

# INDONESIA

**BHINEKA TUNGGAL IKA**  
unity in diversity



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## Executive Summary



In the aftermath of the global crisis, Indonesia has emerged as a strong candidate for foreign investment. With a sizable domestic market, diversified natural resources, and a competitive labor force, Indonesia is poised for astounding growth in the coming years that has led to many an economist to call for the inclusion of Indonesia into 'BRIIC'. The country's resilience to the global crisis demonstrates the strong fundamentals of its domestic economy. We believe that Indonesia will be where the growth is at while other economies are only recovering from the global economic meltdown of 2008.

In the first half of this report, we present a detailed country and business environment analysis to give you a basic understanding of the political, social and economic conditions of Indonesia. After carefully considering and presenting the opportunities and risks of investing in Indonesia, we have shortlisted three investment recommendations with our complete analysis for your consideration.

## Investment Highlights

### PT Bumi Resources Tbk

- Very positive industry outlook on coal demand driven by China, India, and heightened domestic demand in Indonesia because of government policies
- Has a very strong track record of successful acquisitions that has increased its returns on invested capital tremendously

### PT Bank Rakyat Indonesia

- One of the pillars of the banking sector of Indonesia
- Superior operating margins, loan growth and return on equity
- One of the oldest banks in Indonesia and its long history has allowed it to have one of the largest distribution channels to reach its customers

### PT Indocement Tungal Prakarsa

- Has a very large cash balance that allows company to make strategic investments to increase shareholder returns
- Industry is expected to experience significant growth because of government's pledge to improve infrastructure
- Management team is acclaimed widely and has been awarded many accolades for their actions

# Table of Contents

<b>Country Analysis .....</b>	<b>4</b>
Demographics .....	4
History .....	4
Government and Politics .....	4
<b>Economy .....</b>	<b>5</b>
Economic Overview .....	5
Trade Balance .....	6
Government Debt .....	6
Inflation .....	6
<b>Business Environment Analysis .....</b>	<b>8</b>
Stock Market .....	8
Listing Fees .....	8
Regulation .....	8
Tax Incentives .....	8
Business Legal System .....	9
Property Rights .....	9
Intellectual Property Protection .....	9
Foreign Investment Capital Law of 1967 .....	9
Auditing and Financial Reporting Standards .....	10
<b>Strengths and Opportunities .....</b>	<b>10</b>
Infrastructure Development .....	10
Resilient Economy .....	11
Development on Political Stability and Corruption .....	11
<b>Risks .....</b>	<b>12</b>
Currency Risk .....	12
Corruption and Inefficient Government Bureaucracy .....	13
Foreign Ownership and Stock Float .....	14
<b>P.T. Bumi Resources Tbk .....</b>	<b>15</b>
Industry Analysis .....	15
Company Overview .....	16
Investment Strengths .....	18
Investment Risks .....	19
Valuation .....	19
Investment Summary .....	20
<b>P.T. Bank Rakyat Indonesia Tbk .....</b>	<b>21</b>
Industry Analysis .....	21
Company Overview .....	21
Investment Strengths .....	22
Investment Risks .....	23
Valuation .....	23
Investment Summary .....	24
<b>Indocement Tunggul Prakarsa .....</b>	<b>25</b>
Industry Analysis .....	25
Company Overview .....	26
Investment Strengths .....	27
Investment Risks .....	28
Valuation .....	28
Investment Summary .....	29

## Country Analysis



### Demographics

Indonesia is the fourth most populated country in the world, after the United States, China, and India, with a population of nearly 240 million people. Approximately 130 million people inhabit the island of Java; however, the region is still relatively poor and underdeveloped.

Indonesia's population is made up of a very diverse set of ethnic groups. There are approximately 300 distinct cultural groups living in Indonesia with 41.7% of the population identifying themselves as Javanese, 15.4% as Sundanese, 3.7% as Chinese, and the rest making up of hundreds of other cultures. In addition, Indonesia is the most populous Muslim country in the world; however, the country does not follow the Islamic Courts as their neighbor, Malaysia, has adopted.

In regards to business, Indonesia's per capita income is currently \$3,900 making it a big and promising domestic market. In addition, 44% of the population is under the age of 24 and the literacy rate is approximately 87%, suggesting that there is a vast and growing supply of quality workforce in Indonesia. Nevertheless, Indonesia is still looking to invest more in education to create more skilled labors in order to move into higher value-added industries.

### History

Indonesia, stretching along the equator in Southeast Asia and neighboring Malaysia and Papua New Guinea, is an archipelagic country encompassing approximately 17,500 islands, two-thirds of which are inhabited. The country's strategic sea-lane position fosters inter-land and international trade. The spread of Islam in the country started in the western region of the archipelago and by the end of the sixteenth century; Islam was the prevailing religion in Java and Sumatra.

Additionally, Indonesian history has been influenced by foreign powers drawn to its natural resources. Muslim traders brought Islam, and European powers fought one another to monopolize trade in the Spice Island of Maluku during the Age of Discovery. In the early 1900s, Indonesia's struggle for independence began through the formation of its first nationalist movement, the Budi Utomo; however, the Dutch imprisoned those who supported such political activities, including Sukarno, the country's first president. After nearly three and a half centuries of Dutch colonialism, Indonesian nationalist leaders, Sukarno and Dr. Mohammad Hatta, proclaimed independence in 1945 after World War II and the country became the Republic of Indonesia. Indonesia's history has since been turbulent, with challenges posed by natural disasters, corruption, separatism, a democratization process, and periods of rapid economic change.

### Government and Politics

The Republic of Indonesia is a multi-party presidential democracy where parliamentary and presidential elections take place every five years. In 1957, President Sukarno had initially introduced a new political system, which he called "Guided Democracy." The power of Parliament was subsequently reduced and

his own power greatly increased causing much political unrest. His opponents formed a separate Parliament called the “Revolutionary Government of the Republic of Indonesia.” The second president, Suharto, introduced the “New Order,” which lasted from 1966-1998 under his reign and was characterized by corruption, nepotism, and collusion. These periods were characterized by rapid economic expansion; however, the 1997 Asian Financial Crisis crippled the country resulting in mass riots and protests.

Following the resignation of President Suharto in 1998, four amendments were added to the 1945 Constitution of Indonesia, which greatly revamped the executive, judicial, and legislative branches. In addition, the president of Indonesia serves as the head of state, commander-in-chief of the Indonesian National Armed Forces, and the director of domestic governance, policy-making, and foreign affairs. The president appoints a cabinet who are not required to be elected by members of the legislature.

In 2004, the president, Susilo Bambang Yudhono and the vice president were elected by direct popular vote for the first time in history. The National Legislature comprises the People’s Consultative Assembly (MPR) consisting of a 560-member House of People’s Representatives (DPR) and a 128-member Regional Representatives’ Council (DPD). Historically, Indonesia has been marred by political unrest and instability; however, there seems to be a potentially bright future for Indonesia. Separatist and sectarian conflicts have abated, military dictatorship seems a distant memory, the notion of a coup seems rather unlikely, and Islamist extremism has been marginalized through moderation and tolerance.

## Economy



### Economic Overview

Indonesia is the largest economy in Southeast Asia and is a member of the G-20 major economies, as well as the WTO and ASEAN. The economy is expected to double in the next six years by 2015. CLSA Asia-Pacific Markets cited that China, India, and Indonesia not only would generate \$10 trillion for investors by 2015, but would become the next “next growth triangle.” Indonesia’s GDP in 2008 is estimated to be approximately US\$511.8 billion (US\$916.7 billion purchasing power parity) and is composed of 14.4% Agriculture, 48.1% Industry, and 37.5% Services, with petroleum and natural gas, textiles, mining, and cement among its main industries. Indonesia’s real GDP grew 6.1% in 2008 and the World Bank believes that the Indonesian economy can grow at a rate significantly higher than 7% per year if the government improves the country’s infrastructure.

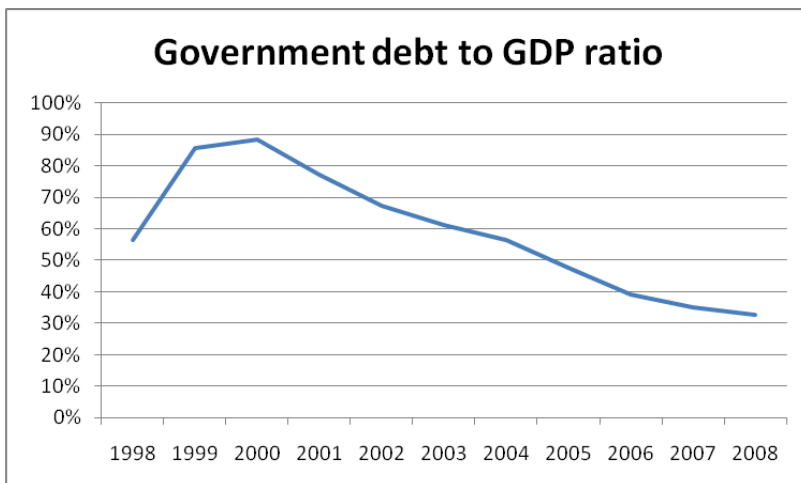
Indeed, the Indonesian government seems to acknowledge this observation as the government has pledged to prioritize infrastructure development by offering incentives to encourage private sector investment. Other than that, the general economic policy is geared towards achieving growth domestically and from foreign investment by establishing policies that promote competition. On the domestic end, the government is focused on tackling corruption, reducing corporate cost by simplifying bureaucratic procedures, providing tax benefits to promote small and medium businesses, and opening

up previously closed sectors to private enterprises. Tax incentives are also provided to foreign entities to promote their participation in the domestic market, while regulations on foreign participation in various sectors such as the banking sector have been eased in recent years. As a testament to these changes, Indonesia's Investment Coordinating Board (BKPM) stated that investment in 2008 grew by 15.5% from 2007 to US\$17 billion (as compared to the US\$12 billion of investment Singapore received).

## Trade Balance

Indonesia's trade balance in 2008 was a surplus of US\$20 billion with US\$139 billion worth of exports and US\$116 billion worth of imports. From 2007 to 2008, Indonesia's export grew by nearly 17% while its imports grew by about 35% over the same period, providing a glimpse into the increase in consumer demand and consumption, even amidst a recession. The archipelago nation mainly exports oil and gas products, electrical appliances, and textiles to Japan, U.S., Singapore, and China which account for about 50% of total exports in aggregate. On the other hand, capital goods, chemicals, fuel, and foodstuffs are its main imports and Singapore (13.2%) and China (11.5%) are its key trading partners.

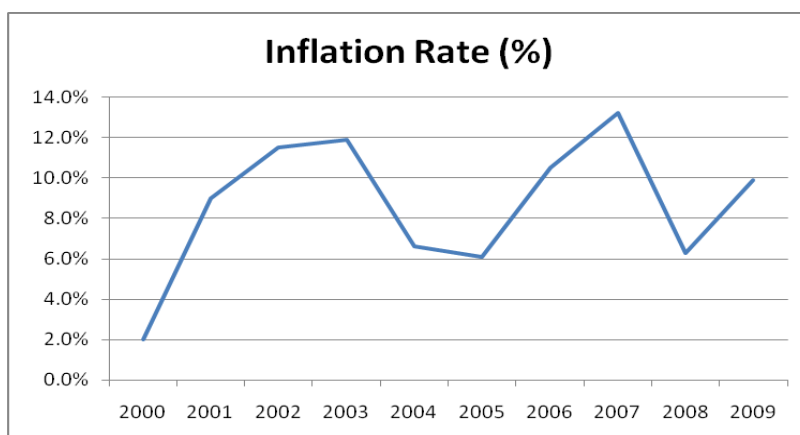
## Government Debt



The government debt to GDP ratio reached its peak of nearly 90% when the country needed large amount of external aid during the 1998 Asian Financial Crisis. Since the recovery of the economy from the crisis, Indonesia has successfully managed to reduce its debt to GDP ratio significantly to about 30% in 2008 which is in line with the ratio of neighboring countries. This reduction in the national debt is widely attributed to economic growth spurred by

strengthening economic fundamentals and the government's fiscal responsibility. In addition to the declining debt ratio, the national debt is also increasingly composed of domestic debt than foreign debt.

## Inflation



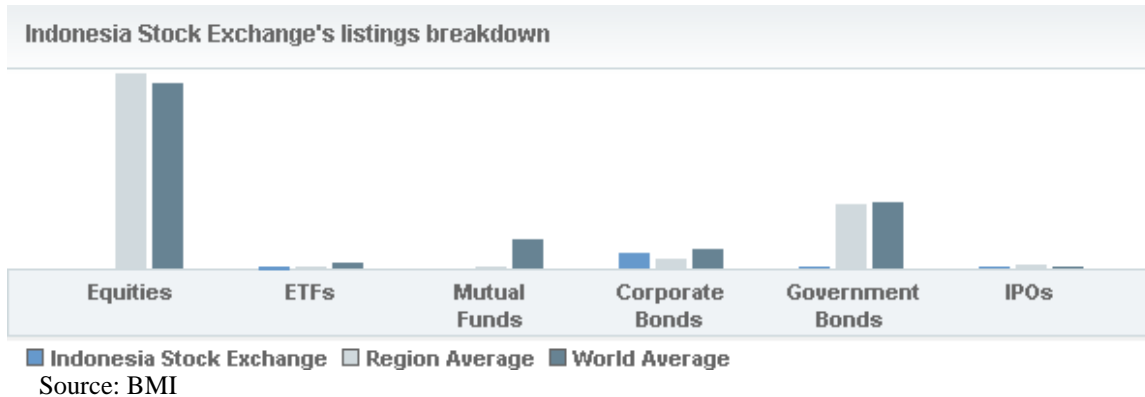
Indonesia has generally experienced annual inflation rate higher than 6% in nominal terms as reflected in the chart below. While this figure may seem high, real inflation that the country is experiencing is actually lower than this figure, taking into account that the central bank's (BI) benchmark interest rate stands at 6.5% as of November

2009. The inflation rate of Indonesia has been rather volatile in the past few years, but the country never did experience any serious inflationary problems. BI's latest stance on inflation in the short and medium terms have been more optimistic, as the central bank expects inflation to be around 5% in 2010, and for it to continue declining to a level that is equivalent to neighboring countries.

## Business Environment Analysis

### Stock Markets

Since its reactivation in 1977, the Indonesia Stock Exchange (IDX) has seen a slew of regulatory changes, all which have built up to form a “red tape.” The Capital Market and Financial Institutions Supervisory Agency are responsible for regulating the market. The government has recently been pushing to simplify the procedures by lowering the costs involved to list on the exchange.



### Listing Fees

As it stands, Indonesia has only 387 publicly listed companies, a relatively low number compared to other Asian countries (e.g. neighboring Malaysia has 1,000). Smaller companies are less likely to list in Indonesia due to the costs as current regulations command a listing fee of Rp 110 billion (US\$11mm) to Rp 165 billion (US\$16.5mm) depending on the number of shares offered. There is also an application fee of Rp 10 million (US\$1,000) to list on the secondary development board and Rp 15 million (US\$1,500) for the main board.

### Regulation

Beyond the ability to provide the financial means to list, companies must also have been engaged in their core business for at least three years for a main board listing and two years for a listing on the development board. Prospective companies must also have net tangible assets of at least Rp 100 billion (US\$10mm) and Rp 5 billion (US\$500,000) for a main board listing and a development board listing, respectively.

### Tax Incentives

The government is looking to incentivize firms to list publicly through tax benefits. Last year, the government cut the corporate income tax rate from 35% to 28% and will cut an additional 3% this coming year. Publicly listed companies are further given a 5% cut in their income tax. All of these tax incentives are expected to translate into ten to twenty additional public listings each year. The president of the Indonesia Stock Exchange, Ito Warsito, is confident that the total number of listed companies would reach 500 in the next three years.

	2004 <sup>[3]</sup>	2005 <sup>[4]</sup>	2006 <sup>[5]</sup>	2007 <sup>[6]</sup>
<b>Number of Listed Companies</b>	331	336	344	383
<b>Domestic Market Capitalization (in \$ million)</b>	73,251	81,428	138,886	211,693
<b>Value of Shares Traded (in \$ million)</b>	27,518	41,634	48,810	114,631
<b>Average Daily Turnover (in \$ million)</b>	114	171	202	466
<b>Average Value of Trades (in \$ thousand)</b>	7.4	10.4	10.1	9.7
<b>New Capital Raised from Initial Public Offerings (in \$ million)</b>	239	364	365	1,976
<b>New Capital Raised from Secondary Public Offerings (in \$ million)</b>	468	621	1,465	3,447
<b>Number of Trading Days</b>	241	243	242	246

## Business Legal System

According to the World Economic Forum's 2009 Global Competitiveness Report, Indonesia ranks poorly compared to other countries in terms of the legal infrastructure necessary to protect and promote commerce. The commercial law in Indonesia is based upon the Commercial Code 1847, a Dutch Colonial Law that was in place before Indonesia gained independence in 1945. In later years, Indonesia adopted several more laws, including the "Banking Law of 1992" and the "Anti-Monopoly Law of 1999," to regulate the rapidly expanding business environment. For foreign investments, it is important to consider issues relating to property rights, intellectual property protection, foreign direct investments, and accounting standards.

## Property Rights

Property rights are a fundamental building block that ensure and protect entrepreneurs and business owners that their property cannot be taken away and are enforceable by law. Property rights in Indonesia exist, but only provide a general understanding of the processes in place. According to the Global Property Guide, Indonesia ranks near the bottom quartile compared to other Asian countries in terms of enforcing private property rights. Thus, it is difficult to implement due to the broad interpretation of the law and the complexity of accounting for nearly 17,500 separate islands.

## Intellectual Property Protection

Intellectual property is an intangible asset such as a trade secret or distinct brand image that usually serves as a company's competitive advantage over their rivals. In 2000, Indonesia started to aggressively enforce intellectual property rights by enacting seven laws that protect trade secrets, industrial design, patents, marks, and copyrights. The consequences for infringement are detailed and meaningful, marking a strong development in protecting companies and their ideas. Although it currently lags behind some of their peer countries, more time and exposure to the intricacies of intellectual property laws will improve their current system and entice foreign investors to invest in companies' with strong patents and ideas.

## Foreign Investment Capital Law of 1967

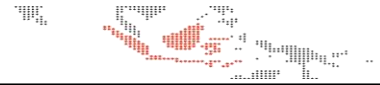
The "Foreign Investment Capital Law of 1967" provides the rules in regards to foreign investments in Indonesia. Indonesia, in recent years, has deregulated on a few rules by allowing foreigners to own upwards of 95% of a company. These relaxed measures include a simplified licensing process and tax

incentives, which has encouraged other countries such as Japan, Hong Kong, and United Kingdom to dramatically increase their foreign investments in Indonesia. A significant portion of these investments are targeted towards the mining, natural gas, and chemicals sectors. On the other hand, certain industries such as public transportation and freshwater fishing remains closed to outside investors.

## Auditing and Financial Reporting Standards

Accounting scandals and controversies have plagued the credibility of businesses in Indonesia in the past, leading to steadily improving reforms in the country's auditing and reporting standards. In the World Economic Forum's 2009 Global Competitiveness Report, Indonesia ranks in the middle for their strength in accounting practices. The current standard is based on Financial Accounting Standard (PSAKs) developed and adopted in 1994 with the guidance of the World Bank to improve Indonesia's accounting regulation. Other laws including the "Capital Markets Law of 1995" and "Government Regulation (No.64) regarding Company Financial Statements of 1999" all provide a more universal and transparent standard for companies to use. Although the standards are not perfect, it does provide investors with a fairly honest and objective view of a company's financial health.

## Strengths & Opportunities



Indonesia presents many attractive opportunities when it comes to investing. Traditional industries such as mining and agriculture have been growing consistently while the demands for information and environmental technologies, industrial chemicals, medical supplies, security systems, and energy have increased rapidly in the recent years. Interestingly, the most promising opportunities are currently in infrastructure and banking.

## Infrastructure Development

Because of its large population and sparse geography, Indonesia has historically experienced problems providing sufficient public goods such as proper roads, railroads, and ports. The lack of such basic infrastructure has effectively restricted Indonesia's capabilities to transport resources, stifling economic growth and development. The country is also experiencing an electricity and energy shortage, as the growing demand greatly exceeds the static supply. As a result, many areas including major cities suffer from blackouts regularly even at this time and age. The table below gives a comparison of Indonesia's infrastructure facilities with that of neighboring Malaysia and Thailand. Despite Indonesia's larger land area and population, the country is found to be trailing its neighbors significantly in roads built, electrification, and teledensity.

### Infrastructure facilities in three Southeast Asian countries

Country	Ratio of Built Road to Highway %	Electrification %	Teledensity %	Category of Main Airport
Indonesia	12	643	3.7	2/Feasible
Malaysia	84	86	18.6	4/Good
Thailand	76	90	10.6	4/Good

Source: GlobeAsia Reserach

In order to provide the necessary basic infrastructure, the Indonesian government is working with the World Bank in coming up with effective projects that would improve current conditions. For example, the government is offering tax incentives to encourage private investments in infrastructure development projects that used to be off-limits to private corporations. It is also liberating existing rules and will increasingly allow the participation of foreign entities in most infrastructure projects on the condition that these foreign companies partner with Indonesian firms. With the new administration's recognition and pledge to significantly upgrade the country's infrastructure, many construction projects for roads, highways, railroads, ports, power plants, water, and sanitation facilities are in the pipeline.

### Resilient Economy

Indonesia has proved to be very resilient to the global financial crisis of 2008. The country's GDP grew by 6.1% last year, making it one of the fastest growing economies in Asia. This resilience is widely credited to its domestic driven economy and sound economic policies. Indonesia has a large domestic market and as of last quarter, private consumption is 62.1% of GDP, indicating that the economy is largely driven by domestic consumption and is relatively less affected by global conditions. In addition, we are optimistic that the sound economic policies of the government mentioned earlier will be able to drive growth further and make Indonesia be where the growth is at while other nations are recovering from the economic slump. Also, Indonesia's resilience indicate to investors that investments in Indonesian assets would prove to provide benefits of diversification as there is less correlation with other countries.

### Development on Political Stability and Corruption

Since the fall from power of former strongman Suharto, Indonesia's political scene could be described as somewhat chaotic. The country experienced four different presidents in six years when a presidential term in Indonesia lasts for five. Political instability in developing countries often has strong impacts on its economy as it deters foreign investors from staying put in the country, especially so with Indonesia where many businesses have strong ties to political figures. As mentioned earlier, the peaceful reelection of incumbent President Yudhoyono marks the first time that Indonesia has democratically reelected a president. We believe that the reelection of President Yudhoyono would provide Indonesia with some consistency and continuity in its economic and business development policies which have been widely acclaimed to have served the country well especially through the global economic meltdown. In addition to this positive development for businesses and investors, battling corruption has been one of President Yudhoyono's top priorities which are reflected by the establishment of the anti-corruption commission and a number of high profile convictions. While corruption still runs rampant in

the country even at the highest levels, we are optimistic about the situation as Indonesia has made more progress to battle corruption under President Yudhoyono's reign than it had in the past.

## Risks



### Currency Risk

Indonesia's government abandoned the managed float and adopted a free floating exchange rate policy in mid-1997 amid the Asian Financial Crisis when the currency was experiencing severe speculative downward pressure. With a more flexible exchange rate system, the Indonesia Rupiah has experienced some historical spikes in volatility as the government's policies to maintain exchange rate stability no longer keeps the value of the Rupiah within a specified band. The graph below illustrates the value of the Indonesian Rupiah against the U.S. Dollars since 1992. It is observed that the Rupiah has fallen five-fold in value against the US Dollars after the Asian Financial Crisis. The value of the Rupiah has also become more volatile with observed sharp spikes ever since the currency was freely floated. The main reasons quoted for the sharp and persistent depreciation of the Rupiah after periods of seeming stability are sudden short term capital flight, fragile domestic financial sector, political instability, and threats of terrorism.



Source: Bloomberg

In the free float exchange rate regime, the government would intervene in the market to remove excess Rupiah liquidity in order to maintain the stability of the currency. In addition, to further support foreign exchange management, Bank Indonesia has issued the following regulations:

- Prohibiting offshore trading in rupiah
- Conduct indirect supervision by monitoring foreign exchange transactions

- Conduct on-site supervision among main commercial banks
- Regulation on improved net open position

While the fundamentals of the economy have become more stable in the last few years under the direction of President Yudhoyono and threats of terrorism has been largely mitigated, the biggest risk of the Rupiah is still in the tendency for capital flights. Despite Indonesia's resilience to the global economic downturn, the Rupiah still depreciated by about 35% in late 2008.

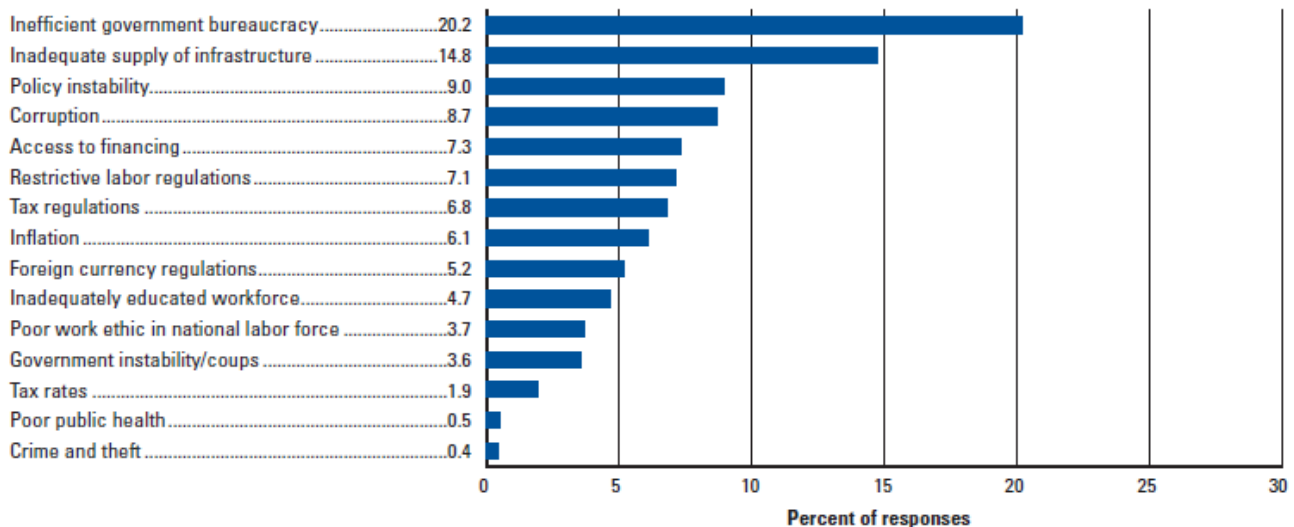
## Corruption and Inefficient Government Bureaucracy

Corruption has been an endemic problem that has largely defined Indonesia during the Suharto era. While the political landscape has undergone a massive facelift since the step-down of the former president in 1998, Indonesia is still trying hard to eradicate corruption and shake off the image of a corrupt country.

Ever since President Yudhoyono gained power in Indonesia in 2004, he has made corruption eradication one of his primary targets. A significant move of his presidency has been the creation of the Corruption Eradication Commission (KPK) which to date has led the arrests of many prominent politicians, government employees and businessmen. However, it will be naïve to think that the KPK has been very successful as recent investigation indicated that high level officials of the National Police and Attorney General's office have accepted bribes and fabricated evidence to arrest two prominent anti-graft vice-chairmen of the KPK. While the KPK has sent out a clear signal of its goal to eradicate corruption, it is likely to be easier said than done as evidence indicates that corruption still exists even at the highest level.

According to the World Economic Forum's 2009 Global Competitiveness Report, corruption and inefficient government bureaucracy rank as the main challenges to doing business in Indonesia. Corruption has been one of the major causes for inefficient government bureaucracy on top of the

### The most problematic factors for doing business

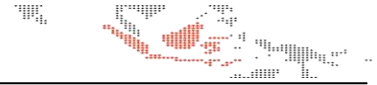


structure of the bureaucracy itself. This fact is duly noted by current vice-president Boediono who wrote in his book that “government failure” will be a bigger challenge facing the country than “market failure” as the former will take at least 5 years to reform while the latter could be corrected in a much shorter time.

### **Foreign Ownership and Stock Float**

A recent census carried out by the BAPEPAM (equivalent of the SEC) has uncovered the fact that foreign investors own about 65% of total assets traded in the Indonesian Stock Exchange. In addition, most of the publicly traded companies listed on the Indonesia Stock Exchange float less than 50% of their outstanding shares. On one hand, the large proportion of foreign investors in the local stock market could be a positive indicator of the potential of Indonesian assets; while on the other hand, it should be a cause of concern because foreign investors often do not have the same objectives and interests as local investors. Foreign investors do not have the same incentives as local investors to stay invested in Indonesia during challenging or uncertain periods which would introduce greater volatility to the stock market.

## P.T. Bumi Resources Tbk



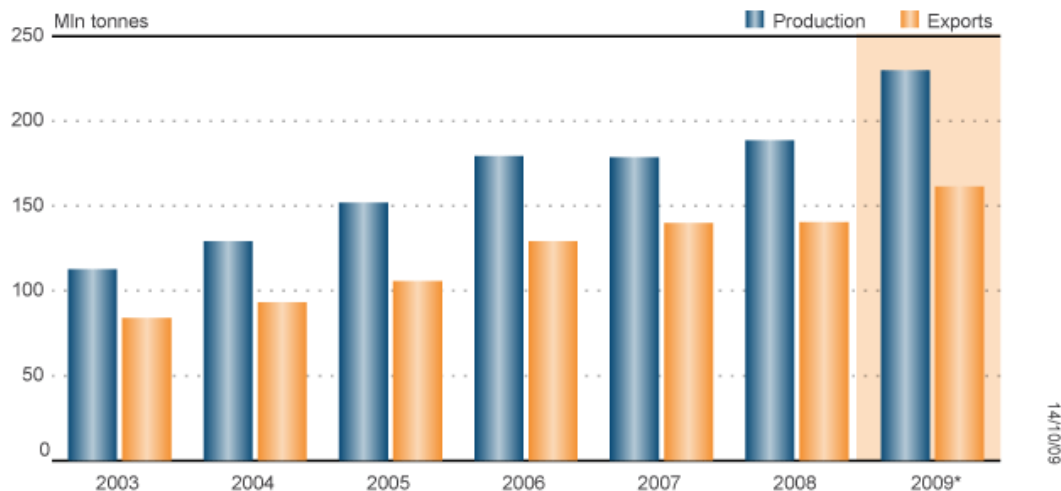
### Industry Analysis

Indonesia is the world's largest exporter of thermal coal and the second largest exporter of coal in the world. Presently, Indonesia has mineable reserves of 20.99 billion tonnes and about 99% of the identified coal resources are situated in Sumatra and in the South and East Kalimantan provinces of Borneo with the rest scattered amongst Java, Sulawesi and Papua. At the current production rate, Indonesia's reserves will be depleted in about forty years if there are no new discoveries. But coal resources are expected to increase as large areas such as Papua are still largely unexplored.

Interestingly, Indonesia exports more than 70% of its annual coal production to Asian markets including China, Japan, South Korea, and India, and also to European and American markets. Of the remaining 30% of coal sold domestically, nearly 60% of domestic demand for coal, or 68 million tonnes this year, are used for power generation. With the government's plan to add 10,000MW of power generation capacity to lessen chronic power shortages, the use of coal for power generation is expected to increase significantly in the next few years.

The graph below illustrates historical coal production and exports in Indonesia since 2003. Both coal production and exports have been increasingly steadily over the years and Indonesia produced approximately 200 million tonnes of coal and exported about 145 million tonnes. Substantial increase in demand for coal from India and China, which is set to become a net coal importer in the near future, has boosted Indonesia's expected coal output in 2009.

### Indonesian coal exports



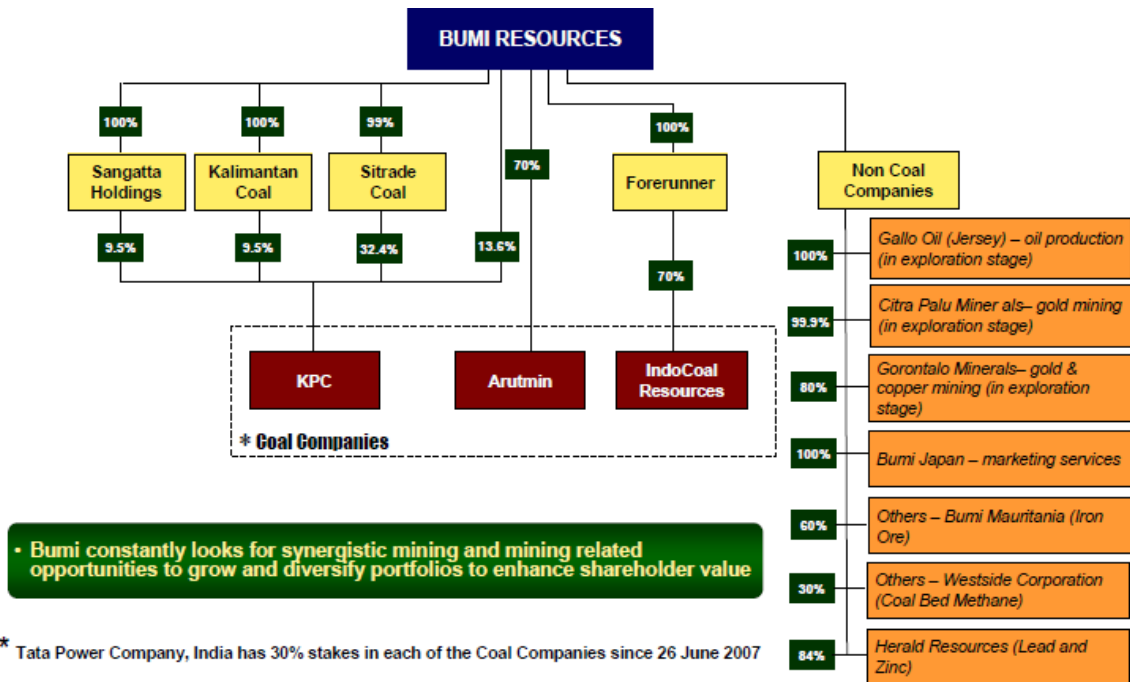
Source: Indonesia Mining Ministry, [www.esdm.id](http://www.esdm.id), \*forecasts

Coal resources in Indonesia are officially owned by the state and private companies that wish to carry out mining activities are required to develop a production-sharing contract with the state, which is infamous for having one of the toughest contract terms in the world. Private enterprises can go into these mining contracts with one of four distinct state-owned enterprises: PT Tambang Batubara Bukit Asam (PTBA), Coal Contracts of Work (CCoW), Mining Authorization (KP) Holders or Cooperative Units (KUDs). There are three generations of coal production contracts, each with different ownership, royalty, and tax provisions.

In December 2008, a new mining law was passed that altered the permitting structure of the long-term Contracts of Work to shorter-term permits covering various stages of the mining process. This change would allow closer involvement and more oversight by the government, and also included new rules of divestment. This new law mandates that established foreign investors divest 5% of their investment every year, and another 20% of their investment on the fifth year. These foreign investors can sell their stakes to the government, state-owned enterprises or domestic private companies. This new permit system is similar to the one implemented in Australia and should make Indonesia's mining sector less corrupt and more transparent. In addition, another new mining law was also passed around the same period that aims to boost domestic mining investments. This new law limits contract work that can be outsourced and favors local players to be given first preference to win these contracts, while the energy ministry's permission is required prior to hiring foreign affiliates.

## Company Overview

PT BUMI Resources TBK operates in the exploration of coal deposits, including coal mining, and oil exploration activities and is the dominant company in the Indonesian mining industry. BUMI owns Indonesia's largest coal miner and has existed in its current form since 2000. The company offers its services to cement companies and power plants, as well as middle and large scale industrial companies that involve chemical, mine, and textile businesses. BUMI Resources also has interest in mining gold, silver, and copper. The chart below demonstrates BUMI's ownership structure for both coal and non-coal assets.



Source: Bumiresources.com

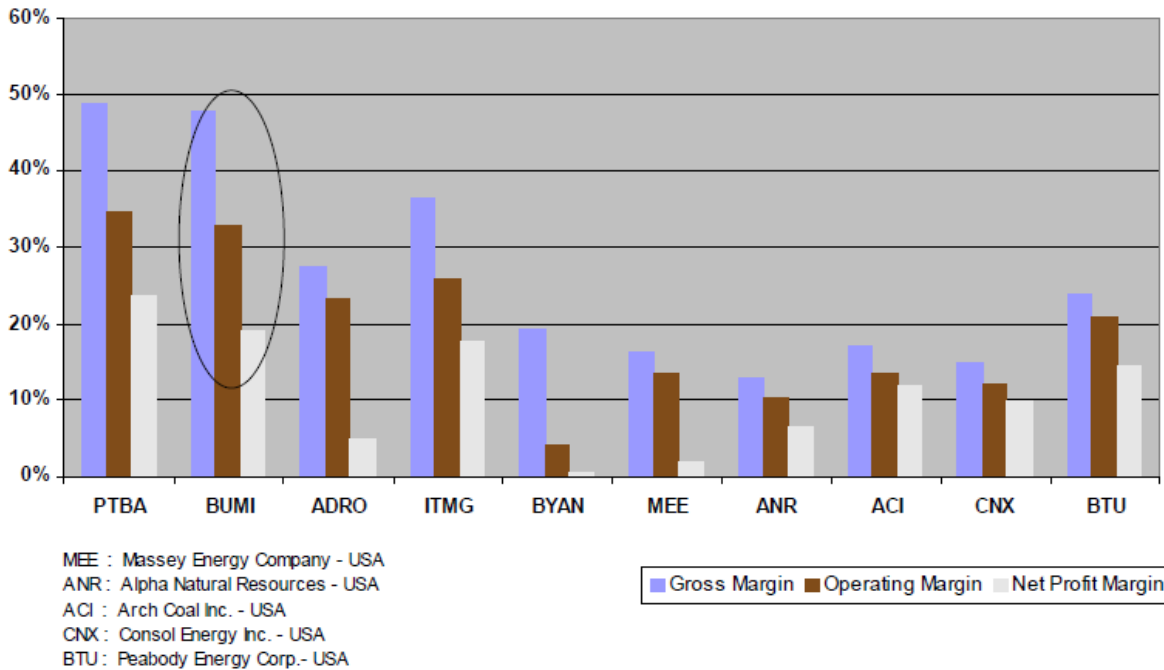
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## Investment Strengths

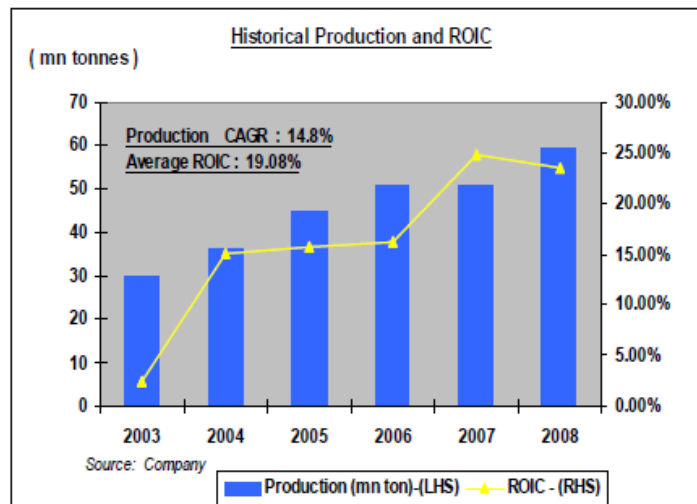
BUMI is a large and profitable company especially considering that KPC and Arutmin are among the biggest thermal coal exporters in the world. In terms of production, both subsidiaries account for 33% of total coal production in Indonesia. BUMI's large size and dominant position in the Indonesian coal industry has allowed it to gain significant competitive advantages over its rivals due to economies of scale and ability to leverage its scale to make use of key acquisition opportunities. With the use of debt, BUMI plans to double production which will further increase its profitability and shareholder returns.

Coal Companies Profitability Margin : 2008



Source: Bloomberg, based of FY2008 financial data

Bumi also has a proven stellar record of return on invested capital as depicted in the graph below. After acquiring KPC in 2003, ROIC increased from 2.4% to 15.1% while production has only been increased by about 20% in the same period.



Source: Company

BUMI has made use of acquisitions as a key driver of its growth and strategy to maintain its dominance in the market. In the last quarter of 2008, BUMI has made a series of three key acquisitions using external financing. Although, these additions have yet to have an impact on BUMI's ROIC, its track record of successful acquisitions in the past should provide investors with comfort about the soundness of these acquisitions.

Another strength is the optimistic outlook for demand of Indonesian coal. Historically, Indonesia has exported a large part of its coal production and exports more than 70% of its annual coal production as previously mentioned. A positive development on this front for Indonesia's coal industry is the fact that China is on its way to becoming a net coal importer which could result in up to 100 million tons of annual coal imports and independent power producer projects (IPP) are expected to restart in India. The expected rapid increase in global demand coupled with the tight supply in the global coal market for the next six to eighteen months could benefit coal price. Coal futures trading with maturities up to 2013 indicate that coal prices is expected to increase by more than 25%, which could prove to be a boon for BUMI. In addition, domestic demand for power coal is also expected to increase significantly as the Indonesian government's attempt to improve the country's basic infrastructure has led it to announce a 10,000MW power generation scheme.

## Investment Risks

As with all investments, there are also risks involved and some of the major concerns with BUMI are government intervention, coal reserves, the development of alternative energy, and corporate actions. Traditionally, there has been ample government intervention in the energy and utilities sectors. For example, petroleum products are heavily subsidized to keep prices affordable to the average Indonesian citizen. As the government seeks to purchase more coal to power its lofty power generation project and alleviate chronic power shortages, there is the possibility of government implemented quantity quota or price limits on these coal purchases. Such intervention could prove detrimental to the company's profitability and competitiveness against foreign players.

A second risk that we have identified pertains to BUMI's coal reserves and volatility of coal prices. Insiders in the coal industry value their reserves on four criteria: amount of reserves, quality of reserves, distance to transportation facilities, and penetration rate. With the rapidly increasing demand, Indonesia's coal reserves will be depleted much faster than the forty years that is estimated today. Proven coal reserves are also one of the key drivers of a coal miner's value and the risk of not being able to find new reserves that have the quality to help the company's profitability may prove detrimental to BUMI. In addition, BUMI as a company does not have the ability to control coal prices which is a commodity. Therefore, the volatility of coal prices in the future will always add a degree of uncertainty to BUMI's financial performance.

## Valuation

Following our investment theses, we carried out some comparable company analysis and have summarized our findings on various financial and operating metrics in the table below:

Company	Mkt cap (bn)	P/E	EV/EBITDA	ROE	Operating margin	Reserves (mm ton)	Cap Ex (mm)
Bumi Resources	5.48	9.53	5.96	47.82%	31.51%	2119	24.875
Adaro Energy	5.44	31.23	5.95	10.75%	23.28%	928	17.988
Indo Tambangraya	3.02	13.43	5.45	44.05%	25.82%	312	19.173
Tambang Batubara	3.58	13.69	8.85	57.53%	34.56%	1990	NA

From the comparable companies that we looked at, we consider Adaro Energy as the closest company to BUMI because of its equivalent size. Nonetheless, we also included the third and fourth largest firms by market capitalization to provide more color on how the industry is generally performing. On the financial aspect, BUMI has one of the highest returns on equity of 47.82% which is significantly higher than that of Adaro's 10.75%. In addition, while BUMI's EV/EBITDA ratio is very much in line with its peers, it has a significantly lower P/E ratio which indicates that its stock price may be undervalued.

On the other hand, three key operating metrics we look at among others are operating margin, reserves and capital expenditures. As coal mining companies are in the commodity business, they compete solely on price and BUMI's relatively high operating margin of 31.51% indicates that it is one of the more efficient players in the industry. We are also encouraged to see how BUMI's large capital expenditures combined with its high reserves capacity would bring positive effects to its financial performance and valuation.

## Investment Summary

BUMI has demonstrated effective strategic acquisitions in the past with KPC and Arutmin and has positioned itself as one of the world's leading coal producers in terms of profitability and production capacity. As the company continues to invest in its future with large capital expenditures and acquisitions, we believe that tight supply in the global coal market could raise coal prices and increased demands from China, India, and Indonesia will further help the company's cause. In addition, to believing that the company's strengths outweigh the risk of investing in it, financial ratio analysis also gives an indication that BUMI's stock is undervalued relative to its peers. Therefore, we believe that BUMI will prove to be a prudent investment to a foreign investor wishing to invest in Indonesia.

## PT Bank Rakyat Indonesia Tbk

### Industry Analysis

The commercial banking sector in Indonesia is an oligopoly characterized by a few large players dominating the scene. As of end 2008, there were 124 commercial banks in Indonesia serving the 238 million people and its \$433 billion economy. Notably, the ten largest banks in the market account for 62% of total assets. After going through an overhaul ten years ago when the banking system collapsed amidst the Asian Financial Crisis, the Indonesian banking industry continues its strong recovery with significant government presence still remaining in the industry. The national government is the majority or 100% shareholder of five prominent banks, with 3 of them ranking among the ten largest banks in the country.

In recent years, opportunities and favorable changes in regulation of the commercial banking sector in Indonesia have been attracting foreign players into the field. Foreign banks operating in Indonesia is defined by one of two classes of membership in the Foreign Banks Association of Indonesia. Ordinary 'A' members are branches of foreign banks licensed to operate in Indonesia while ordinary 'B' members are Joint Venture banks – Indonesian-domiciled organizations which are established and controlled by foreign-domiciled banks. Currently only two foreign banks make the top ten largest banks in Indonesia, indicating that the industry is still dominated by local firms. The commercial banking industry in Indonesia can be classified into two distinct tracts: traditional commercial banking and the rapidly developing Syariah banking (Islam compliant banking). The development of Syariah banking is even more prominent in Indonesia as it is the world's largest Muslim country in the world with about 85% of its population following Islam. While many banks do not give a breakdown of their traditional and Syariah compliant holdings, an increasing number of banks are starting to offer Syariah banking services.

Looking at the banking industry as a whole, we believe that it is a cyclical industry that closely reflects the growth and state of the country's economy as a whole. Indonesia has found itself to be resilient to the global financial meltdown in 2008 due to its prudent economic policies and resilient domestic demand which accounts for roughly 60% of GDP. Indonesia is expected to come through this crisis fairly well and outperform most other Asian economies with predicted real GDP growth of 4% in 2009 and 4.8% in 2010. This strong performance in the country's economy is expected to be reflected by an expected average 15% annual growth rate in bank assets, loans, and deposits from 2009 to 2013.

### Company Overview

Bank Rakyat Indonesia (BRI) is the second largest bank in Indonesia as of end 2008 with a market capitalization of approximately US\$9 billion and with assets of approximately US\$2 billion on its books. BRI's ancestor was founded in 1895 by Radne Aria Wiriatmadja in the small town of Purwokerto in Central Java. Throughout its long history, the bank has undergone different regimes in Indonesia and has had its name changed multiple times. BRI became the first state-owned bank of the government in 1946 shortly after Indonesia gained its independence.

In 2003, BRI became a publicly listed company when the government divested 30% of its shares to the public. Today, the government owns about 57% of the bank's stocks and of the publicly held 43%, foreign investors account for about 80% of the public holders. As a state-owned bank, BRI is heavily involved in helping the government implement and achieve its vision in the development of the country's economy. On top of that, BRI has a very strong focus on micro, small, and medium businesses and has started a Syariah banking arm under the name BRI Syariah through an acquisition. Ever since its public offering, BRI's stock performance has been stellar and is shown in the chart below:



## Investment Strengths

BRI's long history and significant government ownership since its founding has allowed it to become one of the pillars of the Indonesian banking system and we are optimistic that the state of the Indonesian economy and its demographic is advantageous to BRI to further consolidate its position as a leading Indonesian bank. There is still significant income inequality in Indonesia and approximately 18% of its population lives below the

poverty line. Furthermore, the low per capita GDP of US\$3,900 indicates that a majority of the Indonesian population falls under BRI's target market. We believe that BRI's size, prominence, and large distribution network would help exert its dominance in the micro loan market which is growing rapidly in Indonesia. BRI has nearly 4,500 channels to reach its customers when postal service centers, branches, and offices are taken into account. Based on economic studies of developing nations, the availability of credit is one of the key engines of economic development. We believe that Indonesia has reached the stage of development where there will be significant increase in demand for credit, especially in the micro, small, and medium enterprise loan markets.

Company	Operating margin	Total Loans (US\$ bn)
BRI	50.44%	15.3
Mandiri	38.91%	16.3
BNI	45.82%	10.7
BCA	47.19%	11.1
Danamon	25.15%	6.5

BRI is the second largest lender in Indonesia after PT Bank Mandiri with US\$15.3 billion worth of loans in 2008. Even though Mandiri has made a billion dollars more loans, BRI's profitable business model is

reflected in its stellar operating margin in excess of 50%. We believe that this profitable model will further enhance BRI's performance if the bank is able to increase its market share in the micro, small, and medium loans market as planned. In the case of BRI, we actually see the significant government ownership in the bank as a boon as it helps to mitigate risk and ensures that the bank sticks to its proven business model and excel in its niche. This has been exemplified by the criticism that the bank received from lawmakers when it attempted to re-enter the corporate loan market which is deemed to have higher risks.

## Investment Risks

Even though BRI's outlook on loan growth looks very promising, one area of concern could be the loss of clients to Syariah banks which are vying for the same clientele. We expect many of BRI's new clients to be of Islamic faith who could be attracted to the increasingly popular Syariah compliant financial products. Even though BRI has recently set up a Syariah banking arm, it is considered a small player in this field as compared to other more established players like PT Bank Syariah Mandiri and PT Bank Muamalat Indonesia. On top of that, a significant increase in Syariah loans could potentially increase the risk profile of BRI. While Syariah banking is a profitable business, banks are not allowed to charge interest for its loans and rather earn its profit through income sharing schemes. This could heighten the risk of the bank's loans as the bank is now invested in the myriad of businesses it is financing. In addition, more complex methods of debt trading are heavily frowned on in the Syariah space and this could curtail BRI's access to flow through profit from its loans.

Secondly, the high percentage of foreign ownership in the publicly held shares of BRI is a red flag in our view. We believe it to be prudent to make the conservative assumption that foreign investors do not have the same determination or motivation to stay invested in a company as local investors. As a result, we think that a significantly high foreign ownership of BRI's shares make it more susceptible to capital flight when there are less encouraging news. This observation is corroborated by BRI's precipitous drop in stock price in late 2008 during the global recession even though Indonesia's economic fundamentals proved resilient.

## Valuation

Company	Total Assets (US\$ mm)	ROE	P/E	5-year Loan Growth	5-year Income Growth	Operating margin	Loan/Deposit	Tier 1 Ratio
BRI	27,599	26.65%	15.1	26.86%	11.85%	50.44%	74.26%	13.40%
Mandiri	36,649	17.41%	17.4	14.56%	3.76%	38.91%	54.79%	13.69%
BNI	20,362	7.92%	26.6	18.08%	-6.27%	45.82%	63.58%	N/A
BCA	27,163	24.81%	19.6	25.64%	16.34%	47.19%	51.39%	14.42%
Danamon	10,013	14.46%	16.3	17.90%	-5.37%	25.15%	84.05%	14.82%

We looked at a few performance metrics to determine if they support our investment thesis on BRI. From our findings, BRI is found to give the highest return on equity among its peers while having the lowest price to earnings ratio indicating an undervalued, well-performing stock. We also like the combination of a high 5-year loan growth and operating margin which we believe will set BRI apart from its competitors as the credit market in Indonesia develops. Other industry specific metrics like loan to deposit ratio and tier 1 ratio reflects that BRI is largely in line with its peers on these fronts. Tier

1 ratio is gives the ratio between a bank's core capital to its total assets and is interpreted as a measure of the bank's financial strength.

## **Investment Summary**

We are very bullish that Indonesia's credit market will develop significantly in the near future as Indonesia continues its march to become one of the fastest developing emerging markets in the world. In light of this industry expectation, we believe that BBRI is a great investment candidate because it has unique competitive advantages over its rivals that will allow it to cement its place as one of the pillars of the Indonesian banking system. In addition to these advantages and strong operating metrics, our financial analysis also indicates that investing in BRI would provide the highest return on equity as opposed to any other firm in the Indonesian banking industry.

## Indocement Tunggal Prakarsa

### Industry Analysis

The cement industry in Indonesia is dominated two key players- Semen Gresik and Indocement both of which have market capitalizations of approximately US\$4.5 billion. There are several other smaller players, but only Holcim Indonesia and Jasa Mara are of notable sizes with a market capitalization of about US\$1.2 billion. Demand for cement is determined mainly by construction rates for public infrastructure, housing and non-residential buildings. As cement is considered a commodity, competition is intense and profitability is determined by operational efficiencies as companies must compete solely based on price. Indonesia's cement industry has a production capacity of about 45 million tonnes of which approximately 70% of the industry's capacity is devoted to meet domestic demands, while the remaining 30% are exported after domestic demands have been satisfied.

Domestic demand is largely the driver for cement sales in Indonesia. It is worth noting that despite the downturn in 2008, the cement industry continued to grow robustly supported by Indonesia's resilient domestic economy. There has been a great economic focus by the government to build new and upgrade existing infrastructure since 2007 and this has contributed to the 8% annual average growth rate of the industry. This high growth rate of about 7-8% annually is expected to continue well into 2015, and this trend has been recognized by industry players who have planned investments of up to US\$1.94 billion over the next five years to increase capacity.

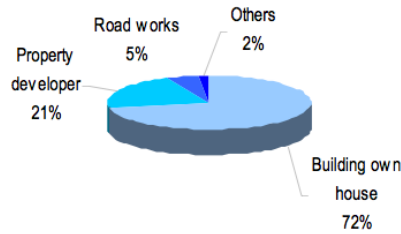
Another notable characteristic of the domestic demand for cement in Indonesia is that consumer spending on bag cement accounts for a majority of total cement sales. This is due to the fact that almost 80% of Indonesians construct their own houses and would purchase cement in bags instead of bulk.

**Figure 1: Forecast domestic sales based on users**

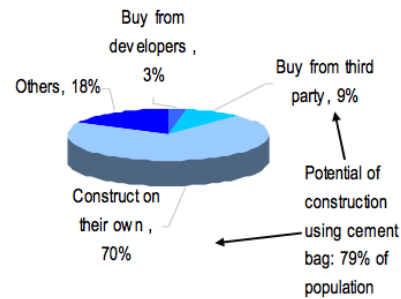
	2009	2010	2011	2012
<b>Cement (m tonnes) required from:</b>				
Investment in toll road (Bulk)	0.1	0.2	0.5	0.6
Property developers (Bulk)	5.5	5.8	5.9	5.9
Build own house (Bag)	24.4	25.5	26.0	26.0
<b>Subtotal (m tonnes)</b>	<b>30.0</b>	<b>31.5</b>	<b>32.4</b>	<b>32.5</b>
Others (renovation, road works ex toll road) (Bag)	6.1	8.2	10.1	12.1
<b>Domestic sales forecast (m tonnes)</b>	<b>36.1</b>	<b>39.7</b>	<b>42.5</b>	<b>44.6</b>

Source: BPS, CIMB Research,

Cement accounts for 50% of property construction costs vs. less than 7% for infrastructure



80% of Indonesians construct their own houses. This should explain the higher bag proportion to bulk cement



Source: BPS, CIMB Research

## Company Overview

Indocement Tunggal Prakarsa Tbk (“Indocement”) was established in 1985 and grew to become the second largest cement producer in Indonesia with annual capacity of nearly 17.1 million tons. It owns twelve manufacturing factories—eleven of them are located in West Java, one of the fastest growing regions in Indonesia, and one in Kotabaru—each producing the company’s three bestsellers: Portland cement, oil-well cement, and ready-mixed cement. In 2001, HeidelbergCement Group, the world’s leading cement producer based in Germany, assumed a controlling majority shareholder stake in Indocement. In November 2008, due to internal restructuring, HeidelbergCement Group transferred all of its shares to Birchwood Omnia Limited, which is another United Kingdom based cement company owned by the HeidelbergCement Group. Indocement is controlled by three groups of shareholders: Birchwood Omnia (51%), PT Mekar Perkasa (13%), and the public (36%). PT Mekar Perkasa is an investment company that is owned by the Salim Group, a conglomerate family in the Indonesian business scene. The chart below reflects the historical stock price of Indocement since 2003 and shows its strong performance having appreciated by more than six-fold.



Source: Bloomberg

## Investment Strengths

One of a company's most important qualities is having the capacity and flexibility to adjust production levels given an increase in demand, especially in such competitive industries. Indocement was able to raise its production levels in a timely way to capture the opportunity fueled by Indonesia's cement market boom since 2008 which was driven by the government's pledge to improve and build new infrastructure. Today, the company's production capacity has not been fully utilized leaving about 21% of capacity to provide operational flexibility. Besides increasing production, Indocement's management has recognized the importance of pursuing continued operating efficiency improvements and has invested in a number of projects for this. Some of these measures include the modernization and refitting of kilns and major equipment. In one successful scenario, the revamping of a plant enabled it to generate an additional 600,000 tonnes of cement per year.

Secondly, Indocement increased its holding of cash by more than seven-fold from Rp 252 billion to Rp 1.72 trillion to indicate its strong financial performance. Such a large increase in the holding of cash is not a common move for any corporations and we believe that the company has plans to use this cash to increase its production capacity to meet the growing cement demand in the coming few years. We take confidence in this move by the company because of its track record of winning industry accolades and

innovative actions. Indocement has received many business and leadership awards, and we particularly focus on its awards for the Seven Best Managed Companies in Indonesia 2008 and The Value Creator Award 2008. On top of being acknowledged for its corporate governance, improved risk management, and better auditing and accounting standards, the management of the company has shown through its actions that it is ready to implement innovative solutions to gain operational competitiveness. For example, the company integrated a new online production monitoring system, which provides hourly updated analysis and viewing of cement operations to help improve efficiencies and quality control. Indocement has also adopted the use of alternative fuels to reduce its operating cost.

## Investment Risks

Indocement has plans to build a new cement factory in Central Java, as announced in October 14, 2009, with a total investment value of around IDR 4.5 trillion – IDR 5 trillion. The new factory will have a total capacity of 2.5 million tonnes per year and is expected to last several decades. However, large scale projects such as this incur many economic and social risks. In rival PT Semen Gresik's experience, the local people rejected the company's new-built cement factory, causing massive delays to production and a shortage of workers. In addition, the time taken to build a new cement factory may make the company vulnerable to fluctuating cement prices and demands.

## Valuation

Company	Market Cap (US\$ mm)	P/E	EV/EBITDA	ROE	Operating Margin	Sales - 1 Year Growth	Sales - 5 Year Growth	CAPEX (US\$ mm)
Indocement	4,307	18.00	10.96	26.78%	34.99%	-4.75%	14.64%	2.5
Semen Gresik	4,389	13.86	9.02	37.42%	31.48%	17.30%	16.92%	73.7
Jasa Mara (Persero)	1,278	18.08	10.55	11.28%	41.44%	4.86%	N/A	41.6
Holcim Indonesia TBK	1,257	40.59	9.56	10.00%	21.60%	0.99%	24.91%	7.9
Adhi Karya TBK PT	75	8.39	7.39	20.15%	4.51%	3.43%	21.66%	0.1

Looking at the table above, Semen Gresik is the only competitor that is comparable in market capitalization to Indocement. This is not a surprising observation as we have established that the Indonesian cement industry is dominated by these 2 players. Taking a glance at the return on equity column, we can see that Indocement has been a better investment than its smaller competitors. Therefore, we will focus our comparison to Semen Gresik.

Comparing the two giant companies head to head on the metrics that we have selected, many investors might conclude that Semen Gresik is the better investment because of its lower P/E ratio, higher return on equity, higher growth rate and capital expenditures. To this point of view, we will first counter by restating our belief that Indocement would be making significant capital expenditure in the near future as depicted by its large cash holdings. Secondly, Indocement has been able to edge Semen Gresik in its operating margin and we believe that it is attributable to Indocement's superior management. We are very impressed by the quality of Indocement's management and believe that backing such a team would prove beneficial.

## Investment Summary

Indocement is the second largest producer of cement in Indonesia behind Semen Gresik, and typical of many publicly listed companies in the country, only 36% of its stocks are held by the public. One of the biggest factors for our choice to invest in Indocement besides favorable market opportunities and superior operational capabilities is the highly acclaimed quality of the company's management team. In an industry where the products of a company are considered a commodity, we are very encouraged that a superior management team that is ready to take innovative actions and creative solutions will create significant value to its investors.

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