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# Investment Case for Indonesia Small-Caps



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# I. Overview: Investment Case for Indonesia Small-Caps

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## Indonesian Economy: Large, Stable and Resilient

- largest economy in Southeast Asia, strategically positioned in Pacific Asia
- proved resilient to recent global downturns aided by strong domestic consumption levels

## Attractive Destination for Foreign Direct Investment

- stable fiscal and political environment
- further bolstered by improving sovereign credit quality

## Small-Cap Stocks: Potential to Benefit from Domestic Consumption Growth

- traditionally provided high exposure to domestic demand oriented sectors
- youthful demographics and increasing consumption levels may benefit domestic oriented companies

*Sources: The World Bank, worldbank.org; Asian Development Outlook 2011, Asian Development Bank, adb.org  
SEE SLIDES 2 AND 3 FOR IMPORTANT DISCLOSURES*

## II. Indonesia: Country Overview

Indonesia is an archipelago situated along the equator, north of Australia and south of Malaysia and the Philippines.

- Home to roughly 240 million people: world's fourth most populous country.<sup>1</sup>
  - domestic market is becoming increasingly consumer-oriented as incomes rise<sup>1</sup>

Economically, Indonesia may offer great potential\*:

- GDP PPP of \$1.054 trillion USD in 2010
  - largest economy in Southeast Asia
  - 18<sup>th</sup> largest economy in the world, greater than Switzerland and Poland
- A modest but growing per capita GDP PPP of \$4,383 USD in 2011
  - \$2,973 in 2010, \$2,331 in 2009, \$2,233 in 2008
  - greater than a four-fold increase from 2000 level of \$804
- Situated in a region that has rapidly developed since the 1970s:
  - growing ties with China and India
  - an annual GDP growth of 11% since 1970
- Diversified economy that incorporates a substantial domestic sector, and a broad export line-up.<sup>1</sup>
  - energy, light manufacturing goods, commodities, minerals, metals and energy



*GDP PPP: Gross domestic product (GDP) is a measure of the value of all final goods and services produced within a nation in a given year. Purchasing power parity (PPP) is a type of GDP calculation that takes into account the relative costs and the inflation rates of a country, rather than using exchange rates which may distort the real differences in income.*

\* Source: The World Bank, [worldbank.org](http://worldbank.org)

<sup>1</sup> Source: Asian Development Outlook 2011, Asian Development Bank, [adb.org](http://adb.org)

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## Indonesia: From Crisis to Fiscal and Political Stability\*

Indonesia has realized a remarkable recovery from the Southeast Asian economic crisis (late '90s) by pursuing sounder fiscal and monetary policies and a broad agenda of reforms.

### ■ Improved Balance Sheet\*:

- reduced net external debt
- reduced government debt
- increased FX reserves

	2000	2011
Net External Debt (% of GDP)	147%	30%
Central Government Debt (% of GDP)	80%	25%
Foreign Exchange Reserves (billion US\$)	27.3	111.3

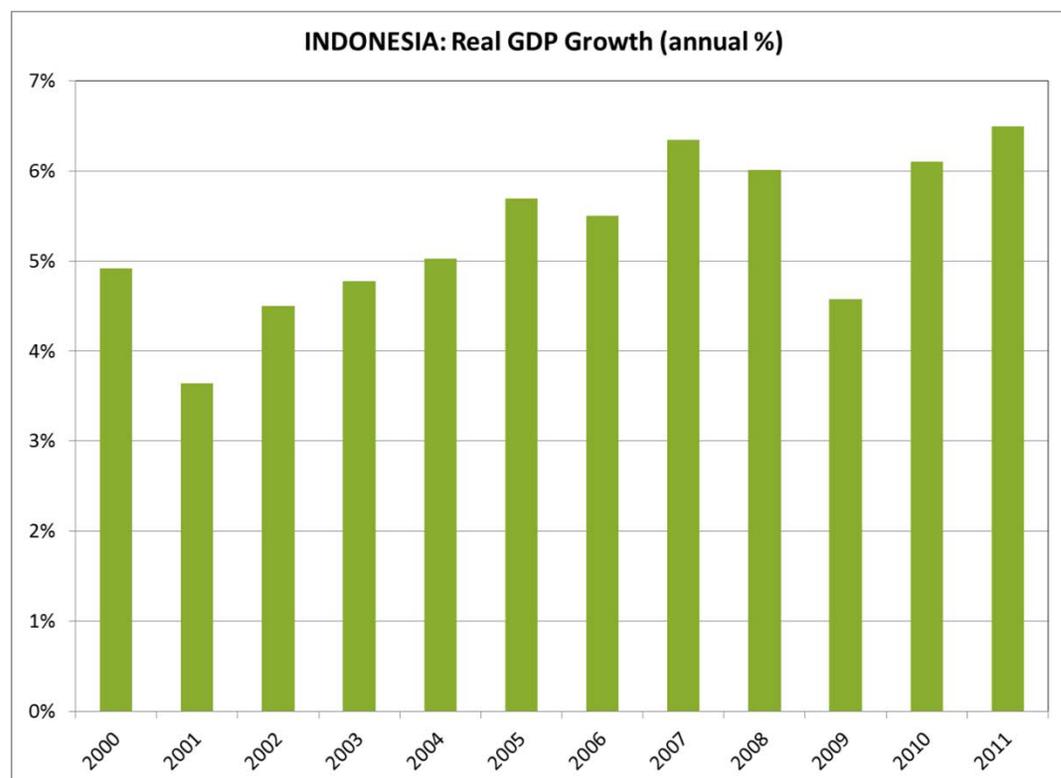
Source: The World Bank

### ■ Political Stability\*:

- democratic government began in 1998 after dictator (General Suharto) of 32 years was forced to resign
- Susilo Bambang Yudhoyono became Indonesia's first directly elected president in 2004 and was re-elected in 2009

### ■ Continued Growth amid Global Uncertainty<sup>1</sup>:

- continued and consistent positive GDP growth since 2000
- modestly affected by 2001 and 2008-09 global recessions



Source: The World Bank. Chart is for illustrative purposes only. Past performance is no guarantee of future results.

\* Source: The World Bank, [worldbank.org](http://worldbank.org)

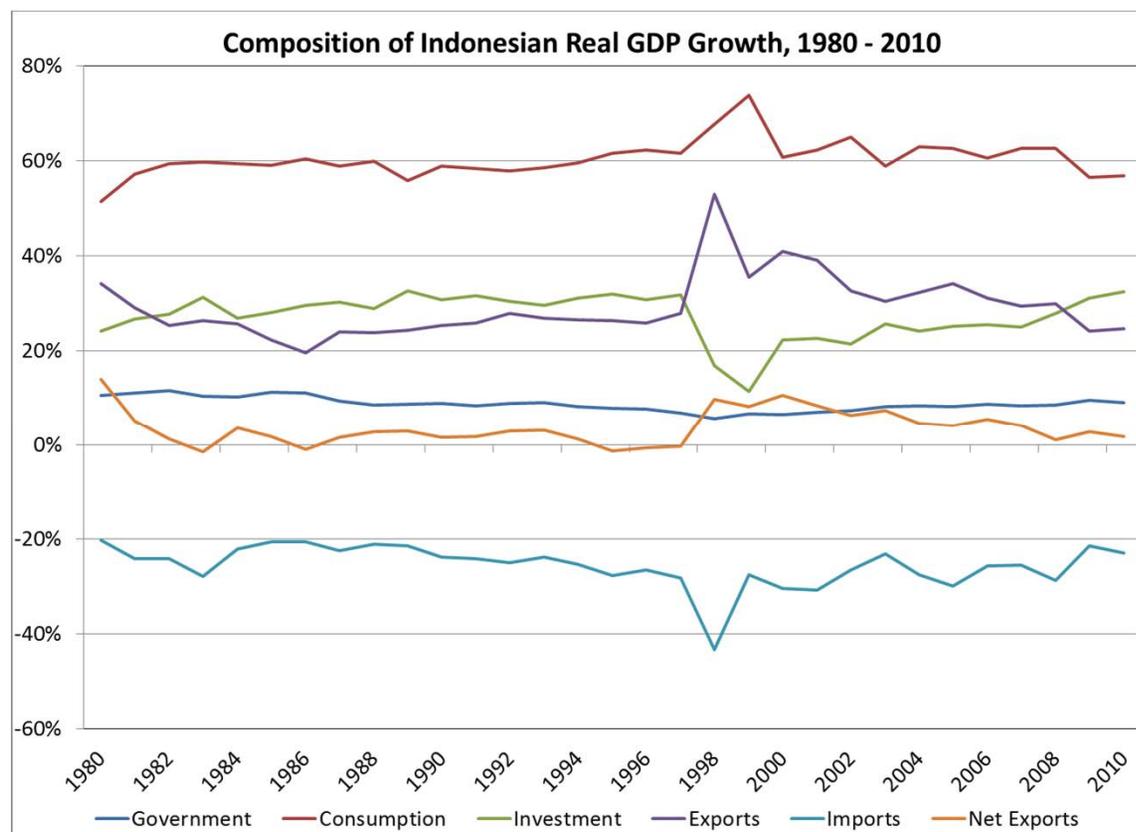
<sup>1</sup> Source: Asian Development Outlook 2011, Asian Development Bank, [adb.org](http://adb.org)

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## Indonesia: Economic Stability\*

According to economists, Indonesia's resilience to global recessions stems from its economic composition:

- **Large Domestic Consumption**
  - accounts for roughly 60% of the country's GDP since 1981
  - has allowed economy to remain fairly decoupled from global economy.
- **Modest Net Export Levels**
  - exports have fallen while imports have increased since 1998
  - net export amount continues to contribute negligibly to overall GDP growth
- **Diverse Economy and Broad Export Spectrum**
  - oil and gas, minerals, agriculture and manufacturing
  - large number of export destination markets



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\*Source: The World Bank, [worldbank.org](http://worldbank.org).  
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# Indonesia: Magnet for Foreign Direct Investment\*



Indonesian Foreign Direct Investment (FDI) has witnessed sizeable growth since 2000 due in part to:

- **Country's Stable Economic and Political Environment**
- **Improved Sovereign Credit Quality\***
  - regained its investment grade status: Fitch Ratings (as of 12/15/11), Moody's Investors Services (1/18/12)
  - FDI levels have tended to increase in lockstep with credit rating upgrades

Indonesia Sovereign Long Term Credit Rating			
Fitch		Moody's	
Credit Rating	Effective Date	Credit Rating	Effective Date
BBB-	12/15/2011	Baa3	1/18/2012
BB+	1/25/2010	Ba1	1/17/2011
BB	2/14/2008	Ba2+	12/1/2010
BB-	1/26/2005	Ba2	9/16/2009
B+	11/20/2003	Ba3	10/18/2007
B	8/1/2002	B1+	8/1/2007
B-	3/16/1998	B1	5/19/2006
B+	1/21/1998	B2+	2/27/2006
BB-	1/8/1998	B2	9/30/2003
		B3+	6/26/2003
		B3	3/20/1998
		B2	1/9/1998

Source: Bloomberg

Fitch and Moody's ratings are BBB-/Baa3- and above for investment grade and BB+/Ba1+ and below for non-investment grade.



Source: The World Bank. Chart is for illustrative purposes only. Past performance is no guarantee of future results.

\*Source: The World Bank, worldbank.org.

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# Indonesia: Current Economic Challenges

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Indonesia's economy is not without its challenges.

- At \$120 per barrel oil (Brent), it is expected that<sup>1</sup>:
  - the total amount of government fuel subsidies will rise to above 3% of GDP, which is not allowed by Indonesian law.
  - would force a reduction in these government subsidies by as much as 33% which may provide a headwind to economic growth.
- Inflationary Threats<sup>2</sup>
  - On February 8, 2012, the Bank of Indonesia (BI) lowered the short-term borrowing rate from 6.75% to 5.75% in order to keep the economy growing above 5.0%.
  - As of December, the Indonesian Consumer Price Index was 3.79%; however, it is estimated that an internal price shock such as a rise in fuel prices could drive the inflation rate near 7.0%.
- Protectionist Policies<sup>3</sup>
  - On February 21, 2012, Indonesia unveiled a new mining law, limiting foreign ownership in the industry to 49% from 80% previously.
  - On March 10, 2012, another policy decision that limits foreigners from holding certain senior management positions at local companies was announced by the Ministry of Manpower and Transmigration.
- Inadequate Infrastructure<sup>4</sup>
  - Many analysts believe that Indonesia lacks a workable infrastructure, which does not satisfactorily address the current economy and may slow future economic growth.
  - In 4Q 2011, the government approved a land acquisition bill that is viewed as having the potential to expedite many major infrastructure projects.

<sup>1</sup> Source: *Jakarta Globe*, (February 29, 2012). *Indonesian Officials Outline Fuel Subsidy Cuts*.

<sup>2</sup> Source: *Jakarta Globe*, (March 9, 2012). *Indonesian Bonds, Rupiah Tumble on Inflation Threat*.

<sup>3</sup> Source: *CNBC*, Vaswani, Roshan . (March 13, 2012). *Indonesia Trade Minister Rejects Protectionist Label*.

<sup>4</sup> Source: *Jakarta Globe*, (December 16, 2011). *Indonesia Passes Land Acquisition Bill*.

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### III. Small-Cap Opportunity: Capturing Domestic Demand Momentum



Traditionally, small-cap stocks have offered greater exposure to domestic demand oriented sectors.

- For example, the Market Vectors Indonesia Small-Cap Index (MVIDXJTR) has a 60% exposure to domestic demand driven sectors\*:

Sector Allocation Index Weightings	
Market Vectors Indonesia Small-Cap Index (02/29/12)	
<b>Domestic Demand Oriented Sectors</b>	
Consumer Discretionary	5.32
Consumer Staples	15.50
Financials	39.49
<b>Total</b>	<b>60.31</b>
<b>Export/Global Oriented Sectors</b>	
Energy	15.61
Materials	5.80
<b>Total</b>	<b>21.41</b>
<b>Split Focused Sectors</b>	
Industrials	18.27
<b>Total</b>	<b>18.27</b>
<b>Total</b>	<b>100.00</b>

*Indonesian small-caps could benefit greatly from the current domestic demand momentum which may be poised for rapid growth.\*\**

*Chart is for illustrative purposes only. Current data may differ from data quoted. An investor cannot invest directly in an index.*

\* Source: FactSet

\*\* Source: Financial Times, Divecha, Arjun. (January 4, 2012). Global stocks best way to tap domestic EM growth.

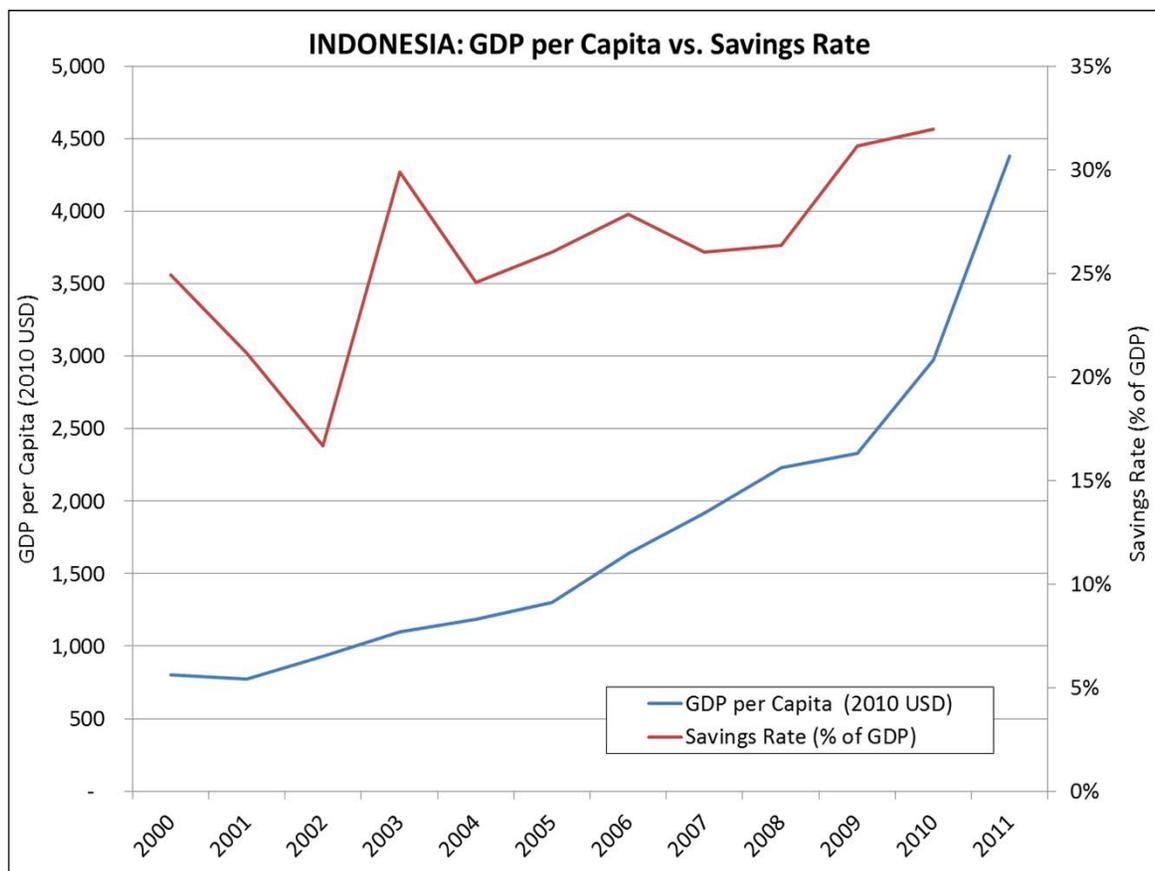
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## Small Cap Opportunity: Continued Fuel for Domestic Consumption

Domestic consumption is supported by two underlying and connected forces<sup>\*\*</sup>: one economic and one demographic.

- Indonesia's GDP per capita has grown significantly since 2000.
- GDP per Capita is currently \$4,383 (2011) which, based on observations by economists (see below), could set the stage for a dramatic increase in domestic consumption growth.

*Historically, a country's savings rate increase until its GDP per capita reaches the range of \$3,000-\$10,000 at which point the per capita consumption of all goods and services tends to rise in a highly non-linear fashion.\**



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## Small Cap Opportunity: Continued Fuel for Domestic Consumption



Domestic consumption is supported by two underlying and connected forces: one economic and one demographic.

- Indonesia's demographics are poised to maintain or even increase its consumption habits.\*
  - fueled by a youthful population whose median age stands at 27.7 years (as of 12/31/11).
  - aggregate amount of consumer expenditures has grown more than 50% over the past three years
  - growth in consumer expenditures is fueled by growth in the country's disposable income level.

	2008	2009	2010	2011	3-Year Growth
Consumer Expenditure (USD million)	750,838	783,289	987,140	1,153,116	53.58%
Annual Gross Income (USD million)	1,080,849	1,113,493	1,411,513	1,625,098	50.35%
Annual Disposable Income (USD million)	1,073,243	1,095,399	1,387,971	1,597,346	48.83%
GDP per Capita (USD)	2,233	2,331	2,973	4,383	96.29%

*Source: The World Bank. Table is for illustrative purposes only. Past performance is no guarantee of future results.*

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