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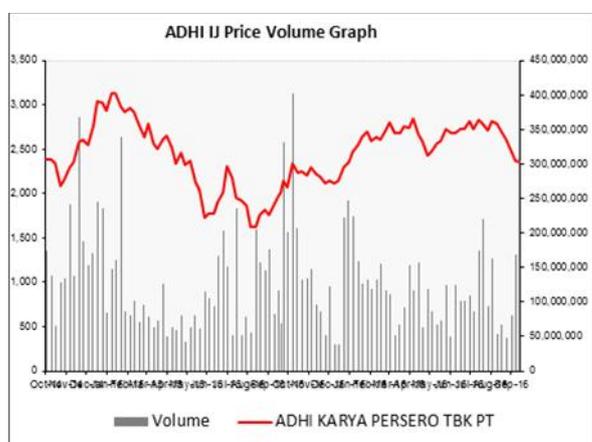
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beyond construction

**PT Adhi Karya (Persero) Tbk is an Indonesia-based company primarily engaged in provisioning construction services. Its business is classified into five segments: construction, engineering, procurement and construction (EPC), property, real estate, and investment**

**Current Price: IDR 2,430**
**52-Week Target Price: IDR 3,120**

**Initiating Coverage**
**PT Adhi Karya (Persero) Tbk (ADHI)**
**One Step Away**
**BUY**

**We initiate coverage on PT Adhi Karya (Persero) Tbk (ADHI) as BUY with 52-week target price of IDR 3,120 (28.4% potential upside) as we roll over our valuation base to FY17E, deriving via P/E multiple.** Our TP implies FY17 P/E of 16.5x (0.5SD above stock's five-year historical mean). While there is still a risk on FY16E earnings, we remain positive that the turnaround story is still valid on the long-awaited award of LRT contract in 2H16 though the growth will mainly shifting to 2017.

**Looking forward to LRT contract signing.** To provide a greater clarity on LRT project, a new decree (Perpres 65/2016) has been released, replacing the Perpres 98/2015. The new decree gives details on contract signing timeline and payment steps. Since there are four steps on contract signing timeline where each step needs to be completed within 30 days, we expect there is a massive jump in new contracts in the coming months from LRT project.

**Still have an ample room to leverage.** ADHI's 1H16 cash position stands at IDR 3.4 Tn (vs. IDR 4.3 Tn in FY15), making up 1H16 net gearing ratio stands at 0.1x. The reduction on gearing ratio mainly because of the right issue conducted last year with total proceeds of IDR 2.74 Tn to partly finance the construction of LRT project. The improvement on its gearing ratio enables ADHI to leverage its upsized equity to secure larger scale projects.

**So much bad news has been priced into the share price.** So far, since the 1H16 earnings result has been released at the end of July 2016, the stock price fell down by 15%, relative to JCI. We feel that the correction in the stock price is most likely generated by the incredibly soft 1H16 performance, particularly a huge decline in net income (-21.2% YoY), coupled with slow performance on new contract achievements, and the uncertainty on LRT project funding which signaling most of the bad news has been priced in, in our view. A piece of positive news will be in favor at share price to soar back up. Positive news, in our view, is the LRT contract signing which could become a source of earnings upside for the company and a relief from uncertainty.

The risk to our call: 1) Lower than expected LRT project's margin; 2) Government budget cuts; 3) Faster than expected construction works on LRT.

**Share Price Performance**

Price (IDR)	2,430
52-Week High (04/26/16)	2,910
52-Week Low (10/07/15)	1,920
52-Week Beta	1.14
YTD Change/%	290.00/13.55%

**Stock Information**

Market Cap (IDR)	8,432.1B
Shares Out/Float (M)	3560.8M/2,642.2M

**Financial Highlights**

	2014	2015	2016E	2017F	2018F
Revenue (IDR Bn)	8,654	9,390	14,148	17,840	21,343
% growth		9%	51%	26%	20%
Gross Profit (IDR bn)	998	975	1,505	1,920	2,364
Net Profit (IDR bn)	311	464	506	671	867
% growth		49%	9%	33%	29%
EV/EBITDA (x)	12.1	9.3	9.4	7.9	6.8
Gross Margin (%)	11.5%	10.4%	10.6%	10.8%	11.1%
Net Margin (%)	3.6%	4.9%	3.6%	3.8%	4.1%
ROE	9.0%	9.0%	9.5%	11.4%	13.7%
ROA	2.3%	2.6%	2.4%	2.7%	3.6%

Source: Company Data, Sinarmas Investment Research

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**Please see important disclaimer and disclosure at the end of the document**

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## Company Background

PT Adhi Karya (Persero) Tbk (ADHI) is an Indonesia-based company primarily engaged in provisioning construction services. ADHI was established in 1960 and listed in 2004 as the first construction company in Indonesia Stock Exchange and is currently 51% government-owned. Its business is classified into four segments:

1. **Construction.** Civil and building contractors that engage in civil and building development projects owned by government and/or private companies.
2. **Engineering, procurement, and construction (EPC).** Activities that covers engineering, procurement, and construction for oil and gas industry as well as power business for both government and/or private companies.
3. **Property/Real Estate.** Focuses on the development of high rise building for commercial use, office, residential (apartment), high quality residential area, landed house, home office, home store (shop), and shopping centers (malls). Also, specializes in either land development or in residential design development
4. **Precast Manufacturing.** Business activity that engages in production of manufactured precast concrete to fulfill the needs on roads, bridges, buildings, foundation and retaining wall, port and sea, as well as special needs.

In running the business, ADHI established the subsidiaries, namely PT Adhi Persada Gedung (APG), PT Adhi Persada Properti (APP), and PT Adhi Persada Beton (APB) where each subsidiary focuses on different line of businesses.

1. **Adhi Persada Gedung (APG)** engages in construction services focusing on high rise buildings.
2. **Adhi Persada Property (APP)** engages in development of high rise buildings, such as apartments, hotel, condotel, office tower, and property operator.
3. **Adhi Persada Beton (APB)** engages in industrial work, export-import and trading of precast concrete, and related business activities.

## Company & Shareholder Organization Structure



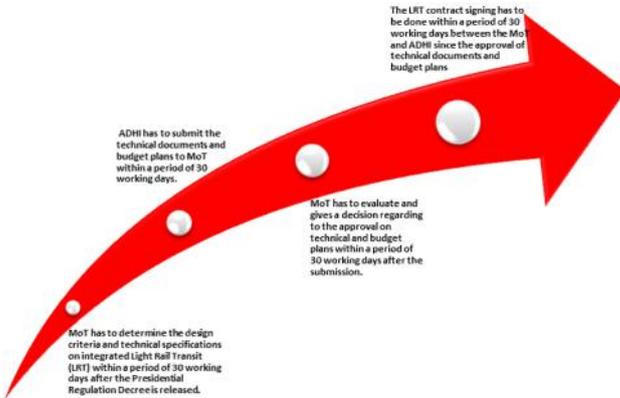
Source: Company Data

## Investment Theses

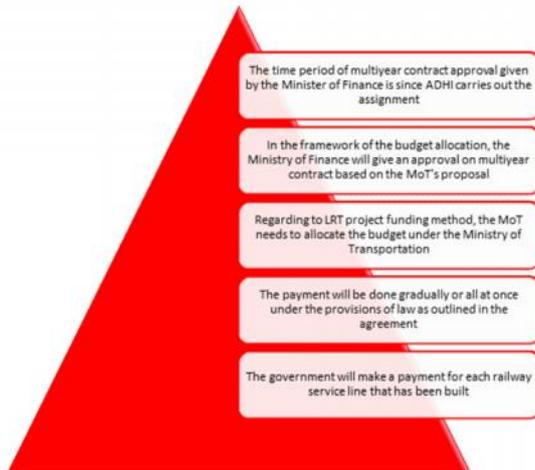
### Catalysts:

- **Greater clarity on LRT project backed up by Presidential Decree (Perpres) 65/2016.** The new decree (Perpres 65/2016) has been released to give some clarifications related to the development of LRT project, such as the contract signing timeline, payment steps, and the appointment of Kereta Api Indonesia (KAI) for the procurement and operation of LRT facilities where the project owner is under the Ministry of Transportation (MoT). The MoT is assigned to allocate the required budget for the project where the payment is made by construction stages which means positive for ADHI due to earlier cash flow. Besides, it also mentioned that ADHI will get additional construction works on depots which potentially will increase the project value. ADHI expects to get ~ IDR 20 tn from LRT phase I and ~ IDR 600 bn from depots. With a slow progress on 8M16 new contract achievement that stands at IDR 9.2 tn, ADHI's FY16 performance is most likely more dependent on LRT project.

### Contract Signing Timeline



### Payment Steps



- **The LRT contract signing should be imminent.** Based on our discussion, the progress on contract signing timeline is currently at finalizing technical and budget plan (step 3). Since there is only one more step left, it can be said that the company is set to benefit from a significant jump in total contracts in the coming months. ADHI expects to sign the contracts within 30 days which is on November 2016 at the latest. We hope that by the time LRT contract is signed, there is no more discrepancy between cost and revenue recognition related to LRT project since at the moment the construction works on LRT has been started though the contract has not been signed yet. The LRT project is expected to carry GPM level at around 13% (vs 10-11% GPM on general construction), but due to the contract signing has not been materialized, ADHI recorded the revenue from LRT project at costs.

- **Currently trading at a discount compare to its peer.** ADHI is currently trading at 15.18% discount to its comparable median in terms of T12M P/E ratio, makes ADHI becoming the cheapest SOE contractor compare to other SOE contractor companies in the market. ADHI's FY17E P/E stands at 16.5x (0.5SD above stock's five-year historical mean).

### Risks:

- **FY16E earnings risk due to soft results in 1H16.** ADHI recorded a weak 1H16 net income of IDR 56 bn (-21.2% YoY) which stood under our/consensus FY16 projections, represents only 9-11% of our/consensus FY16 estimates. Further, at gross margin level, it went down to 8.56% (vs. 10.12% in 1H15) due to losses from EPC segment and a decrease on 2Q16 construction margin that stood at 12.3% (vs. 13.1% in 1Q16) since there is a difference between cost and revenue recognition on LRT project where the construction works on LRT has been started though the contract has not been signed yet.

Company	Ticker	T12M P/E Ratio
PT Pembangunan Perumahan	PTPP	21.89
PT Wijaya Karya	WIKA	25.53
PT Adhi Karya	ADHI	18.16
PT Waskita Karya	WSKT	20.93
<b>Median</b>		<b>21.41</b>
<b>Company Discount</b>		<b>-15.18%</b>



- Weak new order booking.** Along with the increase in government infrastructure budget in 2016, ADHI's management put a quite ambitious new contracts target at the beginning of the year 2016, amounting of IDR 25.1 Tn (exclude LRT new contract), up 80.6% compared to the realization of new contracts in 2015 amounting of IDR 13.9 Tn. Since there is a slow 6M16 YTD new contracts achievement which is only 24% of the target, we are still waiting for the management to revise down its new contract target in order to fully represents ADHI's new contract performance. The management targeted the FY16 revenue/net income at IDR 20 Tn/750 Bn. The LRT project most likely carries 31 Tn on contract value which is divided into two phases, with ~ IDR 20 Tn in Phase 1 and IDR 11 Tn in Phase 2.

Uraian	APBN'16	APBN P'16	RAPBN'17
<b>A. Pendapatan Negara</b>	<b>1,822,546</b>	<b>1,786,225</b>	<b>1,737,629</b>
<u>I. Pendapatan Dalam Negeri</u>	1,820,514	1,784,250	1,736,257
1. Penerimaan Perpajakan	1,546,665	1,539,166	1,495,894
2. Penerimaan Bukan Pajak	273,849	245,084	240,363
<u>II. Penerimaan Lihlah</u>	2,032	1,975	1,373
<b>B. Belanja Negara</b>	<b>2,095,725</b>	<b>2,082,949</b>	<b>2,070,466</b>
<u>I. Belanja Pemerintah Pusat</u>	1,325,551	1,306,696	1,310,439
Belanja Kementerian Negara/Lembaga	784,126	767,810	758,378
Belanja Non Kementerian Negara	541,426	538,886	552,061
<u>II. Transfer ke Daerah dan Dana Desa</u>	770,173	776,253	760,027
<b>C. Keseimbangan Primer</b>	<b>(88,238)</b>	<b>(105,506)</b>	<b>(111,431)</b>
<b>D. Surplus/Defisit Anggaran (A-B)</b>	<b>(273,179)</b>	<b>(296,730)</b>	<b>(332,837)</b>
% Defisit terhadap PDB	-2.15	-2.35	-2.41
<b>E. Pembiayaan</b>	<b>273,179</b>	<b>296,724</b>	<b>332,837</b>
Ministry of Public Works	101,700	94,700	102,900
Ministry of Transportation	45,700	39,900	44,900

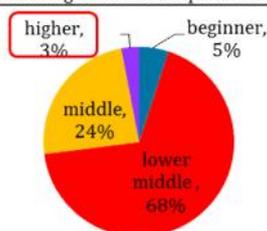
- The sustainability of infrastructure budget.** The risks related to infrastructure development in Indonesia is government spending cuts. The investors have a big concern if the government is not being able to keep up with the acceleration of infrastructure spending where declining state revenue and expanding state deficit become the parameters of government spending capacity. Recently, the government has published its planned state budget for next year (RAPBN 2017), with the budget on Ministry of Public Works (MoPW)/Transport (MoT) increase by 8.6%/12.53% to IDR 102.9 Tn/IDR 45 Tn (vs. IDR 94.7 Tn/IDR 39.9 Tn in APBN-P 2016), but if we compared to APBN 2016, the MoPW's budget has decreased by 1.17%, while MoT's budget increased by 1.34%. However, the state expenditures has been expected to fall down by IDR 10 Tn YoY to IDR 2,070 Tn.

**There are still concerns over the LRT funding scheme.**

- Potential higher than expected working capitals and further delay in contract signing due to the change in MoT's funding scheme.** Based on the Presidential Regulation (Perpres) 65/2016 about the LRT Project Acceleration, it mentioned that LRT project will be funded by using APBN budget. In fact, the MoT has not allocated the IDR 5 Tn budget required for the LRT projects in 2017 mainly due to its limited budget and preference for de-concentrating the budget for outer-Jakarta regions, making up the uncertainty on the project funding. The ministry plans to adopt the Availability Payment (AP) Scheme which requires funding from and partnership with private investors, thus potentially leading to further delay in the project's construction works.

However, currently scarcity to source qualify project managers

Number of project managers based on qualification



Given strong growth in demand, currently there is a scarcity of project managers with relevant experience and good PM skills

- Limitation on qualified project managers.** Construction business is an asset-light business with subcontracting systems and people as its most important asset. However, currently there is a scarcity of qualified project managers in the market. In such case, a huge increase in order book volume, this might slow down the project realization, which in turn will create an escalating project backlog ratio.

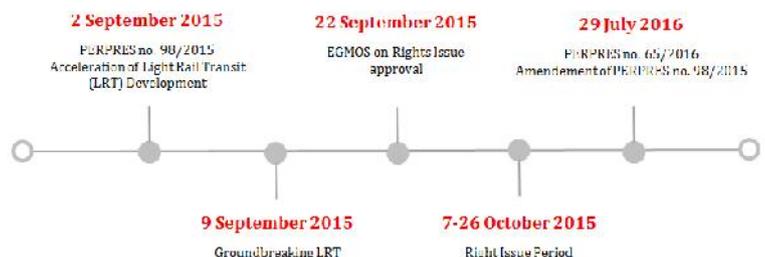
### LRT at a Glance.

In line with government programs of infrastructure development, especially in organizing an integrated mass transportation in Greater Jakarta areas, ADHI had been taking an active role in giving recommendation on Light Rail Transit (LRT) base mass transportation with the objective of reducing traffic level in Jakarta capital city. In 2015, ADHI won an approval from both the government and House of Representatives (DPR) for rail-based mass transportation development proposal (Light Rail Transit/LRT). The assignment referred to Presidential Decree No 98/2015 regarding the acceleration of integrated Light Rail Transit development for Jakarta, Bogor, Depok, and Bekasi areas. The development of LRT project was began after Groundbreaking on September 2015 and is due to completion in year 2018 for Asean Games. To support the project, government gave the capital injection, amounting of IDR 1.4 Tn through right issuance. Meanwhile, along with the process, there is an argument between the Ministry of Transportation (MoT) and the provincial government of Jakarta regarding the type of rails to be used. The ministry preferred to use the narrow type of rails while the Jakarta government preferred the standard type. As a result, works on LRT carried out by ADHI have stopped for several days due to a dispute over the project's ownership. Since the issue has made some delays, resulting LRT development cannot be completed on time, President issued the new Presidential Decree (Perpres) 65/2016 on 29 July 2016 to clarify some issues, include type of railways used, contract signing timeline, payment steps, assignment of KAI as an operator, etc.

The LRT project undertaking with a total length of 79.7 km which carries 6 services, (1) Cibubur - Cawang (14.3 km); (2) Cawang - Dukuh Atas (10.5 km); (3) Cawang - Bekasi Timur (18.5 km); (4) Dukuh Atas - Senayan (5.7 km); (5) Cibubur - Tanah Baru (25 km); and (6) Palmerah - Grogol (5.7 km).



### LIGHT RAIL TRANSIT (LRT) TIMELINE



### SOE Consolidation Plan.

There are a lot of news regarding to the government's plans to form holding companies for SOEs in several sectors, such as banks, toll roads, housing, energy, and mining. The main reasons of the government creating several holdings are to improve the capital structure between SOEs so they are not much dependent on capital injection from the government. On another note, the government hopes that these holdings can increase cooperation and synergy between SOEs. Initially, the government has a plan to form EPC holding but is now cancelled because the performance of SOE companies in that sector is quite good so it is not necessary to create EPC holding anymore. Since the EPC holding is cancelled, SOE construction companies are divided into 2 different sectors. WIKA will be joining under toll road holdings together with WSKT and JSMR, with Hutama Karya as the holding. Meanwhile, PTPP and ADHI will be under Perumnas in the housing holdings. On top of that, the holdings mechanism seem to be leaning more towards direct transfer of government shares to the holding company with 100% of government ownership.

Regarding to SOE holdings formation, there is no further information on how the projects will be allocated since the formation will for sure change the way the company works. However, in our view, since in RAPBN 2017, there are no more capital injection from the government, the contractors with the biggest balance sheet capacity under each respective holdings will no doubt get benefit from this formation. Nonetheless, apart from financial performances, there are also politics involved that become a major factor in determining who will get advantage from holdings structure. In our view, the new management team of respective holdings will have an important role in terms of allocating the projects to subsidiaries.

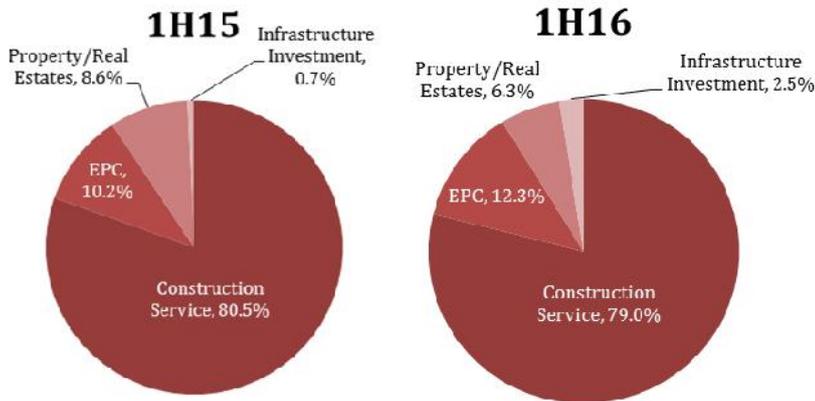
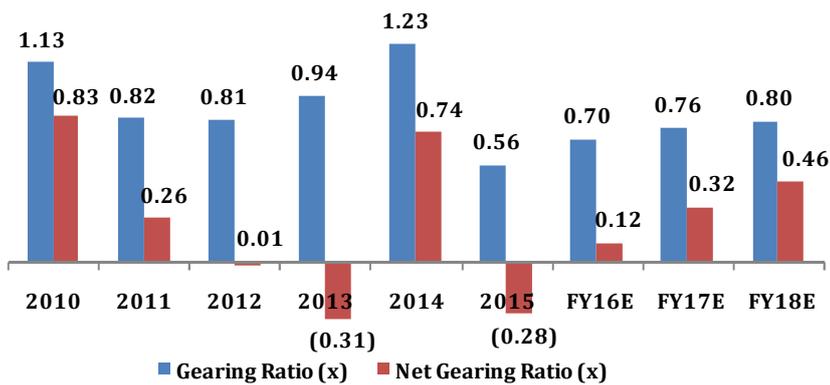
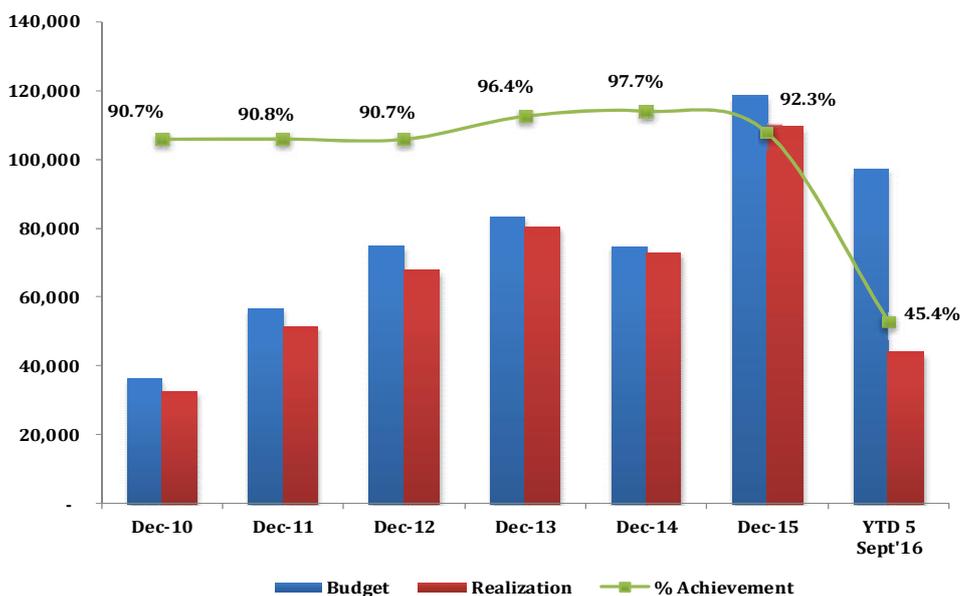
Actually, the idea of forming the SOE holdings is not the first the government ever proposed. Before, the government has formed holding company at cement sector where PT Semen Indonesia (SMGR IJ) becomes the parent company of several SOE cement companies (Semen Gresik, Semen Padang, and Semen Tonasa). However, it took more than 5 years to synergize all of them. Because of that, our view towards the government's plan to form holding companies on various sectors will also take several years to be materialized.

#### Toll Road Holdings



#### Housing Holdings



**Appendix I: An Overview**
**Figure 1: Contribution from each segment to total revenue:**

**Figure 2: Leverage**

**Figure 3: Budget vs. Realization—MoPW's Budget**


**Appendix II: 1H16 Net Income**

	2Q15	1Q16	2Q16	QoQ	YoY	1H15	1H16	YoY
<b>Revenue</b>	<b>1,971</b>	<b>1,329</b>	<b>1,802</b>	<b>35.6%</b>	<b>-9%</b>	<b>3,212</b>	<b>3,131</b>	<b>-2.5%</b>
Construction Service	1,593	1,066	1,406	31.9%	-12%	2,585	2,472	-4.4%
EPC	205	141	243	72.0%	18%	327	384	17.2%
Property/Real Estates	159	83	113	36.9%	-29%	276	196	-28.9%
Infrastructure Investment	14	39	40	3.4%	180%	23	79	237.2%
<b>COGS</b>	<b>1,779</b>	<b>1,202</b>	<b>1,661</b>	<b>38.2%</b>	<b>-7%</b>	<b>2,887</b>	<b>2,863</b>	<b>-0.8%</b>
Construction Service	1,451	927	1,233	33.1%	-15%	2,352	2,160	-8.2%
EPC	202.6	186.4	317.7	70.5%	57%	318	504	58.6%
Property/Real Estates	111.5	59.0	77.0	30.6%	-31%	194	136	-30.0%
Infrastructure Investment	14.0	29.7	33.3	11.9%	137%	23	63	173.4%
<b>Gross Profit</b>	<b>192.39</b>	<b>126.94</b>	<b>140.92</b>	<b>11.0%</b>	<b>-27%</b>	<b>325</b>	<b>268</b>	<b>-17.6%</b>
EBIT	141	78	146	86.2%	3%	229	224	-2.4%
PBT	114	47	96	103.5%	-16%	165	143	-13.3%
Net Income	60	11	45	319.8%	-25%	70	56	-21.2%
<b>Gross Margin</b>	<b>9.8%</b>	<b>9.6%</b>	<b>7.8%</b>			<b>10.1%</b>	<b>8.6%</b>	
<b>EBIT Margin</b>	<b>7.2%</b>	<b>5.9%</b>	<b>8.1%</b>			<b>7.1%</b>	<b>7.2%</b>	
<b>Net Margin</b>	<b>3.0%</b>	<b>0.8%</b>	<b>2.5%</b>			<b>2.2%</b>	<b>1.8%</b>	
GPM Construction Service	8.9%	13.1%	12.3%			9.0%	12.6%	
GPM EPC	1.1%	-32.1%	-30.9%			2.9%	-31.4%	
GPM Property/Real Estates	29.9%	28.8%	32.1%			29.7%	30.7%	
GPM Infrastructure Investment	1.7%	23.0%	16.7%			1.0%	19.8%	

**Appendix III: Financial Ratios**

Financial Ratios	2014	2015	2016E	2017E	2018E
P/E	19.05	10.55	17.11	12.89	9.99
Yield (%)	3.3%	1.4%	1.2%	1.6%	2.1%
P/B	3.84	1.48	1.65	1.51	1.36
EV/EBITDA	12.14	9.26	9.36	7.88	6.83
ROE	9.0%	9.0%	9.5%	11.4%	13.7%
ROA	2.3%	2.6%	2.4%	2.7%	3.6%
Debt/Equity	1.30	0.60	0.70	0.76	0.80

**Appendix IV: Financial Statements**

<b>Income Statement (in IDR Bn)</b>	<b>2014</b>	<b>2015</b>	<b>2016E</b>	<b>2017F</b>	<b>2018F</b>
<b>Revenues</b>	<b>8,654</b>	<b>9,390</b>	<b>14,148</b>	<b>17,840</b>	<b>21,343</b>
Cost Of Sales	(7,655)	(8,415)	(12,643)	(15,921)	(18,979)
<b>Gross Profit</b>	<b>998</b>	<b>975</b>	<b>1,505</b>	<b>1,920</b>	<b>2,364</b>
Joint Venture Income	18	-	-	-	-
<b>Gross Profit Incl Joint Venture</b>	<b>1,017</b>	<b>975</b>	<b>1,505</b>	<b>1,920</b>	<b>2,364</b>
Selling Expenses	(17)	(20)	(28)	(36)	(43)
General And Administrative Expenses	(340)	(376)	(447)	(525)	(619)
<b>Operating Income</b>	<b>591</b>	<b>635</b>	<b>923</b>	<b>1,241</b>	<b>1,577</b>
Interest Income	33	51	177	87	76
Total Gains	100	165	(7)	68	77
Interest Expenses	(137)	(137)	(161)	(187)	(220)
Income Before Tax	581	746	931	1,208	1,508
Tax Expenses	(268)	(281)	(424)	(535)	(640)
Minority Interest	(3)	(1)	(1)	(1)	(1)
<b>Net Income</b>	<b>311</b>	<b>464</b>	<b>506</b>	<b>671</b>	<b>867</b>
<b>EPS (Rp.)</b>	<b>183</b>	<b>203</b>	<b>142</b>	<b>189</b>	<b>243</b>

<b>Balance Sheet (in IDR Bn)</b>	<b>2014</b>	<b>2015</b>	<b>2016E</b>	<b>2017F</b>	<b>2018F</b>
<b>Current Assets</b>					
Cash and Cash Equivalents	811	4,317	2,945	2,403	2,132
Total Receivables	3,214	3,311	5,155	6,687	7,954
Inventories	132	163	233	292	355
Amount Due From Customers	2,617	3,093	3,542	4,776	5,466
Prepaid Taxes	623	857	990	1,375	1,697
<b>Total Current Assets</b>	<b>9,484</b>	<b>14,691</b>	<b>16,115</b>	<b>19,512</b>	<b>22,776</b>
Other Long-Term Receivables	36	6	6	6	6
Real Estate Assets	5	48	48	48	48
Investment In Joint Ventures	45	368	368	368	368
Fixed Assets	496	1,099	1,758	2,231	2,793
<b>Total Assets</b>	<b>10,459</b>	<b>16,761</b>	<b>18,857</b>	<b>22,720</b>	<b>26,549</b>
<b>Current Liabilities</b>					
Total Payables	5,424	7,139	8,366	10,616	12,685
Customer Advances	495	692	923	1,236	1,473
Short Term Loans	692	1,115	1,115	1,115	1,115
<b>Total Current Liabilities</b>	<b>7,070</b>	<b>9,414</b>	<b>11,108</b>	<b>13,872</b>	<b>16,338</b>
<b>Total Liabilities</b>	<b>8,707</b>	<b>11,599</b>	<b>13,755</b>	<b>17,148</b>	<b>20,371</b>
<b>Equity</b>					
Share Capital & APIC	50	2,588	2,588	2,588	2,588
Retained Earnings	1,510	1,790	2,144	2,614	3,220
<b>Total Equity</b>	<b>1,752</b>	<b>5,162</b>	<b>5,102</b>	<b>5,572</b>	<b>6,178</b>

<b>Cash Flow (in IDR Bn)</b>	<b>2014</b>	<b>2015</b>	<b>2016E</b>	<b>2017F</b>	<b>2018F</b>
<b>Net Income</b>	<b>311</b>	<b>464</b>	<b>506</b>	<b>671</b>	<b>867</b>
Depreciation	25	30	47	59	75
Working Capital	(1,466)	220	(1,102)	(1,176)	(1,068)
<b>Operating Cash Flow</b>	<b>(1,181)</b>	<b>1,133</b>	<b>(962)</b>	<b>(442)</b>	<b>(123)</b>
Change in Fixed Assets	(201)	(634)	(707)	(535)	(640)
<b>Investing Cash Flow</b>	<b>(403)</b>	<b>(1,008)</b>	<b>(721)</b>	<b>(529)</b>	<b>(644)</b>
Debts	560	849	462	630	756
Dividends	(108)	(183)	(152)	(201)	(260)
<b>Financing Cash Flow</b>	<b>455</b>	<b>3,381</b>	<b>310</b>	<b>429</b>	<b>496</b>

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