Stable outlook for food and beverage industry

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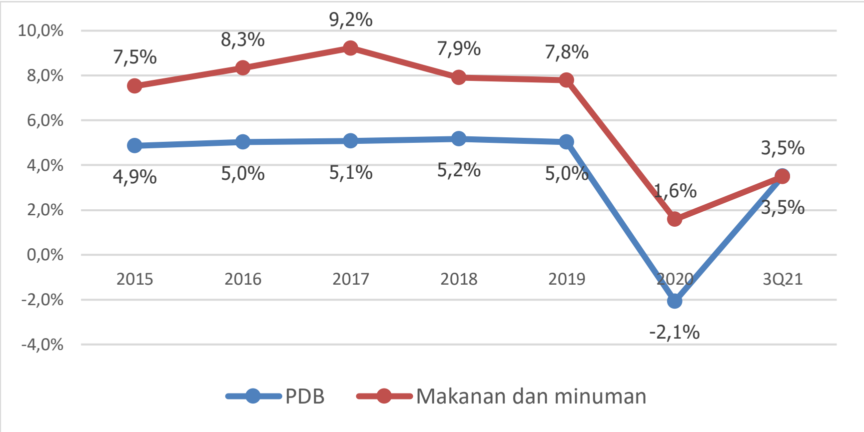
PEFINDO views the risk profile for the food and beverage (F&B) industry in Indonesia to remain low with a stable outlook over the near to medium term. The outlook is induced by potential large consumption from Indonesia's large population base of over 260 million people, half of whom are in productive age, and the tendency of the society to shift their spending to essentials, such as food and beverage, while cutting back on most non-essential categories. These compensate for weakening performance amid Covid-19 pandemic, particularly during the year 2020.

Positive growth for F&B industry despite the pandemic

We are of the view that the F&B is currently one of the resilient industries in Indonesia, as it recorded positive growth during the pandemic, albeit at a slower pace relative to the pre-pandemic era. Based on the data released by Bank Indonesia, the F&B industry grew by 0.2% year-on-year (YoY) in 2020, well below that of 7.8% YoY in 2019; yet, higher than Indonesia's gross domestic product, which contracted by 2.1% YoY in 2020.

Figure 1: Indonesia's GDP and F&B growth (constant price 2010)



Source: Bank Indonesia, processed by PEFINDO

The subdued demand for the F&B products in 2020 was attributable to the weakening consumers' purchasing power, stemming from the current economic downturn as reflected in the deflation during the year.

Figure 2: Indonesia's CPI

Source: Bank Indonesia, processed by PEFINDO

Physical distancing measure brings about unfavorable impact on the F&B industry

We view that physical distancing (*Pembatasan Sosial Berskala Besar* or PSBB and *Pemberlakuan Pembatasan Kegiatan Masyarakat* or PPKM) has unfavorably impacted the F&B industry. Many shops, including school canteens and retailers, are closed or open with limited capacity, resulting in reduced F&B sales. The drop in demand for F&B products was also apparent during the festive seasons such as Eid al-Fitr holidays.

The sales of F&B products in the second quarter of 2020 (2Q2020) were subdued relative to the same period in 2018-2019 when the Eid al-Fitr holiday occurred in the second quarter of the year, reflected by low growth of less than 1.0% YoY in 2Q2020 compared to the average growth in the second quarter of 2017-2019 of 7.7% YoY.

The subdued demand for F&B products was also reflected in the performance of several major F&B companies, such as PT Indofood Sukses Makmur Tbk (INDF), PT Mayora Indah Tbk (MYOR), PT Ultrajaya Milk Industry and Trading Company Tbk (ULTJ), PT Siantar Top Tbk (STTP), and PT FKS Food Sejahtera Tbk (AISA). In 1H2020, those F&B companies recorded lower revenue than that in the same period in 2018 – 2019.

Gradual lifts on travel and activity restrictions bolstered by the Government's stimulus package help to boost the demand for F&B products

The gradual easing of travel and activity restrictions, bolstered by the Government's stimulus package, has contributed to boosting the demand for F&B products, although it has not recovered to the pre-pandemic level. The more robust demand was reflected in the growth of the F&B industry of 2.4% YoY and 2.9% YoY in the first and second quarters of 2021 (1Q2021 and 2Q2021), relative to the industry growth during the same quarter of 2020 at 3.9% YoY and 0.2%YoY, respectively. The industry growth trend continued until the third quarter of 2021 (3Q2021) with a growth of 3.5% YoY compared to the same quarter of 2020 of only 0.7% YoY

The F&B companies under our portfolio also recorded signs of recovery, as reflected in the average sales growth of 13.8% YoY in the first nine months of 2021 (9M2021), compared to the negative revenue growth in 9M2020.

Figure 3: Revenue growth of F&B companies (% YoY)

Source: Companies' financial report, processed by PEFINDO

Increasing online transaction

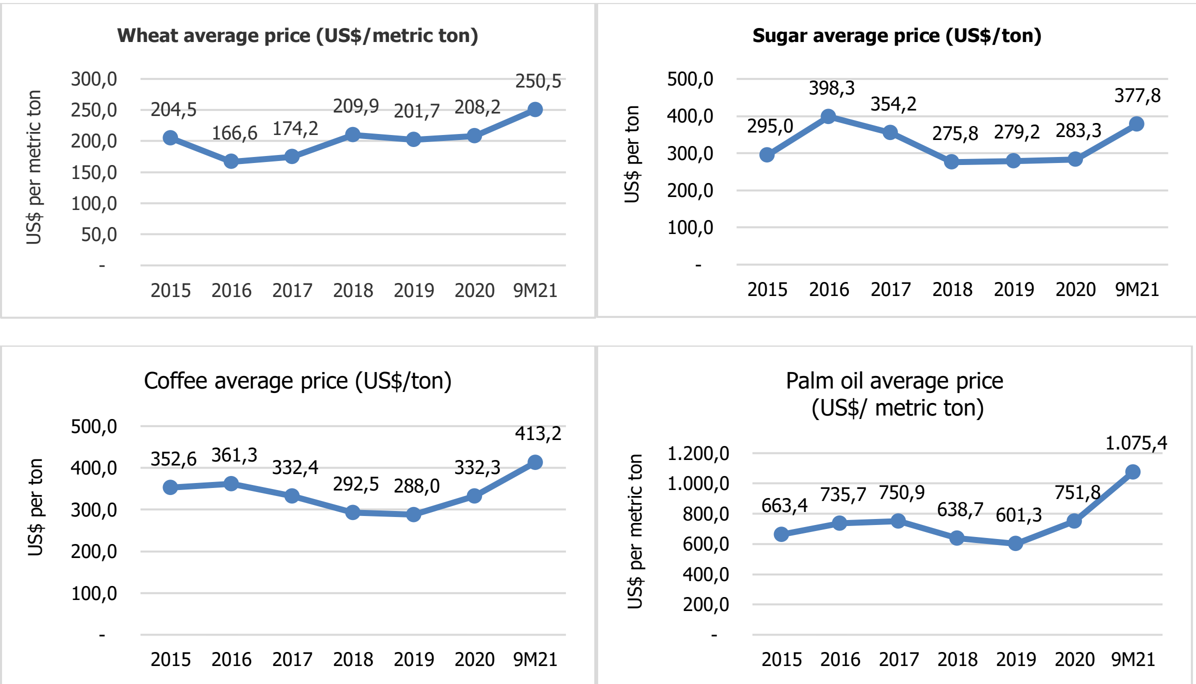
We are of the view that the current partial lockdowns in various regions and social distancing measures to contain the spread of the pandemic have resulted in shifting the consumers' shopping preference to digital media and e-commerce platforms. According to the released data by statista, the current prolonged pandemic, exacerbated by travel and activity restriction, has bolstered the domestic online shopping penetration rate to more than 80% as of June 2021. Facilitated by cashless payment methods, contactless delivery, and a complete selection of products, consumers manage to make purchases more safely and comfortably, without leaving their houses. We view that such a pattern will prevail over the near to medium term supported by continuous development of e-commerce technology and improvement of logistic system, thereby increasing the convenience of online transaction.

Commodity price fluctuation has moderate impact on profit margin

F&B companies are exposed to fluctuating of commodity price, as raw materials constitute a major portion of production costs. Market disruption impacted by the Covid-19 pandemic, unfavorable climate, and surging demand due to concerns regarding food security, were the factors contributing to hikes of raw materials price in 2021. Accordingly, we view that an appropriate change in business strategy is essential to prevent profit margin erosion. Commodity price hedging in the procurement of raw materials is one of the most widely used tools to minimize the negative impact of price volatility. Other strategies include strengthening the supply chain by building strategic partnerships with local farmers and suppliers, diversifying the supply of raw materials, and substituting expensive raw materials without compromising the product quality.

Although being exposed to the fluctuation risk of raw material prices, we expect it will have a mild to moderate impact on the F&B companies under our portfolio as we view the companies' policy has been effective to manage the raw material price fluctuation such as through maintaining the optimum inventory level of raw material for a continuous production. Some companies may also pass on the rising costs to their product price, although such price adjustments cannot be made immediately as it also needs to consider consumer purchasing power, product affordability, and competition. F&B companies' capability to mitigate the risk of fluctuation of commodity prices was reflected in the relatively stable profit margin and manageable cost of goods sold (COGS) over the past years.

Figure 4: Wheat, sugar, coffee, and palm oil price indexes



Source: www.worldbank.org, processed by PEFINDO

Stable credit quality of F&B companies under PEFINDO coverage

PEFINDO has rated five F&B companies, namely PT Indofood Sukses Makmur Tbk (INDF, idAA+/Stable), PT Mayora Indah Tbk (MYOR, idAA/Stable), PT Ultrajaya Milk and Trading Company Tbk (ULTJ, idAA-/Stable), and PT FKS Food Sejahtera Tbk (AISA, idBB+/Stable). We are of the view that the rating outlook for each issuer will remain stable over the next 12 months, given Indonesia's vast population base and relatively strong market position of the companies under our portfolio. We also believe that product diversification, market penetration, and effective marketing strategy will contribute to sustaining sales growth.

Regarding the impact of the Covid-19 pandemic, we view these companies were also exposed to weakening consumers' purchasing power as reflected in the decline or even negative sales growth in 2020. In 2020, both INDF's and STTP's sales still increased by 6.7% and 9.5% YoY, respectively, while those of AISA, MYOR, and ULTJ experienced declined by 15% YoY, 2.2% YoY, and 4.1% YoY, respectively. In addition to the sluggish domestic sales, MYOR's contraction in sales was stemmed from lower export, especially to China and India as its export destination countries, due to the imposition of lockdowns to curb the spread of the Covid-19. In the case of AISA, other than the Covid-19 pandemic, the sales decline was attributable to the instability of its internal conditions as AISA's status on suspension of debt payment (*Penundaan Kewajiban Pembayaran Utang* or PKPU) was just settled in 2019.

In terms of profit margin, those of the companies in our portfolio were relatively stable, resulting from the adoption of an appropriate cost management control. The companies' financial flexibility was also sufficient, underpinned by strong internal cash flow and adequate support from related parties, such as banks, and an ample credit line, given the relatively conservative financial leverage ratio. We view that INDF will remain the market leader and the best performer in the industry, bolstered by its well-diversified business portfolio, vertically integrated business operations, and strong financial performance.

Regarding debt instrument maturity in our F&B portfolio, there will be no maturing debt instruments in our portfolio that will mature in December 2021, while the debt instruments of those rated companies worth IDR3.95 trillion will mature in 2022, which we expect to be repaid by internal cash or other repayment sources.

Figure 6: Financial Highlights

Financial highlights	AISA 30-Sep-21	INDF 30-Sep-21	MYOR 30-Sep-21	STTP 30-Sep-21	ULTJ 30-Sep-21
Total adjusted assets [IDR Bn]	1,724.0	113,115.1	20,130.7	3,708.7	9,010.0
Total adjusted debt [IDR Bn]	254.8	56,362.0	5,223.4	0.0	3,024.0
Total adjusted equity [IDR Bn]	615.2	23,948.6	11,067.4	3,109.4	4,781.9
Total adjusted sales [IDR Bn]	1,093.7	72,808.3	19,887.8	3,045.1	4,792.1
EBITDA [IDR Bn]	14.3	14,971.1	2,127.6	503.2	1,218.9
Net income after MI [IDR Bn]	18.0	5,409.6	977.9	433.3	910.4
EBITDA margin [%]	1.3	20.6	10.7	16.5	25.4
Adjusted debt to EBITDA [X]*	13.4	2.8	1.8	0.0	1.9
Adjusted debt to adjusted equity [X]	0.4	2.4	0.5	0.0	0.6
FFO to adjusted debt [%]*	5.7	25.3	41.0	n.a	37.9
EBITDA to IFCCI [X]	4.3	8.6	9.1	89.1	6.5
Corporate Rating	idBB+/Stable	idAA+/Stable	idAA/Stable	idA+/Stable	idAA-/Stable

**) Annualized figure*
Source: Financial statements, processed by PEFINDO