NEWS LETTER

August 2007
Vol 06/VIII/SOE Research/07

SOE RESEARCH

This Edition

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Recent Issues on BNI Divestment

Did the recent BNI divestment achieve its target?

Despite weak stock market conditions, the Indonesian government, as the major shareholder of BNI, still decided to go ahead with the Limited Public Offering II and Public Offering of Government Owned shares in PT Bank BNI (BBNI) on the Jakarta Stock Exchange (JSE) and Surabaya Stock Exchange (SSE) on August 13, 2007. Bahana Securities and JP Morgan acted as the Underwriters of this issuance.

Controversy on BNI Public Offering

But this resulted in controversy. This controversy centered on the timing of the sale given that the Indonesian capital market was also affected by the global repercussions of the plunge in US stock prices due to the sub-prime crisis.

Most critics have argued that the government should have delayed the BNI issuance until the price of BNI shares had returned to their "normal" level. Otherwise, as stated in the prospectus, the capital losses would potentially be borne by BNI (for the 1.99 billion new shares) and by the government (for the existing 1.50 billion shares). For the record, the offer price was set at Rp 2,050/ share for the Public Offering of Government Owned shares and at Rp 2,025/share for the Limited Public Offering II. However, the highest level for BNI shares in its history was around Rp2,800/share. Some investment bankers, prior to the recent market turmoil, even believed that the price might exceed the Rp3,100 level. Thus, assuming the share price high of Rp 2,800/share, the potential loss is around Rp3.16 trillion (from a price differential of around Rp800/share).

Why did many players and analysts think the offer price was not high enough? Well, they expected that the price would be set at around Rp2,300/share. At this price level, BNI's PBV (Price to Book Value) would be 1.8x. Meanwhile, the average PBV of the Indonesian banking industry is around 2.37x. Therefore, at the Rp2,050 level, the price is clearly below the "normal" level as indicated by the industry average.

Unfavorable Global Market Conditions

Nonetheless, the State Minister of SOEs, Sofyan Djalil argued that the global market conditions were unfavorable and that the underwriters had already made efforts to stabilize the price decline since they have a green shoe option. Furthermore, the underwriters are also hopeful that the share price will rebound.

Furthermore, he suggested that investors should be patient since it was unreasonable to expect short-term capital gains. Also, he foresees the possibility of reviewing the privatization target after consultation with the Minister of Finance and the Coordinating Minister of the Economy.

Recent Development

SOE COOPERATION

Bank Mandiri and PTPN I: Operational Cooperation

Bank Mandiri shall provide PT Perkebunan Nusantara I (Persero) with Rp 90.73 bn of loans for the latter's palm plantation business in Nagroe Aceh Darussalam (NAD). PTPN I will optimize its plant through operational cooperation with PT Basyah Putra Investama (BPI), which has been appointed to manage the plant. The palm plantations cover 13,715 hectares. They are located in Batee Puteh, Kebun Ujung Lamie, and Kebun Krueng Luas.

Danareksa and Pusri sign Foreign Exchange Agreement

Danareksa has signed a Foreign Exchange Agreement with PT Pupuk Sriwidjaja (Persero), the largest state-owned enterprise in the fertilizer industry. The agreement was signed on August 3rd, 2007 by Pusri's President Director, Dadang Heru Kodri, and Danareksa's Caretaker President Director, Wahzary Wardaya, at Pusri's head office in Palembang. With this agreement, Danareksa provides not only day-to-day forex transactions for Pusri's operational needs but also offers solutions for yield enhancement and cost reduction structures for the company as well.

Recent Development (continued from page 1)

SOE CORPORATE ACTION

Pupuk Sriwijaya to build factory in Iran

The President Director of PT Pupuk Sriwijaya, Dadang Heru Kodri said that the company would build a urea fertilizer factory in Iran to help overcome scarcity in the domestic market. The scarcity is due to supply and demand imbalances.

Bank Mandiri to issue US$300 Million of bonds

PT Bank Mandiri Tbk has invited more than 10 foreign investment bankers to underwrite its US$300 Million senior bond issuance. Proceeds from the bond issuance will be used to strengthen Bank Mandiri's balance sheet. The bonds will be issued from October to November. They will have a three-year maturity.

Antam needs US$1.5 Bn for acquisition plan

PT Aneka Tambang Tbk (Antam) is seeking US$500 million - US$1.5 Bn of funding to finance its plans to acquire another mining company. Antam will appoint a financial advisor to handle the acquisition. Those on the shortlist are: Citigroup, Credit Suisse, HSBC Securities and Macquarie Securities. An acquisition is important for Antam given that its Pongkor mine is expected to be depleted within the next few years. PT Newmont Nusa Tenggara and PT Freeport Indonesia are mining companies which are being targeted by Antam.

AP II to take on loans to finish airport project

PT Angkasa (AP) II will take on Rp 1 Trillion of loans from Bank Mandiri and BNI to complete the Terminal 3 Soekarno Hatta airport project. The project is expected to be completed by the end of 2008.

Bank Mandiri to take over multifinance company

PT Bank Mandiri Tbk plans to acquire a vehicle multifinance company next year. In this regard, Bank Mandiri is currently eyeing two big multifinance companies and three small multifinance companies.

Danareksa Events

Agreement Signing with PT Pupuk Sriwidjaja (Persero)
Date and Venue: PT Pupuk Sriwidjaja (Pusri) Head Office, Palembang, August 3rd 2007

As part of Danareksa's comprehensive investment banking and investment management services, particularly treasury transactions, Danareksa has signed a Foreign Exchange Agreement with PT Pupuk Sriwidjaja (Persero), the largest state-owned enterprise in the fertilizer industry.

The signing was witnessed by the Minister of SOE, Sofyan Djalil, during Pusri's seasonal gathering with several companies in the fertilizer industry including Pusri's subsidiaries such as PT Petrokimia Gresik and PT Pupuk Kaltim, Tbk.

Along with this agreement, Danareksa provides not only day-to-day forex transactions for Pusri's operational needs but also offers solutions for yield enhancement and cost reduction structures for the company as well. Moreover, through advisory and training services, Danareksa is also committed to knowledge-sharing with Pusri. Thus, the agreement covers cooperation in upgrading and empowering treasury functions in line with both companies' respective competencies.

Treasury Workshop
2008 Economic Outlook & Effective Budgeting for Hedging
Date & Venue : Bangka, 28-30 August 2007

Speakers :
- Mr.Purbaya Yudhi Sadewa
- Mr. Ahmad Fauzi
- Mr. Raphael S. Kodrata

Participants : PT. Telekomunikasi Indonesia (Persero), Tbk,PT. Exelcomindo Pratama,PT. Aneka Tambang, Perusahaan Gas Negara, Tbk, PT. PAL Indonesia, PT. Kalbe Farma, BTDC, PT. Superintending Company of Indonesia (Persero), PT. Pelat Timah Nusantara,PT. Indosat, Tbk, PT. Garuda Indonesia, PT. (Persero) Angkasa Pura I, PT. Bukit Asam (Persero), Tbk, PT.(Persero) Pelabuhan Indonesia III, PT.(Persero) Angkasa Pura II, PT. (Persero) Krakatau Steel,PT. Mobile-8 Telecom, PT. Pupuk Kalimantan Timur (Persero) and PT. Timah Indonesia (Persero), Tbk

What's on The SOE Executive Club (BEC)

Next BEC Breakfast Meeting is tentatively scheduled in October 2007. The confirmed event will be announced soon.

NEWS LETTER

August 2007
Vol 06/VIII/SOE Research/07

SOE RESEARCH

Danareksa Analysis - published in Kompas, August 6, 2007

Privatization Bond Option for SOEs

by Edwin Syahruzad and Aloysius Kiik RO

The government can issue bonds on a regular basis both in rupiah and in a foreign currency (dollar) to fulfill the state's funding requirements.

The country's improved financial condition means privatization is no longer aimed at just maximizing fund raising.

It is time that the government gives various options to SOEs besides the selling of shares. For instance, issuing exchangeable bonds (EB) can be an alternative.

EB are basically bonds that are combined with stock options as conversion of partial or entire bond principal. If the government is the issuer of EB, the stock option that is offered can be SOE shares. That means EB bondholders can own the shares by the time the conversion occurs.

The amount of bond that is converted into shares is flexible, depending on the design of the EB structure.

From various EB issuances that have been done so far, most EB bonds follow partial conversion, for which only a portion of bond principal can be converted into stocks at a certain time and the conversion price determined earlier.

This EB feature that allows the conversion of the bond principal into SOE's shares means that EB are also known as privatization bonds.

Many countries have issued these privatization bonds. Several European countries, which in the past believed in the welfare state system such as France and Germany, have actively issued EB in alignment with the privatization of their SOEs. In Asia, the Philippines is one country that has issued EB.

EB offer a fixed interest rate just like regular bonds; however, they also have upside potential from stock options. In a bullish stock market, investor appetite for stocks is higher. Historical performance of the return is also quite good and has positive correlation with the recovery of the economy, as indicated by the index return of global convertibles that is in line with the global economic growth trend.

For the government, there are several benefits that can be obtained by issuing EB. First, it results in a cheaper cost of funds. Theoretically, EB's coupon is lower than the coupon of the plain vanilla bond. This is due to the higher expectations of higher returns that will be gained by investors from stock options when stock conversion occurs. Higher returns will be greater if stocks gain ground and this may push down the bond's coupon.

Second, EB can be packaged by creating a conversion structure related to a portfolio basket of SOEs. As a result, the diluted portion that will occur can be lower compared to that if the privatization program is done individually. Third, the issuance of EB can be done by combining stock options of SOEs based on sectors.

Fourth, the issuance of EB will be part of efforts to make SOEs more transparent in their financial management. Indeed, this will encourage improvements in SOE's governance. The capital market provides the most inexpensive monitoring system that can drive the performance of SOEs.

Fifth, the government, in this case the Ministry of SOEs, can reduce the uncertainty in the privatization/divestment process resulting from changes in market risk because stock conversion has been determined in advance when the structure of EB was finalized.

In the event of a declining stock market at the time conversion occurs, it actually become an opportunity for the government to buy back the SOE shares at a cheaper price. The ability of SOE management to buy back shares or the government's efforts to increase its ownership in the SOE again can essentially be an achievement.

Issuance Mechanism

EB issuance requires an underwriter to act as a financial advisor as well as a seller to investors. Financial advisors are in charge of designing the bond structure, incorporating the conversion price, the duration, and the coupon rate.

The role of the financial advisor is very important because a good structure will determine investor interest in the EB bond. A good structure will also determine the dilution effect of the government's shares in SOEs. A good financial advisor will be able to optimize SOE's value so that the dilution aspect resulting from stock conversion will be minimal. Naturally, the design of the conversion structure has to be aligned with the SOE revitalization strategy that should be comprehensive to the overall working program of the SOE Ministry.

Strategic Issues

Several issues must be settled before the issuance of EB is realized. First, the legal framework of the decision making process in the SOE's privatization or divestment issues. On one side, the mechanism of bond conversion into SOE shares in the EB structure has a market mechanism nature. However, the existing law requires each privatization or divestment of SOE to obtain approval from the House of Representative.

As such, a rule of law resolution is required in order to allow agreement between the House of Representatives and the government, especially in relation to the potential of SOE's shares conversion through the EB structure planned to be issued.

Second, synchronization of policies between the Department of Finance and the Ministry of SOE. On one side, the Department of Finance prepares policy that will determine the size of the EB planned to be issued, the portion of bonds that will be converted into shares of several SOEs, besides the targeted coupon.

Despite the above various strategic issues that must be settled, the issuance of EB as a state financing alternative is an attractive option to consider. This option can achieve two goals at the same time, which are an alternative to reduce the interest costs of the government's debt and to accelerat SOE revitaliza-tion by bringing SOE to the capital market. To the capital market investors, EB can add the available choice of instruments, especially hybrid securities in the market, which in turn will extend the investment horizon for investors.

SOE RESEARCH

NEWS LETTER

August 2007
Vol 06/VIII/SOE Research/07

Change in Management of SOEs

There were some changes in the management of some SOEs in August 2007. Presented below are some of the changes.

Top Management			
Previous		New	
Name	Position	Name	Position
	PT Kereta Api Indonesia (KAI)		
Pandu Djajanto	Commissioner	**Yahya Ombara**	**Commissioner**
	PT Industri Kereta Api (INKA)		
Drs. Udin Supriatman, Ak	Director of Administration & Finance	**Bambang Soendjaswono**	**Director of Administration &Finance**
		Gunesti Wahyu Handiko	**Director of Commerce**
		Kurnijanto Indrotomo	**Director of Production & Technology**
	PT Merpati Nusantara Airlines (MNA)		
		Cucuk Suryo Suprojo	**Commisioner**
	PT Kimia Farma, Tbk		
Drs. Gunawan Pranoto	President Director	**Mohammad Syamsul Arifin**	**President Director**
Drs. Sofiarman Tarmizi	Director	**Agus Anwar**	**Director of Marketing**
Drs. Warsito Triatmodjo	Director	**Jisman Siagian**	**Director of Production**
Drs. Handoyo Abdul Rachman S	Director	**Zurbandi**	**Director of General Affair**
		Rusdi Rosman	**Director of Finance & HR**

SOE PERFORMANCE *(continued from page 2)*

Company	First Half Performance	Supported by
Antam	▪ Net Profit rose 457.7% from Rp515.19Bn to Rp2.873 Tn ▪ Net Sales rose 185.79% from Rp2.104Tn to Rp6.013 Tn ▪ Gross Profit rose from Rp975.72 Bn to Rp4.102 Tn ▪ Operating Profit rose from Rp853.64 Bn to Rp3.921 Tn ▪ EBIT rose from Rp735.903 Bn to Rp4.096 Tn ▪ Total Assets rose 51.77% from Rp6.640 Tn to Rp10.078 Tn	Increase in mining commodity prices in the first half of the year
BNI	▪ EBIT rose 25.6% from Rp1.21 Tn to Rp1.52 Tn ▪ Net Profit rose 21.5% from Rp838 Bn to Rp1.02 Tn ▪ Net NPLs declined from 10.88% to 5.4% ▪ LDR increased from 51.78% to 55.32% ▪ CAR declined from 19.04% to 14.27%	Increase in fee based income
Indosat	▪ Net Profit increased 54% from Rp548.8 Bn to Rp845.1 Bn ▪ EBITDA increased 22.6% from Rp3.306 Tn to Rp4.053 Tn	Increase in cellular customers
AP I	▪ Net Profit increased 35% from Rp166 Bn to Rp225 Bn ▪ Operating Revenue reached Rp825 Bn	
Merpati	▪ Net profit reached Rp8 Bn ▪ Target load factor increased from 79% to 100%	Focus on middle up customers, Better services, Competitive prices, and re-opening of old routes
PT Timah	▪ Net profit increased 31 x from Rp23.9 Bn to Rp780.8 Bn ▪ Sales volume increased 60% from 19.083 MT to 30.456 MT	Higher price of tin and increased production volume

Agus Martowardojo: Neighbourhood Chief Banker

In Indonesia, at the present time, the three most senior and experienced bankers are Agus Martowardojo, Rudjito (Bank Rakyat Indonesia/BRI former director), and Sigit Pramono (BNI director). But only one of them is a neighbourhood chief: Agus Martowardojo. In July 2007 he was elected by his constituents at Jalan Tirtayasa, Kebayoran Baru as their chief, to lead about ten sub-neighbourhoods.

Agus Dermawan Wintarto Martowardojo was born in Amsterdam on 24th January 1956. His undergraduate education was completed at the Economics Faculty of Universitas Indonesia in 1984. After that Agus Martowardjojo joined several Banking & Management Courses, in the State University of New York (Buffalo), Stanford University (Palo Alto, USA) and the Institute of Banking & Finance (Singapore).

Agus Martowardjojo began his career at Bank of America NT & SA (1984) through the Officer Development Program and continued as an International Loans Officer. Then he moved to PT Bank Niaga Tbk and became the Vice President of the Corporate Banking Group for Jakarta and Surabaya (1986-1994). At that time Bank Niaga was led by Robby Djohan. Bank Niaga is known as a mid-sized bank that has created many top Indonesian executives like Arwin Rasyid, Emirsyah Satar (Garuda Indonesia), and Agus Martowardjojo.

Then, after he left Bank Niaga, Agus Martowardjojo held various positions in some local companies. He was the Deputy Chief Executive Officer of Maharani Holding (1994), the President Director of Bank Bumiputera (1995-1998), and the President Director of Bank Ekspor Impor Indonesia (1998). In July 1999, four state-owned banks (Bank Bumi Daya, Bank Dagang Negara, Bank Ekspor Impor Indonesia and Bank Pembangunan Indonesia) were merged into one bank, named Bank Mandiri. At Bank Mandiri, Agus was appointed as the Managing Director of Risk Management and Credit Restructuring (1999), the Managing Director of Retail Banking and Operations (2000), and the Managing Director of Human Resources and Support Services (2001). During the height of the banking restructuring process, Agus Martowardjoyo took a more challenging job by joining the Indonesian Banking Restructuring Agency (IBRA).

After he completed his job at IBRA, he was then appointed as the President Director of Bank Permata on 31st Oct 2002. Bank Permata came about as the result of a merger between Bank Bali, Bank Patriot, Bank Artha Media and Bank Prima Express.

Agus Martowardjoyo is currently the President Director of Bank Mandiri. He replaced ECW Neloe in May 2005. He was a suitable choice given he is one of Indonesia's most senior and reputable bankers with many years of experience, including at Bank Mandiri.