Major project finance issues facing Indonesia

Presented by: Bill Banks
Oceania and Asia Pacific Infrastructure Advisory and Project Finance Leader

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Outline

- Background to market opportunities
- Structural issues and the Indonesian response
- Transactional issues and the Indonesian response
- Conclusion

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Project financing opportunities are significant

- Indonesia's appeal as a project financing market lies in strong positive macro-economic fundamentals
  - Indonesia is now the largest emerging economy in South East Asia
  - Indonesia's real growth rate forecast will catch up with those of China and India within the next 10 years and will exceed 7%
- The lack of a well developed infrastructure and a low base provides scope for growth in greenfield projects in transport, mining, energy and utilities
- In terms of scale, Indonesia is one of the largest markets globally
  - BMI forecasts infrastructure investment to be US$34b in 2011 and to rise to US$64b by 2014

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Indonesia has the prerequisites for a successful project financing market

- Long term attractiveness for project financing in this emerging market is dependent upon:
  - A sound banking system with low private sector debt
  - Strong demographics
    - Over 50% of the population is under 30 with a growing middle class
  - Natural resource wealth
  - Commitment to market friendly policy and regulatory frameworks
- Resources are a massive bonus
  - Indonesia is the world's largest exporter of coal for power generation and palm oil
  - Indonesia is the third largest producer of natural gas
  - Indonesia is the region's largest producer of crude oil
- Indonesia's strategic geographic location between China and India provides opportunity to service the increasing resources needs of these two countries

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But a number of major issues are still present

- Indonesia shares the same issues in realising the benefits from accelerated infrastructure developments as most other South East Asian nations
- The major issues can be divided into 2 main classes:

1. Structural issues - issues that result from the basic elements of the Indonesian economy
2. Transactional issues - issues that are driven by the requirements of the various parties to project finance transactions

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Structural issues facing project financing in Indonesia - political and legislative risks

There is still a perception that the Indonesian Government's processes lack transparency and accountability including:

- Certainty of access and the acquisition cost of land necessary to develop infrastructure
- Transparency of the process by which government agencies grant approval for projects
- The role of the Ministry of Finance in funding allocations

Indonesian Government response

There is a clear recognition that regulatory improvement is essential to further infrastructure progress. The Government continues to seek the advice of multilateral agencies in initiatives including:

- The World Bank in establishing a guarantee fund to provide independent financial cover over government obligations in public and private transactions
- The ADB in a wide range of programs including the recent structuring of new land access legislation

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Structural issues facing project financing in Indonesia - economic risks

The primary concerns include:

- Inflation and currency volatility
- Skilled staff shortages
- Core infrastructure efficiency

Indonesian Government response

- The Government has demonstrated resilience in its fiscal and monetary management approach with a continuing commitment to financial reform
- The focus on developing an active PPP market to advance core infrastructure to support further private developments will be a key factor in the achievable pace of project finance expansions

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Transactional issues facing project finance in Indonesia - availability of capital

The global banking market is yet to fully recover from the impact of the global financial crisis and as a result , there are still limits on the available debt funding capacity, particularly for large complex transactions.

- Regulatory pressure on banks to limit lending risk - this has lead to a “flight to quality”
- Debt pricing is being used as a rationing mechanism - this results in margins significantly widening for riskier projects
- Limited capacity of US/European banks to invest outside their domestic markets has further squeezed debt capital supply

Indonesian Government response

Stability is key in attracting debt capital into Indonesia in preference to other developing nations. One factor that counts favourably in the capital markets is achieving an investment grade country rating. This would push up the ceiling on all domestic transactions from a global viewpoint. Key elements in achieving this include:

- Continuing fiscal reform to increase the efficiency and quantum of the taxation base
- Tight control over government debt and deficit levels
- Monetary discipline such that projected increases in inward capital investment do not trigger inflationary asset bubbles

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Conclusion

- Project financing opportunities in Indonesia are significant especially in the mining and infrastructure related sectors
- Key prerequisites for a successful project financing market are present in the Indonesian market
- A number of major issues are still present
- The Indonesian Government is aware of these issues and is actively developing policy and regulatory frameworks to address these issues

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Conclusion cont….

- But at the end of the day project finance is all about risk identification and mitigation

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You must be prepared to take some risk

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But not too much

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…and make sure you that manage that risk carefully

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Thank you

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