on external suppliers. This is because the reported 55 percent of the CPO volume sold to the refineries yields only 41 percent of the turnover of the *Plantations* segment. This means that this CPO would be sold internally for IDR 7 million/ton, while the CPO sold to external customers would yield IDR 12 million/ton. This is not realistic as the average CPO market price in 2015 was IDR 7.5 million/ton. One possible explanation for this discrepancy is that Indofood Agri in reality sold less than 55 percent of its CPO to its own refineries, increasing its refineries' reliance on external suppliers.

The extent to which Indofood Agri enforces its own sourcing policy remains unknown. Currently, the company does not follow industry best practices of publishing lists of its suppliers. While innovative companies that are market leaders prohibit development on peat regardless of depth and High Carbon Stock (HCS) forest, Indofood Agri still allows conversion of secondary forest and peat up to three meters.

This creates material supply chain risks for Indofood Agri Resources, which can spread to other businesses controlled by Anthoni Salim. In 2015, IDR 3,854 billion (28 percent) of Indofood Agri total sales were to related parties. Of this percentage, 11 percent was sold as edible oils and fats products to Indofood CBP, to be further processed into products like noodles and baby food. Another 2 percent was sold to other subsidiaries of Indofood SM - most likely the Distribution segment - while another 15 percent was delivered to other Salim-controlled businesses.

## Anthoni Salim Private Plantations: Palm Oil Supply Chain Risks

Anthoni Salim controls indirectly various private oil palm plantations not owned by Indofood Agri Resources. Some are producing CPO, while others are under development. Salim's ownership ties mean these plantations might sell palm oil to Indofood Agri's refineries. Several of these privately owned plantations are involved in deforestation and peat development. This could amplify supply chain, reputation and regulatory risks for Indofood Agri and Indofood SM. Some examples are described below.

### West Kalimantan: Clearing Peatland Contrary to Indonesian Policy

PT Duta Rendra Mulya (PT DRM) and PT Sawit Khatulistiwa Lestari (PT SKL) operate in the Sintang district in West Kalimantan with a combined concession area of 19,595 ha. Anthoni Salim's controlling stakes in these companies are concealed through complex layers of ownership.

From 2011 to 2015, 4,857 ha were cleared by PT SKL and PT DRM. Of this area, 4,300 ha (89 percent) were still forested in early 2013. The deforestation maps are available in Chain Reaction Research's published report on Indofood Agri Resources.

The Ministry of Environment and Forestry banned the development of peatland for oil palm development in November 2015 stating, "land opening or new land clearing within peatland for plantation purposes is not allowed anymore". But satellite imagery shows that from September 2015 to September 2016, in violation of the peatland moratorium, PT SKL and PT DRM cleared 6,277 ha.

Both plantation companies have commenced planting. They will most likely sell their fresh fruit bunches to the closest mills owned by the Wings, Lyman, and Incasi Raya Groups, all of which rely on refiners with NDPE policies such as Wilmar, Musim Mas, Golden Agri-Resources and others. The latter will now likely instruct these third party suppliers to exclude Salim's subsidiaries from their supply base. PT SKL and PT DRM will have to invest in their own CPO mills to access markets. Other than Wilmar's CEKA refinery in Pontianak, the only refinery facility in the province and proactively implementing Wilmar's NDPE policy.

### East Kalimantan: Clearing Orangutan Habitat

In 2012, the Centre for Orangutan Protection (COP) filed a formal complaint against PT Gunta Samba Jaya (PT GSJ) in East Kalimantan for the clearing of orangutan habitat inside the concession. COP believed that this was a Salim Ivomas Pratama/Indofood Agri subsidiary given on-the-ground reports. Indofood Agri's CEO flatly denied in public that the company was an Indofood Agri or Salim Ivomas Pratama subsidiary. A Salim family member successfully resolved the case.

### West Papua: Near-Term Deforestation Risk

In 2016, the Indonesian NGO MIFEE traced the ownership of four oil palm plantation companies in West Papua to an offshore trust with a Salim address – *Jalan Ahmad Yani kavling 23 No. 15, Jakarta.* This is the same address of the Salim owned plywood business PT Kayu Lapis Asli Murni (Kalamur). Some of the West Papua companies' executives were previously part of the management of Salim businesses. The four plantation companies have acquired plantation concessions covering a total area of

| First Pacific Co. Ltd. | | |
|---|---|---|
| Bloomberg ticker | 142:HK | |
| No. of shares outstanding | 4,281 million | |
| | HKD | USD |
| Present share price | 5.80 | 0.75 |
| 52Week Low | 6.35 | 0.82 |
| 52Week High | 4.7 | 0.61 |
| Market Cap | 24,854 M | 3,203 M |

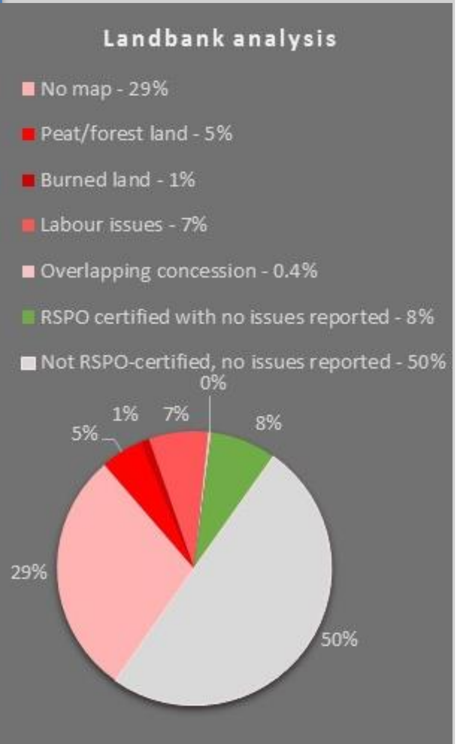
| Main shareholders | Country | % |
|---|---|---|
| First Pacific Investments | Liberia | 18.46% |
| First Pacific Investments (BVI) | BVI | 14.79% |
| Anthoni Salim | Indonesia | 11.73% |
| Brandes Investment | USA | 7.94% |

| IDR billion | 2015 | *F 2016* | *F 2017* | *F 2018* |
|---|---|---|---|---|
| Revenue | 6,437 | 6,557 | 7,044 | 7,604 |
| EBITDA | 1,009 | 1,209 | 1,320 | 1,574 |
| EBIT | 672.90 | 828.15 | 928.65 | 1,006 |
| Net Income | 293.90 | 276.93 | 291.16 | 389.94 |
| EPS | 0.07 | 0.07 | 0.06 | 0.09 |
| Net Debt | 4,750 | 3,983 | 3,691 | 3,090 |
| Net Debt/ EBITDA | 4.71 | 3.29 | 2.80 | 1.96 |

| Returns | 142 | HIS |
|---|---|---|
| 3M Return | -2.19% | 1.05% |
| 1Y Return | -18% | 21.77% |
| 2Y Return | -26% | -5.78% |

135,620 ha. 86 percent of the 135,620 ha total concession's landbank remains undeveloped. It is covered by forest and peatland. Any further development is expected to escalate deforestation and deforestation related supply chain risks.

## Indofood Agri: Contested Land




While Anthoni Salim's privately owned plantations exhibit sustainability risks, similar issues occur in Indofood Agri's 63 palm oil concessions estimated at 549,287 ha, of which 246,359 ha (45 percent) is already planted with palm oil. According to Indofood Agri, as of December 2015 the company had approximately 25,000 ha of land available for future palm oil developments. The remaining 277,928 ha includes community agriculture, mining, timber and other undevelopable land.

Chain Reaction Research partner Aidenvironment's data shows that 42.4 percent of Indofood Agri's landbank is contested. This includes concessions with remaining peat and forest, reported environmental and social issues, and the absence of maps. This also comprises several RSPO certified concessions – estimated at 42,000 ha. For more information see Chain Reaction Research's published report on Indofood Agri Resources.

## Indofood Agri Resources: Labor Concerns and Child Labor

In October 2016, Rainforest Action Network and its local partners lodged a formal complaint against Indofood's subsidiaries PP London Sumatra Indonesia and Salim Ivomas Pratama. The complaint focused on labor violations on multiple PP London Sumatra Indonesia plantations. These alleged labor violations are in contravention of the RSPO Principles & Criteria and violations of the RSPO Code of Conduct.

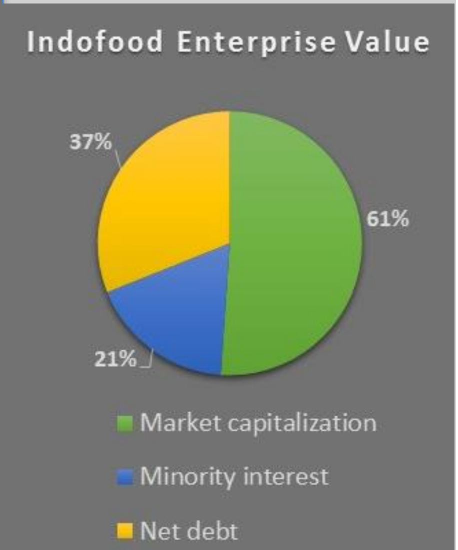
According to the complaint, Indofood Agri violated more than 20 Indonesian labor laws on two plantations in North Sumatra. These violations may be systemic in nature. Among the exploitative practices documented are:

- Child labor
- Exposure to highly hazardous pesticides
- Payment below the minimum wage
- Long-term reliance on temporary workers to fill core jobs
- Use of company-backed unions to deter independent labor union activity

The complainants requested that the RSPO membership status of the two Indofood Agri subsidiaries be suspended until transparent actions are taken to resolve the violations. A RPSO ruling is expected in 2017. In the meantime, Accreditation Services International (ASI) retracted the accreditation of Indofood's certification body, SAI Global, in December 2016.

Based on NGO community experience with the company, Indofood Agri's management is expected to pursue a highly defensive strategy, which may increase the probability of a group suspension, or a voluntary retreat from RSPO. If the company were suspended from the RSPO, it would be excluded from certified sustainable palm oil supply chains. Indofood Agri might lose a price premium for 38 percent of its total CPO production. But as was shown by the 2016 RSPO IOI Corporation case, an initial suspension may magnify into an unexpected and uncontrollable flow of interventions by investors, buyers, joint venture partners and consumers.

## Indofood Sukses Makmur: Equity and Debt Structure




At the end of fiscal year 2015, Indofood SM's enterprise value amounted to USD 5,393 million (IDR 74,730 billion). Shareholder funds accounted for 61 percent, minority interests contributed 21 percent and the net debt 18 percent. The company's total debt consists of 16 percent bonds and 80 percent bank loans.

### Indofood Sukses Makmur: Equity Investors Face Reputation Risks

Indofood SM is 50.07 percent owned by First Pacific, via CAB Holdings. The remaining Indofood SM free float shares, 49.03 percent, are owned by a number of foreign and domestic investors. Figure 1 below lists the most important outside equity investors in Indofood SM.

**Figure 1 Indofood SM's Equity Investors**

| Investor | Country | Holding |
|---|---|---|
| Vanguard Group | United States | 1.63% |
| BlackRock | United States | 1.26% |
| Dimensional Fund Advisors | United States | 1.63% |
| Macquarie Funds Management | Hong Kong | 0.43% |
| Pictet Asset Management | Switzerland | 0.31% |
| Causeway Capital Management | United States | 0.28% |
| PGGM Vermogensbeheer | Netherlands | 0.28% |
| **Total** | | **4.19%** |

Indofood SM's direct and indirect ownership of concessions and CPO suppliers with contested land and labor practices may violate these investors' No Deforestation, No Peat, No Exploitation (NDPE) policies. This possible violation may drive up Indofood SM's cost of equity.

For example, the American fund manager Dimensional Funds Advisors, who recently divested palm oil positions with similar financial risks from two of its portfolios, has a 1.63 percent ownership stake in Indofood SM.

### Indofood Sukses Makmur: Financial Risks for Banks

**Figure 2 Indofood SM's Outstanding Bank Loans, end of FY 2015**

| Bank | Country | Value (USD million) |
|---|---|---|
| Bank Central Asia | Indonesia | $454.9 |
| Bank Mandiri | Indonesia | $117.7 |
| Bank of Tokyo-Mitsubishi | Japan | $70.0 |
| Citibank | United States | $88.3 |
| DBS | Singapore | $163.3 |
| Mizuho Bank | Japan | $311.8 |
| Rabobank | Netherlands | $17.9 |
| Standard Chartered | United Kingdom | $4.8 |
| Sumitomo Mitsui Bank | Japan | $48.6 |
| UOB | Singapore | $141.1 |
| **Total** | | **$1,418** |

Indofood SM (INDF) and Indonesian market index return (JKSE)

| Indicator | INDF | JKSE |
|---|---|---|
| 1M return | -4.2% | -1.88% |
| 3M return | -14.99% | -5.08% |
| 1Y return | 49.04% | 13.13% |

As net debt accounts for 18 percent of the company's enterprise value and bank loans account for 80 percent of its total debt, banks are important stakeholders in Indofood SM. Indofood SM's bank loans outstanding at the end of 2015 are listed above in Figure 2.

## Indofood Sukses Makmur: Underperforms its Peer Group

Stronger IDR pushed up Indofood SM's net profit by 29 percent year-over-year for the six months ending June 30, 2016, as the company stemmed losses on foreign-currency denominated debt. The company reported a USD 169 million (IDR 2.23 trillion) profit. Finance expenses declined to IDR 803 billion from IDR 1.48 trillion. Figure 3 below compares the key ratios of Indofood SM to its peer group.

**Figure 3 Comparison of Indofood SM with its Peer Group**

| Company | P/E 2016 | P/E 2017 | EV / EBITDA 2016 | EV / EBITDA 2017 |
|---|---|---|---|---|
| Indofood SM | 16.35 | 15.49 | 9.55 | 8.75 |
| Unilever Indonesia | 45.06 | 41.11 | 31.59 | 28.39 |
| Mitra Adiperkasa | 45.37 | 24.99 | 8.94 | 7.75 |
| Nippon Indosari Corpindo | 29.17 | 24.49 | 15.44 | 13.00 |
| Mayora Indah | 29.06 | 24.74 | 16.29 | 14.28 |
| **Peer Mean** | **37.17** | **28.84** | **18.06** | **15.85** |
| **Peer Median** | **37.12** | **24.87** | **15.86** | **13.64** |
| **Food Products** | **20.47** | **17.09** | **11.94** | **10.43** |

Source: Thomson Reuters

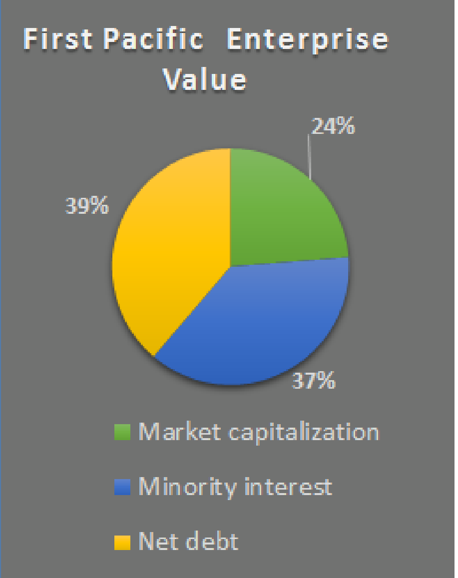
As shown above in Figure 3, Indofood SM underperforms versus its peers and consensus estimates. Indofood SM has P/E and EV/EBITDA ratios below its peer group for fiscal year 2016 and fiscal year 2017. This shows that expectations for Indofood's performance are already lower than for its peers. Additional negative information may also severely affect its equity returns.


## Indofood Sukses Makmur: Equity Valuation

Indofood Agri's contested landbank and labor issues may negatively impact Indofood SM's financial returns and its equity valuation. Indofood Agri is 74.49 percent owned by Indofood SM and accounts for 22 percent of Indofood SM's operational income. Also, 13 percent of Indofood Agri's palm oil sales are to other subsidiaries of Indofood SM.

Because of this close integration, Indofood SM's lenders and investors could conclude that the company is contradicting their ESG lending and investing policies through these financially material upstream relationships. These reputational risks could result in activities similar to Dimensional Funds Advisors recent divestment activity. The threat of losing banks and investors could consequently raise the average costs of capital of Indofood SM.

Assuming a small increase of 5 percent in the cost of capital, due to the ESG risks surrounding one of Indofood SM's subsidiaries, a decrease of 16 percent of the market capitalization of Indofood SM would be possible.




## First Pacific: Equity and Debt Structure

In FY2015, Indofood SM's parent company First Pacific had an enterprise value of USD 11,935 million (HKD 92,504 million). Shareholder funds accounted for 24 percent, minority interests for 37 percent and the net debt contributed 39 percent. The large percentage of minority interest that finances First Pacific represents the equity investors in First Pacific's listed subsidiaries, including Indofood SM. The 39 percent net debt to total capital ratio, and a net debt to EBITDA multiple of 4.24x, makes its bondholders and lenders extremely important financiers of First Pacific.

### First Pacific: Equity Investors Face Reputational Risks

First Pacific is 45.03 percent owned by Anthoni Salim and his business partners, the other 54.97 percent of the shares are owned by other investors. First Pacific's indirect and direct investment in Indofood Agri's contested land and labor risks may violate the ESG policies of these investors, leading to divestments. This development may drive up First Pacific's cost of equity. Figure 4 below lists the most important institutional investors in First Pacific.

**Figure 4 First Pacific's Equity Investors**

| Investor | Country | Shareholding |
|---|---|---|
| Brandes Investment Partners | United States | 7.94% |
| Lazard Asset Management | United States | 6.96% |
| Vanguard Group | United States | 0.98% |
| Nordea Funds | Sweden | 0.83% |
| Blackrock | United States | 0.72% |
| **Total** | | **17.43%** |

### First Pacific: Financial Risks for Banks

As net debt accounts for 39 percent of the First Pacific's enterprise value and banks account for 50 percent of its total debt, banks are important stakeholders of First Pacific. Figure 5 below lists banks providing loans to First Pacific in the past four years.

**Figure 5 First Pacific's Bank Loans 2012-2016**

| Bank | Country | Year | Value (USD million) |
|---|---|---|---|
| Bank of America | United States | 2014 | $40 |
| Bank of Philippine Islands | Philippines | 2012 | $40 |
| China Banking Corporation | Philippines | 2012 | $30 |
| HSBC | United Kingdom | 2014 | $40 |
| Malayan Banking | Malaysia | 2014 | $40 |
| Metropolitan Bank & Trust | Philippines | 2012 | $50 |
| Mizuho Financial | Japan | 2014 | $40 |
| Sumitomo Mitsui Financial | Japan | 2014 | $40 |
| **Total** | | | **$314** |


Bank of America, HSBC and others have policies against financing deforestation and child labor. First Pacific and its subsidiaries' practices are likely violating these. If these banks decide to avoid further lending to First Pacific, this might lead to an increase in the cost of debt. Even a small increase of 5 percent in the cost of capital, due to the ESG risks surrounding one of First Pacific's subsidiaries, can lead to a decrease 35 percent in the market capitalization of First Pacific. Its high leverage contributes to the significant decline in its stock price, as a result of higher costs of capital.