Investment Stewardship Group

Voting Bulletin: PT Indofood CBP Sukses Makmur Tbk

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	**PT Indofood CBP Sukses Makmur Tbk**
Market	Indonesia
Meeting Date	3rd August 2020
Key Resolutions	**EGM Item 1:** Approve Acquisition of the total issued share capital of Pinehill Company Limited
Board Recommendation	FOR
BlackRock Vote	BlackRock voted AGAINST the resolution.

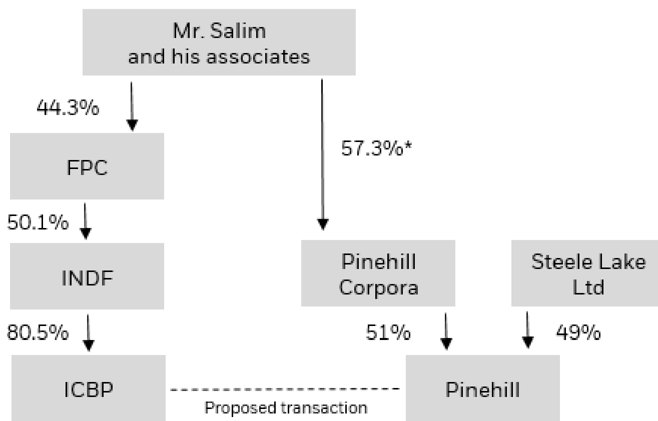
Overview

PT Indofood CBP Sukses Makmur Tbk (ICBP) is a manufacturer of food products including Indonesia's most popular instant noodle brand, Indomie. It is also an indirect subsidiary of Hong Kong-listed First Pacific Company Limited (FPC) through Indofood Sukses Makmur (INDF). ICBP's board sought shareholder approval via an Extra Ordinary Meeting (EGM) to acquire the entire stake of Pinehill Company Ltd (Pinehill), a private holding company that manufactures and distributes the Indomie brand of instant noodles throughout the Middle East, Africa, and South Eastern Europe.

The purchase is from the ICBP affiliate party Pinehill Corpora Ltd (Pinehill Corpora), which is 57.3% controlled by the President Director of ICBP, Mr. Anthoni Salim. Pinehill Corpora owns 51% of Pinehill, with the remaining portion being owned by Steele Lake Ltd. The total consideration for the transaction is US$2.998 billion in cash. Under Indonesian regulations, this is considered an affiliated party transaction given Mr. Salim's roles and holdings in ICBP, Pinehill Corpora, and Pinehill.

Given the size of the acquisition and the ownership structures involved, it constitutes a Material Transaction and therefore requires shareholder approval at the ICBP EGM, as well as from independent shareholders of its Hong Kong holding company First Pacific Company (FPC) at a Special General Meeting mandated under Hong Kong Listing Rules.

BIS has engaged with the management of both companies, as well as an independent director at FPC to inform our proxy voting decision. We have also published a Vote Bulletin on First Pacific Company for this transaction.



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

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 the following concerns:

- **The valuation and terms of the transaction; and**
- **The board's oversight in relation to the inherent conflict of interest**

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 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 appropriate 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 as shareholders in ICPB are significantly overpaying to acquire the assets from Pinehill**.

We are also concerned that ICBP's risk profile will materially worsen as the majority of the cash raised to fund the acquisition is in 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.

Perhaps most importantly, there is a material failure in governance at the ICBP board level resulting in a failure to protect minority shareholders' rights in what is an acknowledged related party transaction. When ICBP first announced the proposed acquisition in February 2020, the company held several investor calls and repeatedly emphasized that the transaction would be earnings accretive and that its controlling shareholder, INDF, would not be allowed to vote on this transaction due to a clear conflict of interest.

However, ICBP subsequently reversed its position in its May 22 filing, stating that INDF would vote despite the fact that it is an 80.5% controlling shareholder in ICBP, which is in turn controlled by the Salim group through the Hong Kong-listed holding company, First Pacific. **With the decision to allow INDF to vote, approval is a foregone conclusion.** ICBP's board determined that the transaction does not involve a conflict of interest as defined under current Indonesian regulations. Of importance, in April 2020, Indonesia's regulator announced it would introduce stricter regulations on Material Transactions coming into effect in October 2020,[1] under which INDF would have been required to abstain from voting on the ICBP transaction.

Market perception of this transaction is clearly reflected in ICBP's share price, which fell almost twenty percent (double the decline of the Indonesian Consumer Sector Index) since the transaction was announced.[2] Furthermore, the total value lost across ICBP and the related companies INDF and FPC over the same time period is estimated to be US$2.9 billion.

Given the concerns over fundamental governance, valuation methods, conflicts of interest, and expedited timing just prior to enhanced regulation, BIS has decided to vote against the proposed transaction. We escalated our concerns to relevant parties in the Indonesian market and have proposed opening a dialogue to discuss minority shareholder protections.

In addition, to address the material failure in governance at the board, BIS intends to hold the current members of the Board of Directors and Board of Commissioners accountable by voting against their re-election at future shareholder meetings.

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[1] No.17/POJK.04/2020 on Material Transactions and Change of Business Activities

[2] As of end-June 2020