

Neutral

Poultry

Chickens less likely to fly higher

January'19 livebird prices drop 12.2% YoY but DOC prices go up by 42.4% YoY

It seems average livebird price during January'19 came up weak, as it declined by 18.2% MoM and 12.2% YoY to Rp17,546/kg. This was largely attributable to the concern of poultry farmers in regard with the presence of outbreaks due to high rainfall season, whilst eventually led to panic selling of livebird. As such, livebird price dropped to a level below previous floor price for broiler enacted by government at Rp18,000/kg. Meanwhile, DOC price slightly decreased by 2.9% MoM, but still remarkably rose by 42.4% YoY to Rp6,470/chick. Amid expensive domestic corn price combined with drop in livebird price, we believe this will have potentially detrimental effects for the poultry farmers' blended margins. Noting that, blended margins of poultry companies are affected by product mix, whereas apart of feed division as the biggest contributor, DOC and broiler segments actually also have considerable portion over revenue.

Government lifts broiler and egg reference price in January'19

New catalyst for poultry industry just showed up recently as Ministry of Trade raised the broiler's reference price at the farmer's level to the new range of Rp20,000-22,000/kg from Rp18,000-20,000/kg. At consumer's level, new reference price for broiler was also adjusted up by 5.9% to Rp36,000/kg from Rp34,000/kg. Actually, government is also lifted reference price for egg at farmer and consumer level to Rp25,000/kg (from Rp23,000/kg) and Rp36,000/kg (from Rp34,000/kg), respectively. We believe such incentives are required in order to give flexibility for poultry farmers to ease the pressure from high corn price environment. In addition, we view that apparently the key focus of government is not only on managing the supply-demand dynamic, but also retain the price at above the level where smaller-sized farmers or breeder bottom line are not in the red territory.

No fears of oversupply this year in spite of higher GPS imports quota

Indonesian poultry industry has seen way better condition on the back of remarkable growth in average price of DOC and Broiler by 31.9% YoY and 16.3% YoY, respectively. This was largely due to lower Grand Parent Stock (GPS) import quota in the last couple years, previous culling programs and ban on Antibiotic Growth Promoter (AGP); as such resulted in tight supply. For this year, we believe oversupply less likely becoming a spotlight, given the support from government in overseeing the supply-demand dynamics and ample chicken consumption growth. However, government has allowed higher quota for GPS imports in 2018 and 2019F to 707,000 GPS (+8.7% YoY) and 800,000 GPS (+13.2% YoY), respectively. Despite population is also expected to rise by 1.3%/year, we believe the impact of higher GPS to be reflected in supply of broiler and DOC in 2020F and 2021F. We think supply of will be normalized starting 2020F onward.

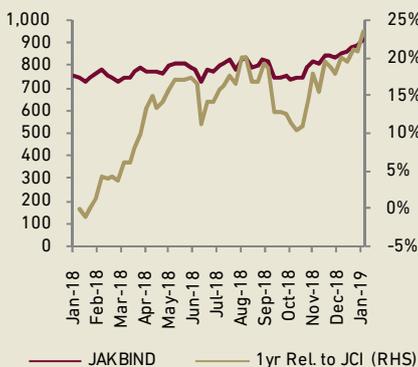
Corn price still relatively high in the early 2019, but harvesting period is yet to come

Lack of corn supply is the looming issue at the moment in our view. In the early of January, according to Indonesian Feedmill Association (GPMT), corn price stood at around Rp6,000/kg or way above the domestic corn reference ceiling price at Rp4,000. Fortunately, to cope with the situation, government has made a move by allowing National Bureau of Logistic (Bulog) as a sole importer to import another 30,000 tons of corn in February'19 after throughout 2018 corn import quota recoded at 100,000 tons. We believe this will protect domestic corn price more widening from reference ceiling price. However, we think government's self-sufficiency program has not yielded a desired outcome. Nevertheless, as the harvest festive is yet to come, starting in March'19 corn price will go down.

Downgrade sector rating to NEUTRAL

We downgrade our poultry sector investment rating from Overweight to Neutral with the rationale of i) uncertainty on corn price that may pressure blended margins of feed millers and ii) possible rising broiler and DOC supply progressively in 1 – 2 years ahead underpinned by higher GPS imports quota and iii) normalized impact of AGP ban. We cut our TP of CPIN to Rp5,850 and downgraded rating to Sell from Hold. We also lower TP of MAIN Rp1,670, and cut rating to Hold from Buy. However, we reiterate a Buy call on JPFA with lower TP of Rp3,000, offering limited upside potential of 11.1%. Thus, JPFA remains our top pick in poultry sector. Currently the counter trades at 12.2x P/E 2019, or 46% discount compare to its peers.

Sector	Poultry		
Bloomberg Ticker	JAKBIND		
Share Price Performance			
Last price	927.5		
52w High/Low price	932/695		
Mkt. Cap (Rpbn/USDmn)	723,938/51,453		
	3m	6m	12m
Absolute (%)	26.0	16.0	22.4
Relative to JCI (%)	13.8	8.1	25.7



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Exhibit 1. Rating and Valuation

Bberg Ticker	Rating	Mkt.Cap (Rp tn)	Last Price	Target Price	Upside pot.(%)	PER 2019F	PER 2020F	EV/EBITDA 2019F	EV/EBITDA 2020F	ROE 19F (%)	Yield 19F (%)
CPIN IJ	SELL	122.6	7,475.0	5,850.0	(21.7)	25.2	24.2	16.1	15.4	21.7	1.6
JPFA IJ	BUY	28.8	2,700.0	3,000.0	11.1	12.2	11.9	7.0	6.7	18.2	2.2
MAIN IJ	HOLD	3.9	1,730.0	1,670.0	(3.5)	16.4	16.4	7.6	7.1	10.1	2.4
Weighted Avg.	Neutral					22.6	21.7	14.2	13.6	20.8	1.7

Unfavorable broiler prices in January'19 but DOC prices remain strong

It seems average livebird prices in West Java during January'19 came up weak, as it declined by 18.2% MoM and 12.2% YoY to Rp17,546/kg. This was mainly buoyed by escalating supply in the farms gate due to presence of outbreaks during high rainfall season which eventually led to panic selling of livebird. As such, livebird prices slipped to a level below previous floor prices (Explained in Ministry of Trade regulation 96) for broiler enacted by government at Rp 18,000/kg.

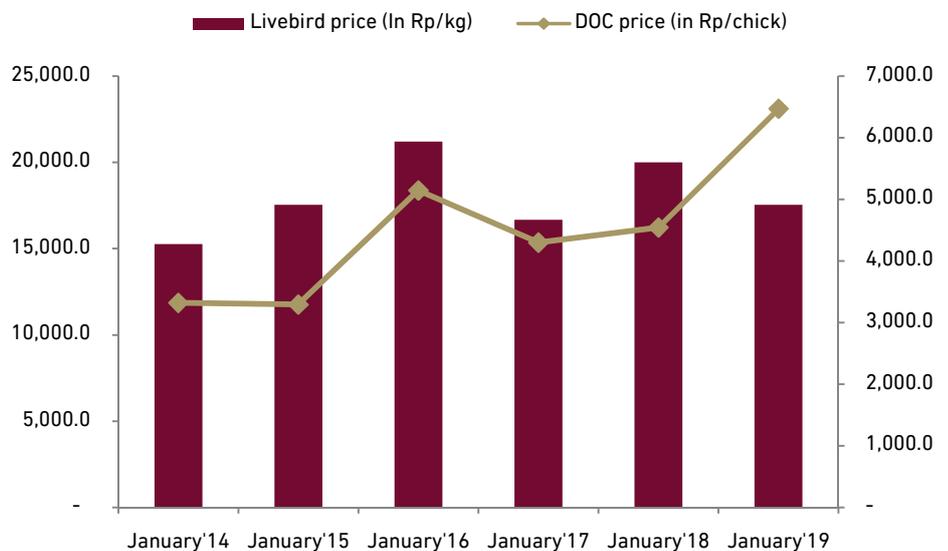
DOC prices somewhat fell by 2.9% MoM, but still remarkably rose by 42.4% YoY to Rp6,470/chick. The DOC market truly tells us about persistently limited supply of breeding and eventually resulted to relatively strong prices of DOC. We estimate DOC prices to remain steady at the current level in 1Q19, and we project margins of breeding farm/DOC division of feed millers will improve in 1Q19 compare to 1Q18. In addition, noting that blended margins of poultry companies are affected by product mix.

Exhibit 2. DOC and broiler price (MoM and YoY growth)

	Jan'19	Dec'18	MoM	Jan'19	Jan'18	YoY
DOC price (in Rp/chick)	6,470.0	6,660.0	-2.9%	6,470.0	4,545.0	42.4%
Livebird price (In Rp/kg)	17,546.0	21,452.0	-18.2%	17,546.0	19,997.0	-12.3%

Source : Company and Ciptadana

Exhibit 3. DOC and broiler price (January 2014 to January 2019)

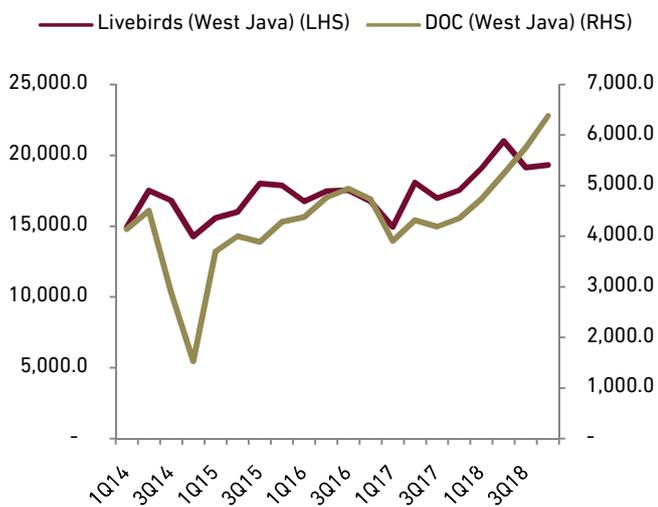


Source : Company and Ciptadana

Brief review of DOC and broiler price at the end of 2018

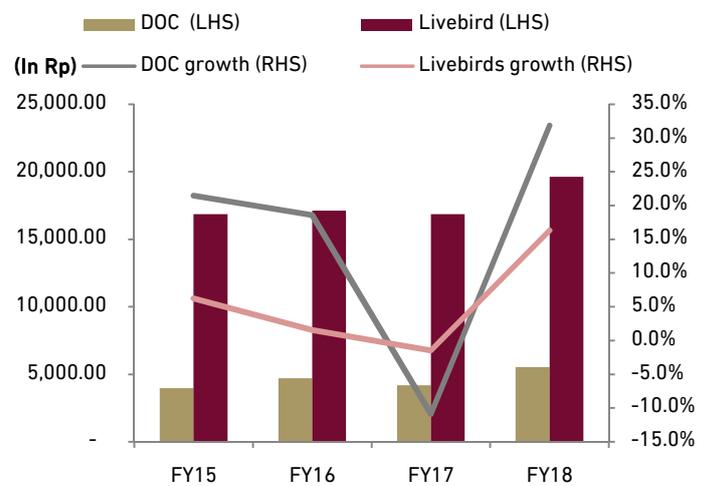
December '18 broiler price came up strong at Rp21,452 (+17.3% MoM and 8.4% YoY), making the average price for 4Q18 somewhat improved QoQ to 19,310/kg from Rp19,116/kg in 3Q18. Toward the end of the year (November to December), broiler prices are seasonally higher due to greater consumption. Nevertheless, we believe rising raw material cost underpinned by corn shortage also contributed to the broiler's price increase in December '18. Meanwhile, DOC price stable at Rp6,660/chick in December '18 compare to a month earlier, yet soared by 45.9% YoY. As such, average price for DOC in 4Q18 rose 10.8% QoQ and 46.5% YoY to Rp6,378/chick. Overall, 2018 was the recovery year for poultry industry after in a year before broiler and DOC price were declined in the aftermath of oversupply. This was largely due to lower Grand Parent Stock (GPS) import quota in 2015-2017, previous culling programs and ban on Antibiotic Growth Promoter (AGP); as such resulted in tight supply. Not that, average FY18 broiler and DOC price edged higher by 16.3% YoY and 31.9% YoY to Rp19,624/kg and Rp5,526.7/chick.

Exhibit 4: Quarterly average of DOC and livebird price



Source : Company and Ciptadana

Exhibit 5: Yearly average of DOC and livebird price

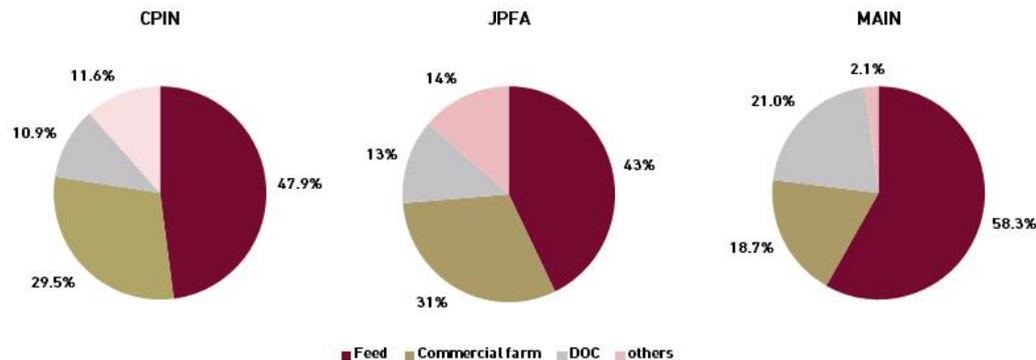


Source : Company and Ciptadana

Not just feed but broiler segment also substantially affecting the overall margins

Looking at the revenue mix of 3 feed millers under our coverage, the biggest revenue contributors for all players still come from feed division. MAIN has the biggest feed proportion to revenue with 58.3%, followed by CPIN (47.9%) and JPFA (43%). Moreover, for JPFA and CPIN, commercial farm or broiler segment is the second biggest contributor with 31.0% and 29.5%. Please note that, despite broiler division was newly combined back in 2016, but the portion has surpassed the DOC division since then. Unlike the top 2 feedmillers, for MAIN it turns out DOC segment is the second biggest revenue contributor with 21% portion, yet the gap between portion of DOC and broiler is just only around 2.3%. Meanwhile for CPIN and JPFA, the difference between DOC and broiler divisions' contribution was 18.0-18.6%. By and large, if the average broiler price in 2019F is lower compare to 2018 and domestic corn production issue prolong, this will detriment the margins of poultry players.

Exhibit 6. CPIN, JPFA and MAIN revenue mix (based on 9M18 data)

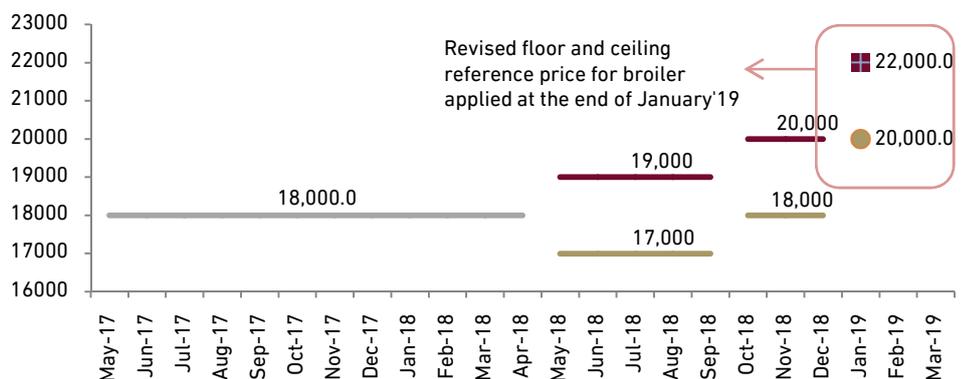


Source : Company and Ciptadana

Government sets new floor and ceiling price for broiler and egg in January'19

Recently Ministry of Trade has just raised floor and ceiling price of broiler at the farmer's level to the range of Rp20,000-22,000/kg from Rp18,000-20,000/kg. At the consumer's level, new reference price for broiler was also applied at Rp36,000, improved from Rp34,000/kg. Egg reference price at farmer and consumer level also adjusted upward to Rp25,000/kg (from Rp23,000/kg) and Rp36,000/kg (from Rp34,000/kg), respectively. Following the recent drops in broiler price, we believe in the near term broiler price will recover to the new reference price supported by possible rising in chicken consumption during the election period. We think the move of government by giving such incentives are highly important even though the impact might be minimum, nonetheless the presence of flexibility for poultry farmers to pass on the pressure from high corn price environment will lead their profitability more stable. In addition, we view that apparently the key focus of government is not only on managing the supply-demand dynamic, but also retain the price at above the level where smaller-sized farmers or breeder bottom line are not in the red territory.

Exhibit 7. Revision on broiler reference price from May'17 until January'19

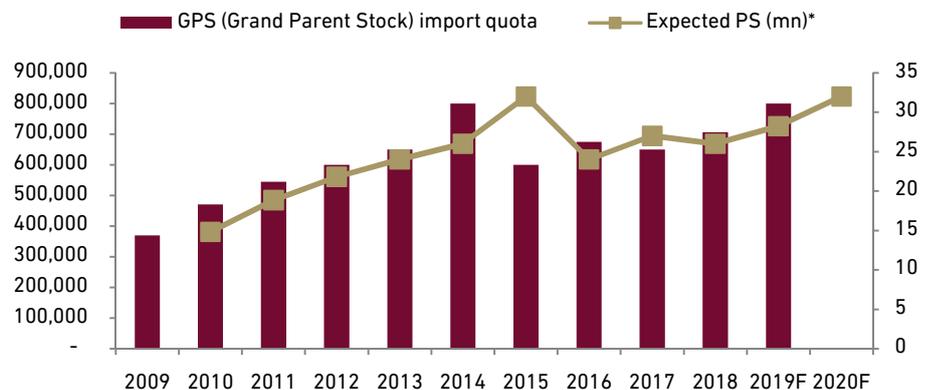


Source : Ministry of Agriculture and Ciptadana

GPS import quota to rise by 13.2% YoY in FY19F

Ministry of Agriculture has set 800,000 GPS import quota for this year, or 13.2% YoY higher compare to estimated import quota for FY18F at 707,000 GPS. We believe the volume growth is comparable with potential demand growth going forward, as our population is also expected to rise by 1.3%/year. Furthermore, as a rule of thumb, one GPS is able to produce 40 PS in 24 – 64 weeks. For the sake of simplicity, let just say the cycle from GPS to PS takes 1 year, we expect in 2020F, there will be an additional of 3.76 mn PS in 2020F. Meanwhile, the impact of higher GPS imports this year will also be reflected in supply of DOC in 2021F, referring to PS to FS production cycle which also takes 1 year as well. However, we see the oversupply that happened in 2015 and 2017 will not reoccur this year, given industry which overseen by government and ample chicken consumption growth. We see government's intervention in controlling the supply and demand dynamic plays pivotal role in managing the healthiness of poultry industry. Nevertheless, we think the supply will be normalized starting in 2020F, and the pricing power due to current tight supply will be lowered.

Exhibit 8. GPS import quota and expected PS



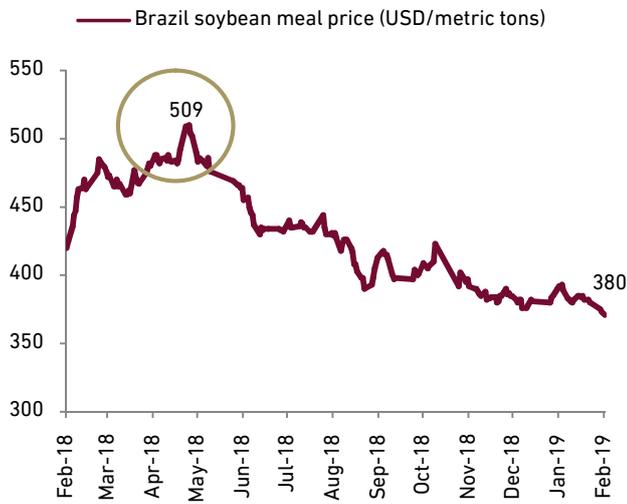
*: as a rule of thumb, 1 GPS produces 40 PS in t+1

Source: Various and Ciptadana

Price of soybean meal imports to remain less expensive

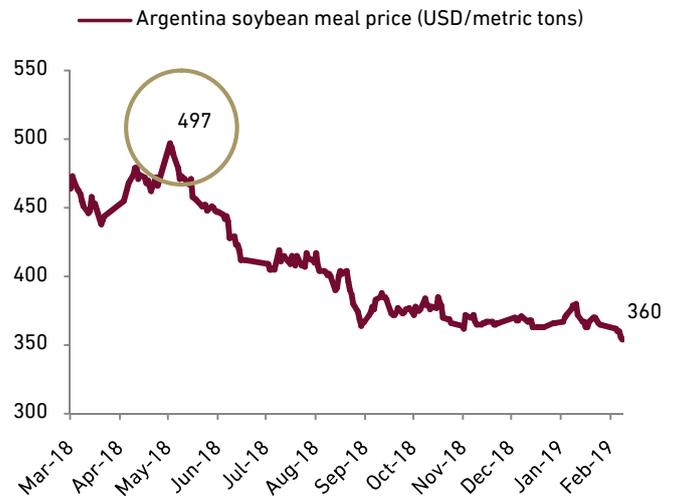
For feed millers, soybean meal is one of key protein source for feeds production. It normally accounts 25-30% of the total raw materials used. We see Indonesian poultry industry potentially reap benefits of relatively less expensive soybean meal price this year. This was attributable to the issues linger in global soybean industry such as U.S. – China trade dispute whilst result to lower use of soybean meal for feeds and swine by the Chinese companies. In other words, this implies the imports will be reduced from China, hence hurting global soybean meal price. Supply matters also came up from favorable production in Brazil after the soybean production was larger; yet another top soybean meal exporter like Argentina experienced crop failure. In fact, by looking at exh.9 and exh.10, the data shown that May'18 was the peak of soybean meal prices, but subsequently trending down by 25-27% up until today. In addition, from October'18 until today, rupiah has appreciated by 8.1%. Thus, we think poultry players will unlikely face input cost headwinds especially from soybean meal. However, we view downside risk on rupiah persists following the uncertainties on fed rate.

Exhibit 9: Brazil soybean meal price



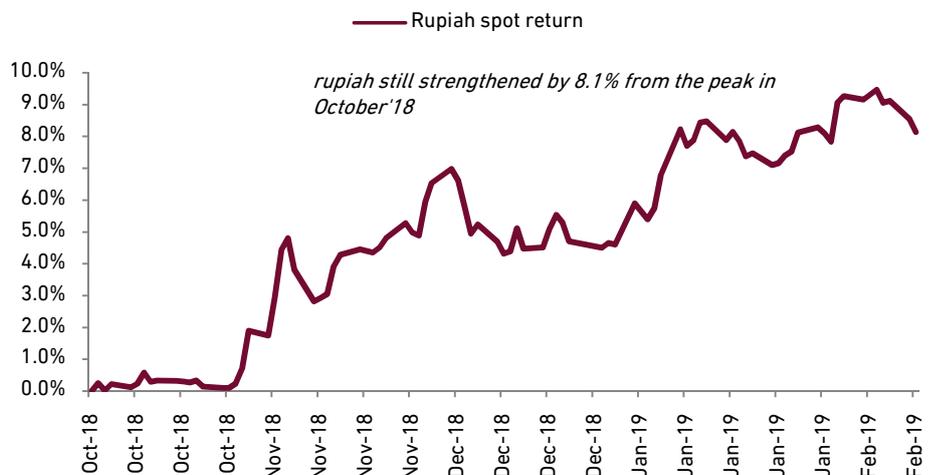
Source : Bloomberg and Ciptadana

Exhibit 10: Argentina soybean meal price



Source : Bloomberg and Ciptadana

Exhibit 11. Rupiah spot return

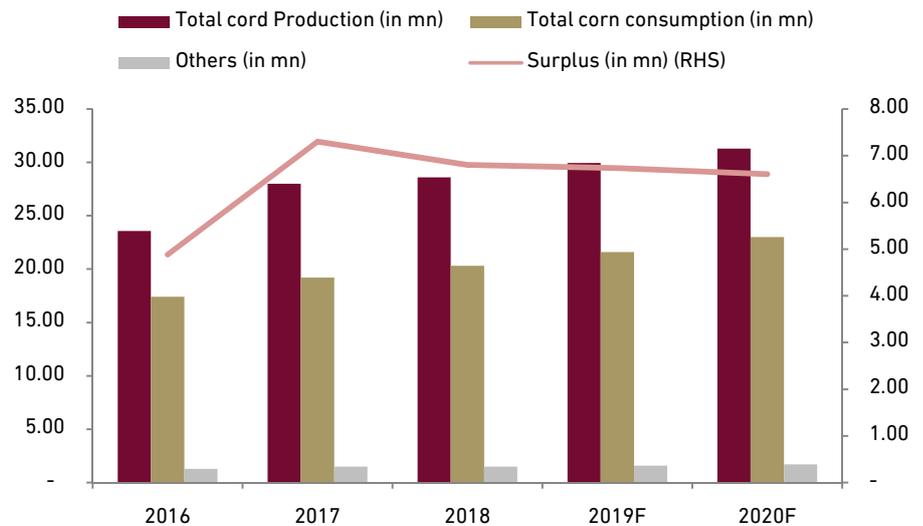


Source : Bloomberg and Ciptadana

Still no significant change in domestic corn production

On the back of self-sufficiency program, in 2017 President Jokowi instructed Ministry of Agriculture (MoA) to restrict the corn imports. Essentially, this was intended to encourage local farmers improving their productivity. Nonetheless, even though MoA claimed that Indonesia currently has been able to export its domestic corn production; last year corn price hit Rp6,000/kg, or way above the corn reference price of Rp4,000/kg, mainly attributable to supply shortage. As a result, when farmers complained about expensive raw material cost, government intervene the market by allowing corn imports. Yet, the redundancies about the condition of local corn production have led us to a conclusion that the outcome of self-sufficiency program has not come as expected. One of the major challenges in creating more stable corn price environment is the plant location which spread across Indonesia, whereas will be linked with the logistic cost as well.

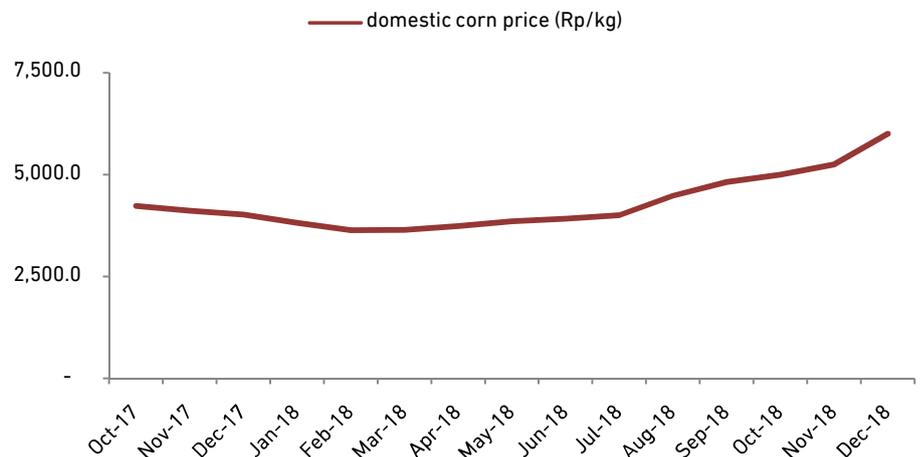
Exhibit 12. Corn production, consumption and surplus



Source : Bloomberg and Ciptadana

Despite of estimated surplus of corn by government, the corn import quota issued by government stood at around 100,000 tons toward the end of 2018. It was scheduled to fully absorb in January'19. Recently, since the harvest festive is delayed and expected to occur in March – April'19, government allowed National Bureau of Logistic (Bulog) as a sole importer to import another 30,000 tons of corn in February'19. We see the permission to import more corn is very important to cope with expensive corn price. At least, the corn price will not further away from the ceiling reference price. However, we expect the corn price to normalize during the harvest season.

Exhibit 13. domestic corn price



Source : Various and Ciptadana

Financial forecast adjustments for 3 poultry companies under our coverage

We lift our broiler ASP assumption for CPIN in 2019 to nearly Rp20,000 as we believe this year's broiler price in the farm gate to be in the range of new reference price enacted by government. However, we think ASP growth in 2020F is limited due to normalized supply of DOC and broiler. However we also lower our feed division sales volume growth by approximately 2%, given our more conservative view on the company's top line growth. We also fine tuned our cost assumption in order to incorporate the impact of high corn price environment; as a result we slightly revise down our gross profit assumption for 2019F and 2020F by 0.6-5.9%. At the bottom line, we trimmed our net profit for 2019F and 2020F to Rp4.85 tn and Rp5.07 tn, respectively.

Exhibit 14. CPIN forecast changes

(in Rp bn)	Old 19F	New 19F	Chg	Old 20F	New 20F	Chg
Revenue	59,457	59,468	0.0%	67,237	65,938	-1.9%
Gross profit	9,888	9,826	-0.6%	11,073	10,415	-5.9%
Operating profit	6,796	6,734	-0.9%	7,543	6,954	-7.8%
Net profit	4,906	4,857	-1.0%	5,523	5,070	-8.2%
Gross margin	16.6%	16.5%	-0.1%	16.5%	15.8%	-0.7%
Operating margin	11.4%	11.3%	-0.1%	11.2%	10.5%	-0.7%
Net margin	8.3%	8.2%	-0.1%	8.2%	7.7%	-0.5%

Source : Ciptadana

On JPFA, after having a discussion with the company, we think our previous projections were quite conservative. Similar like we have done in CPIN, we also raised our ASP assumption for commercial farm division in which the broiler sales accounted to slightly above Rp20,000. We also expand the growth of feeds and DOC division. Hence, we increase our revenue target in 2019F and 2020F by 8.3% and 8.9% to Rp39.9 tn and Rp43.9 tn, respectively. Yet, pressure from corn price seems to hurt blended margins of JPFA. In gross level, we trimmed our gross margin in FY19F and FY20F by 160 bps and 200 bps to 19.0% and 18.1%. Lastly, our net profit estimate for FY19-20F also lower by 6.6-11.4%.

Exhibit 15. JPFA forecast changes

(in Rp bn)	Old 19F	New 19F	Chg	Old 20F	New 20F	Chg
Revenue	36,912.0	39,963.1	8.3%	40,372.0	43,953.1	8.9%
Gross profit	7,601.0	7,601.1	0.0%	8,128.0	7,971.3	-1.9%
Operating profit	4,204.9	3,924.5	-6.7%	4,494.0	4,015.5	-10.6%
Net profit	2,523.0	2,357.4	-6.6%	2,728.4	2,418.7	-11.4%
Gross margin	20.6%	19.0%	-1.6%	20.1%	18.1%	-2.0%
Operating margin	11.4%	9.8%	-1.6%	11.1%	9.1%	-2.0%
Net margin	6.8%	5.9%	-0.9%	6.8%	5.5%	-1.3%

Source : Ciptadana

We also changed our financial projection for MAIN, we lift our revenue forecast for 19F and 20F by 4.7% and 4.5% as we believe the company may reach higher sales volume growth. Nevertheless, in order to better reflect the pressure from input cost in 2019F and lower ASP of broiler and DOC in 2020F, we trim our gross margins estimates by 0.3-0.6% for FY19-20F. Therefore, we arrive at lower net profit figure of Rp236.8 bn and Rp236.3 bn or decline by 4.1% and 12.5% from our FY19F and FY20F previous estimates.

Exhibit 16. MAIN forecast changes

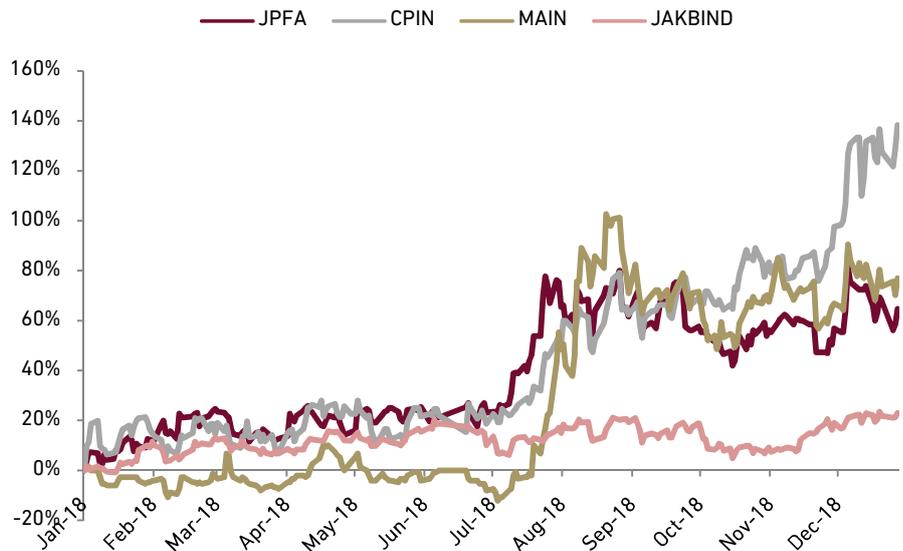
(In Rp bn)	Old 19F	New 19F	Chg	Old 20F	New 20F	Chg
Revenue	6,685.0	7,002.2	4.7%	7,285.0	7,609.8	4.5%
Gross profit	971.0	999.3	2.9%	1,050.0	1,054.6	0.4%
Operating profit	449.0	453.1	0.9%	482.0	461.0	-4.4%
Net profit	247.0	236.8	-4.1%	270.0	236.3	-12.5%
Gross margin	14.5%	14.3%	-0.3%	14.4%	13.9%	-0.6%
Operating margin	6.7%	6.5%	-0.2%	6.6%	6.1%	-0.6%
Net margin	3.7%	3.4%	-0.3%	3.7%	3.1%	-0.6%

Source : Ciptadana

Downgrade sector to NEUTRAL

In 2018, CPIN was the top performer by delivering 141% return, followed by MAIN with 89%, while JPFA was the laggard among its peers with only 65% return. In January'19, rally in CPIN's stock price brought the company valuation exceeded its +4stdev to around 29x P/E. We suspected there are several factors that can justify CPIN's stellar stock performance in spite of underperforming top line growth compare to JPFA. (1) was increased in flow as the company eventually back to be one of LQ45 member in January'19 (2) using rolling relative 5-year historical forward P/E band of CPIN, in 4Q15 amid recovery in broiler and DOC prices, CPIN's P/E rerated to 28.4x P/E or traded at its +3stdev. Hence, if we assumed 2018 was also the recovery year after the setback in 2017; by multiplying similar highest equity multiple with the consensus target price we arrived at Rp7,800/share. Yet, the price was hit Rp8,600 apparently, which seemed too expensive.

Exhibit 17. Feed millers share prices return in 2018



Source : Bloomberg and Ciptadana

In terms of top line growth, Indonesia poultry sector is still in a good shape as the aggregate revenue of 3 biggest feed millers grew at 12.3% CAGR over FY13-18F. Government initiatives in managing the healthy supply-demand dynamics as well as overseeing the key input cost are also positive for the industry. However, last year poultry companies' stock performances were undeniably outstanding on the back of margins improvement across the board. In our view this year's growth will likely decelerate due to high base last year. We think uncertainties on corn price, potential rising DOC and broiler supply in 1-2 years ahead due to higher GPS imports quota and normalizing impact on AGP ban will become issues that overshadow the poultry industry. Therefore, we downgrade our poultry sector's investment rating from Overweight to Neutral. We foresee the sector EPS growth to be slower and we trimmed the sector EPS growth for FY19F and FY20F by 6.6% YoY and 3.7% YoY from 9.8% and 11%.

Further, we cut our TP for the biggest poultry player in Indonesia (CPIN) from Rp6,050 to Rp5,850 (21.7% downside) and downgraded our recommendation to Sell from Hold. The counter trades at a lofty multiple of 25.2x 2019 P/E, or the most premium in the sector. We also downgraded our call on MAIN from Hold to Sell and cut the company's TP to Rp1,670 (3.5% downside) from Rp1,800. MAIN currently trades at 16.4x 2019 P/E, 27% discount compare to industry multiple averages. Meanwhile, we also lower our TP on JPFA from Rp3,150 to Rp3,000, remains our stance remain Buy with limited upside potential of 11.1%. Our TP on JPFA implies 12.2x 2019P P/E, or slightly below its +1stdev and the cheapest in the sector. Overall, we prefer JPFA as our top pick for the poultry sector. We think JPFA potentially trade closer to CPIN and deserve higher equity multiple relative to MAIN.

Exhibit 18. CPIN 3-year P/E band



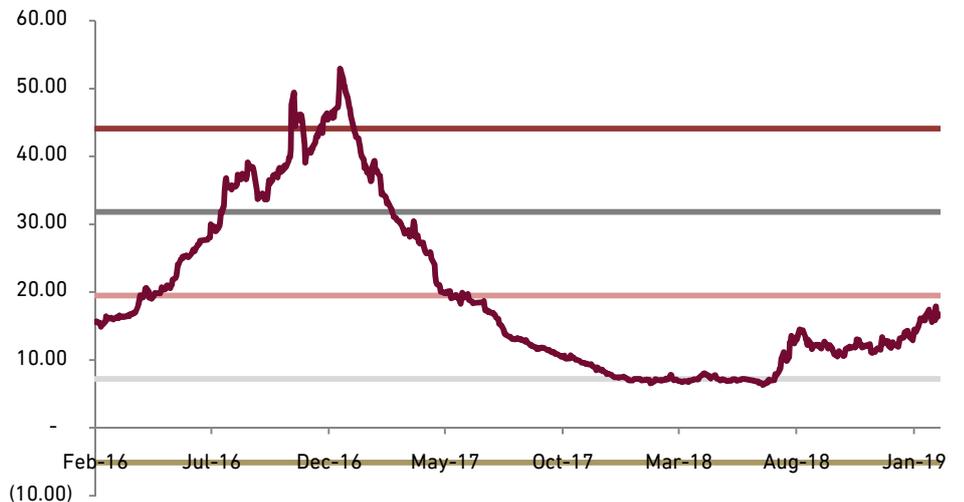
Source : Bloomberg and Ciptadana

Exhibit 19. JPFA 3-year P/E band



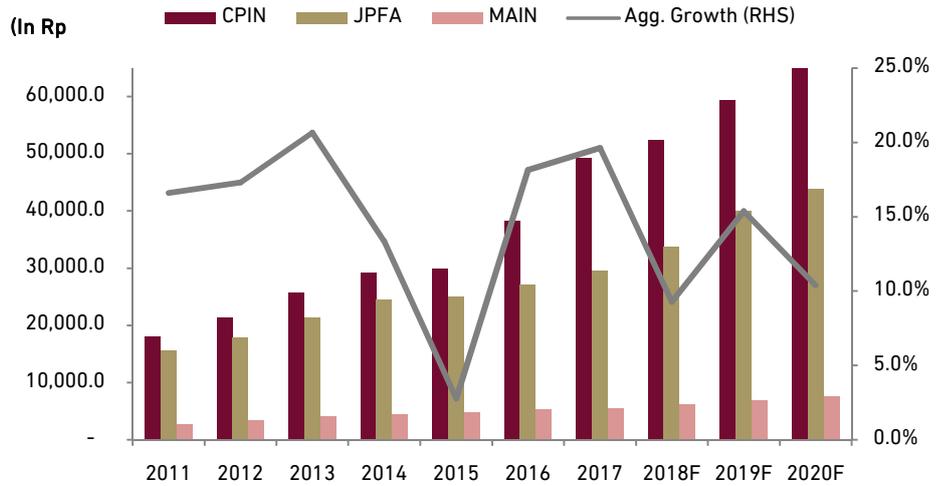
Source : Bloomberg and Ciptadana

Exhibit 20. MAIN 3-year P/E band



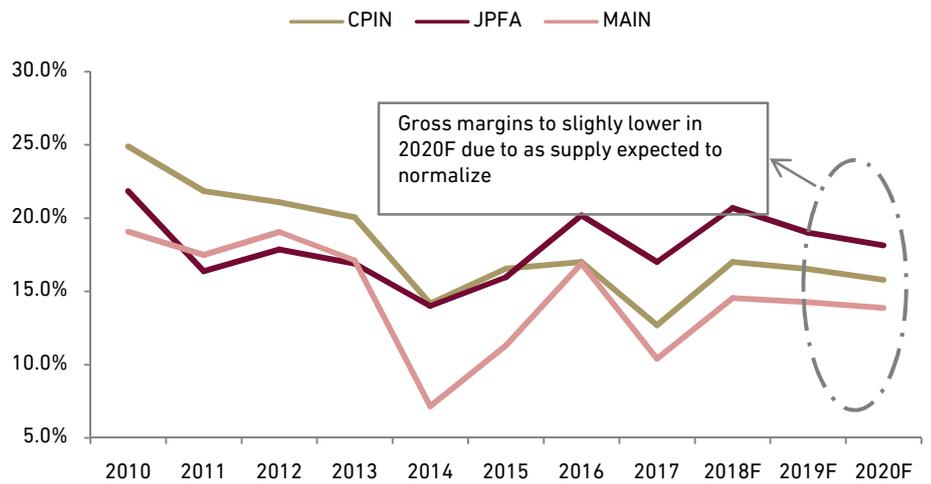
Source : Bloomberg and Ciptadana

Exhibit 21. Aggregate revenue growth of 3 major poultry players



Source : Company and Ciptadana

Exhibit 22. Gross margins of 3 feed millers



Source : Company and Ciptadana

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