Investment Stewardship Group

Voting Bulletin: First Pacific Co Ltd

As part of our fiduciary duty, BlackRock's Investment Stewardship team (BIS) advocates for sound corporate governance and business practices that are aligned with long-term sustainable financial performance. This objective underpins all our engagements and votes at company meetings.

We engage company leadership on key topics emphasizing governance practices including management of environmental and social factors that potentially have material economic, operational or reputational ramifications for the company.

We determine our engagement priorities based on our observation of market developments and emerging governance themes and evolve them year over year as necessary. The BIS team's key engagement priorities include:

1. Board quality
2. Environmental risks and opportunities
3. Corporate strategy and capital allocation
4. Compensation that promotes long-termism
5. Human capital management

We are committed to enhancing the transparency of our stewardship practices. Where we believe it will help to understand our voting decisions at shareholder meetings, we will publish a Voting Bulletin explaining the rationale for how we have voted, and (where relevant) provide information around our engagement with the issuer

Company	**First Pacific Co Ltd**
Market	Hong Kong
Meeting Date	17th July 2020
Key Resolutions[1]	**Item 1**: to approve proposed acquisition by PT Indofood CBP Sukses Makmur Tbk of the total issued share capital of Pinehill Company Limited from Pinehill Corpora Limited and Steele Lake Limited, and related transactions
Board Recommendation	FOR
BlackRock Vote	BlackRock voted AGAINST the resolution.

Overview

First Pacific Co Ltd (FPC) is an investment holding company with operations in telecommunications, infrastructure, consumer food products, and natural resources. It is listed on the Stock Exchange of Hong Kong

[1] Full meeting resolutions can be accessed at: https://www1.hkexnews.hk/listedco/listconews/sehk/2020/0622/2020062200407.pdf

with a market capitalization of HK$6,418 million (US$823 million) as of 30 Jun 2020.[2] The company holds a 50.1% stake in Indofood Sukses Makmur (INDF), which in turn controls 80.5% of PT Indofood CBP Sukses Makmur Tbk (ICBP). Both ICBP and INDF are listed in Indonesia.

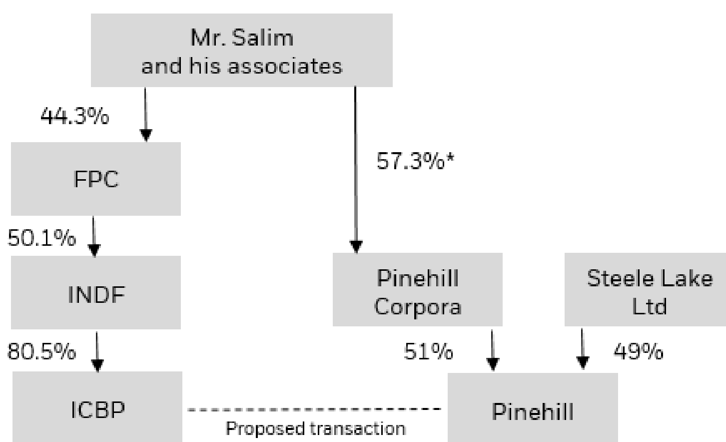
In February 2020, ICBP proposed to acquire Pinehill Company Ltd (Pinehill) from Pinehill Corpora Ltd (Pinehill Corpora) and Steele Lake Ltd for US$2.998 billion in cash. Pinehill is a private holding company that principally manufactures and distributes the “Indomie” brand of instant noodles via several subsidiaries in the Middle East, Africa and South Eastern Europe through a technical agreement for brand use, packaging and sourcing of ingredients and flavouring with ICBP.

Under Hong Kong Listing Rules, this is considered a connected transaction due to the fact that FPC’s Chairman is 1) a substantial shareholder, 2) President, CEO, & Director of both INDF and ICBP, and 3) in control of 57.3% of Pinehill Corpora which is one of the sellers proposing to dispose its 51% interest in Pinehill to ICBP. [3]

Given the size of the transaction, the ownership structures involved, and the respective local regulatory requirements, the transaction requires approval from all of ICBP’s shareholders as well as approval from a majority of its holding company FPC’s *independent* shareholders.

BIS has engaged with the management of both companies, as well as an independent director at FPC to inform our proxy voting decision.

On 13th July 2020, ICBP announced after local trading hours that its shareholder meeting, originally planned to take place on 15th July 2020, would be postponed as the Indonesian Financial Services Authority had made additional inquiries into the proposed acquisition. No timeframe was given as to when ICBP’s shareholder meeting would be held, nor was any information provided on the nature of the additional inquiries from the local regulator. Meanwhile, FPC has not made any announcement regarding the postponement of the shareholder meeting at ICBP, its subsidiary and the buyer in this proposed transaction. FPC has proceeded with its meeting to seek shareholder approval for its subsidiary’s proposal to buy a major asset despite the subsidiary deferring its vote. Approval of the proposed acquisition by ICBP shareholders no later than 28th August 2020 in accordance with Indonesian regulations is one of the conditions for the transaction to be completed.



Percentages refers to percentage of shares controlled.
*Pinehill Corpora is 49% owned by Mr. Salim and 8.3% by a relative of Mr. Salim.
Source: public disclosures by FPC and ICBP

[2] Source: Factset as of on 30 Jun 2020

[3] Source: Company circular published on 22 Jun 2020: https://www1.hkexnews.hk/listedco/listconews/sehk/2020/0622/2020062200359.pdf

Rationale for BlackRock's Vote

The proposed acquisition has merit from a strategic perspective. ICBP has in-depth knowledge of Pinehill's Indomie business, and Pinehill's established footprint in its current markets could provide ICBP a strong platform for overseas growth.

Nevertheless, BlackRock believes it is in our clients' economic interests to vote against the proposed acquisition due to two primary concerns:

- **The valuation and other terms of the transaction; and**
- **The board's oversight in relation to the inherent conflict of interest and lack of transparency regarding the additional inquiries from the Indonesian regulator on the proposed transaction.**

There are several concerns regarding the proposed terms of the transaction. We believe that the decision to include Southeast Asian peers in the pool of comparable companies used to determine Pinehill's valuation had an inflationary effect on the valuation. Given Pinehill's business locations, we do not find the inclusion of Southeast Asian food product companies – which trade at a premium to Middle Eastern and African peers – to be appropriate. On our assessment it inflates Pinehill's valuation by approximately twenty percent.

Moreover, the use of *trailing* price-to-earnings (PE) as a benchmark for the *forward* earnings of the target company is questionable from a valuation methodology perspective. Had the valuation of Pinehill been determined by forward earnings of comparable companies at the time the transaction was announced, it would have yielded a more accurate valuation. If Pinehill's last reported earnings in 2019 were used on a like-for-like trailing PE basis, the proposed acquisition price values Pinehill at 38.6x (after adjusting for foreign exchange and interest expenses), which is double the average multiple that buyers had paid for packaged foods companies in Africa, Middle East, and European emerging markets in the past five years. **As a consequence, our clients would be significantly overpaying to acquire the assets from Pinehill, indirectly as shareholders in FPC and INDF and directly as shareholders in ICPB.**

We are also concerned that ICBP's risk profile will materially worsen as the majority of the cash raised to fund the acquisition is US dollar-denominated loans, therefore introducing significant foreign exchange risk to a company whose revenues are derived mainly from the Middle East and Africa. While the US$128.5 million per annum profit guarantee is reassuring, any failure to fund the loans below the earnings yield of 4.3% on the total acquisition cost could dilute ICBP's earnings. Potential depreciation of the Middle Eastern and African currencies that revenues of Pinehill are denominated in could affect the earnings and expected dividends from this asset for FPC in the medium- and long-term.

Market perception of this transaction is clearly reflected in the related companies' share prices, which fell significantly relative to the local indices since the transaction was announced. Specifically, FPC share price fell as much as forty percent (almost four times the decline of Hang Seng Index) between mid-February to end-June 2020. The total value lost across the three companies (FPC, INDF and ICBP) over the same time period is estimated to be US$2.9 billion.

The proposal being put to vote by shareholders of FPC, even as the subsidiary ICBP has had to postpone its meeting to vote on this acquisition, signals a material failure in board governance. While the independent board committee at FPC appears to have reviewed the transaction, its acquiescence with the selection of comparable companies and its interpretation of earnings multiples in determining the economic consideration reflects a failure to protect the interests of shareholders of FPC.

The lack of communication regarding the indefinite postponement of the shareholder meeting at its subsidiary ICBP in Indonesia demonstrates poor transparency by management and the board of FPC in Hong Kong. This reinforces shareholders' concerns about transparency and due process at ICBP, particularly the company's decision in May to reclassify the transaction as one without a conflict of interest which would allow INDF, ICBP's controlling shareholder with an 80% stake, to vote on the proposal at ICBP's meeting.

In our view, the board at FPC not only failed to communicate with its minority shareholders in a timely manner, it has inappropriately proceeded with FPC's shareholder meeting to vote on the proposal despite the inquiry from regulators of ICBP, which creates uncertainty about whether the acquisition will go ahead as currently proposed.

Given the concerns over fundamental governance, valuation methods, and conflicts of interest, BIS decided to vote against the proposed transaction at the FPC meeting based on public information currently available. In addition, to address the material failure in governance by the board and poor transparency, BIS intends to hold the current members of the board of directors accountable by voting against their re-election at future shareholder meetings.