

Classical Insights -- Emerging Markets

Global Investment Analysis Based on the Classical Economic Model

Classical Insights Emerging Markets Bullet Points January 26, 2009

Jakarta Company Visits

Name + ticker	Price (rupiah)	Target (rupiah)	% upside	Industry	Mcap \$ mln	EV \$ mln	EPS			P/E		
							08e	09e	10e	08e	09e	10e
Indo Tambangraya (ITMG)	9,250	18,000	93%	Coal	\$934	\$759	0.19	0.21	0.13	4.5	3.9	6.4
Medco Energi (MEDC)	1,660	6,500	292%	Oil & gas	\$343	\$403						
Indofood (INDF)	1,000	976	-2%	Agri & food	\$760	\$1,960	123	114	139	8.2	8.7	7.2
London Sumatra (LSIP)	2,925	4,667	60%	Palm oil	\$351	\$259						
United Tractor (UNTR)	4,700	6,543	39%	Coal, hvy equip	\$1,390	\$1,568	731	695	727	6.4	6.8	6.5
BISI Int'l (BISI)	2,025	3,306	63%	Agribusiness	\$540	\$540	135	167	236	15.0	12.1	8.6
Bakriland Dev'p (ELTY)	55	233	324%	Real estate	\$97	\$35						

Additional meetings: Bank Rakyat, Bank Niaga, Bank Danamon, Jababeka, Indika Energy, INCO.

Last week I spent five days in Jakarta and was shocked by how nice it looked. Increasing portions of the city are now *modern*. When I first went to Jakarta in 1997, the place was grim. I walked around thinking “*This* is the Asian miracle? I’ll take Mexico City over this any day.” Things are far better now. There are new modern buildings everywhere. The cars and motorcycles are newer and quieter. New superhighways carry traffic into the city and around the perimeter. Older houses and neighborhoods are being revamped and modern high-rises are going up in the center.



Paving an alley in an older section of South Jakarta – even the poorer parts of town are looking better.

But won't the global crash stop the boom in its tracks – just as happened in 1997? I don't think so. Here's why:

- The banks are fine. Back in '97-98, Indonesia suffered a total financial collapse, driven by massive defaults on dollar loans. Today, in contrast, NPLs are rising modestly, but lending policies have been reasonably tight and existing NPLs are already provisioned;
- Real estate prices are rising today -- and yet real estate is still cheap: you can buy a brand-new one-bedroom apartment in a high-rise in the central business district for \$55,000 (and half the buyers pay cash). The government believes there to be a six-million-unit housing shortage nationwide;

- Tax rates are falling: The corporate tax rate is being cut to 28% this year, and 25% in 2010. That, combined with cheap land, cheap labor and the presence of natural resources, should help keep Indonesia an attractive place for new investment;
- The rupiah imploded in 1997 but this time around it's only down a little. The price of a dollar rose 300+% in rupiah terms in the '97-98 crash. This time, by contrast, the price of a dollar has risen only 25%.
- Commodity prices are still reasonably firm, whereas in 1997-2000 they imploded. This will help the rural economy, in particular;
- The real economy is still decent: New car & motorcycle sales actually rose 1.5% YoY in December. Domestic cement sales were flat YoY in December.

I met with 13 companies in Jakarta. The cheapest were the real estate companies. Some are down more than 90% -- even though real estate prices aren't falling. The coal companies are attractive too, especially with Newcastle coal on the rise again. The banks seem fully valued for this environment. The palm-oil companies make a lot of sense macroeconomically, and at least one (London Sumatra) seems reasonably cheap.

I'd like to go back to Jakarta and see more companies. There surely are some smaller ones trading at ridiculous valuations. When the Asian economy turns, there should be 10-baggers to be had in Indonesia.

If you would like my notes or models for any of the companies I met with, please send an email.

The companies:

Bakrieland Development (ELTY IJ) is amazingly cheap. Bakrieland is one of the top builders (commercial and residential) in Indonesia. It has an NAV of about \$1.1 billion, a market cap of \$92 million -- and an EV of just \$37 million. The share price has been hammered by concerns about the real estate market here and fears about the now-infamous Bakrie family. In both cases, the concerns are overblown:

- Real estate prices are still rising in Jakarta. The central bank has been cutting interest rates, which should flow through into the real estate sector in a few months;
- The Bakrie family owns just 20% of Bakrieland -- so there's no way the family can do to Bakrieland what it allegedly did to Bumi Resources (siphoning away cash via high-priced acquisitions). Avenue Capital owns 31% of Bakrieland. And a new partner at the operating level (Dubai Limitless) is about to make a \$110 million infusion into the firm's big Rasuna Epicentrum project. The Bakrie family is a minority investor in Bakrieland whereas it has a *majority* stake in Bumi Coal.

A fair target for Bakrieland in these rough times might be an enterprise value of \$350 million, which would imply 300%+ upside from the current share price.

Points:

- Bakrieland has the largest land bank in Jakarta. It's also building the tallest office building in Indonesia (the 50-story Bakrie Tower, shown below). Tenants will begin moving in this March. The exoskeleton is almost closed up. (I took this picture last week.) Bakrieland will own 40% of that building when it is completed.



- The firm has a wide mix of commercial and residential projects in the pipeline. The P/E would be 4x if Bakrie could recognize revenue at the time of sale. Instead, it has to wait until the title is transferred to the buyer (i.e. until completion of the project).
- Sales have been stable even though mortgage rates have risen to 15% from 9% last year. The next step should be for mortgage rates to fall, in the wake of recent declines in benchmark central bank interest rates.
- High-rise sales are settled in cash more than 50% of the time. That gives an indicator of the kind of demand and buying power that exists in Indonesia. (For residential home sales in the firm's Bogor development, about 30% are cash buyers.) The government says there is a six-million-unit housing shortage in Indonesia.

Bakrieland's three projects are the Rasuna Epicentrum Central Business District, Bogor Nirwana housing development and Kancie Pecagan toll road in central Java.

Rasuna Epicentrum: I visited this site and it is BIG. One difference between Asian and U.S. development patterns is that in Asia entire business districts are often developed by one company, on one piece of land. Below is a model of part of Rasuna Epicentrum, at the sales office. The white buildings in the front already exist (having been developed by Bakrieland years back). The bigger, colored buildings behind are under construction now. (The big blue one in the back left is Bakrie Tower, shown in the photo above.)



Bakrieland is taking in a partner in the Rasuna Epicentrum project: Dubai Limitless. This firm is going to buy 40% of the Rasuna project for \$110 million, thereby providing the capital needed to finish construction. What makes this deal interesting is that it gives a benchmark for valuing the whole of Bakrieland: Limitless is paying \$110 million for a *portion of one piece* of Bakrieland's business – and yet the market is valuing the entirety of Bakrieland for much less than \$110 million.

Bogor Nirwana Housing development. The other key piece of Bakrieland's business is a big housing project 30 km south of Jakarta. These are nice houses – and the architecture is more interesting than in similar American houses. Last year the firm sold 700 units on this development. Bogor is the top spot for residential housing construction in the Jakarta region (since there's not much space to build homes in Jakarta proper).

BISI International

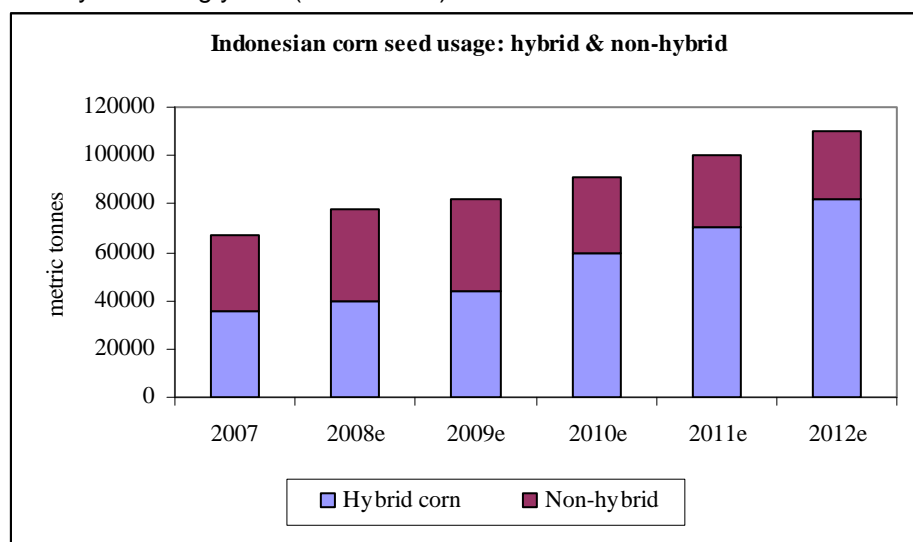
BISI IJ -- 2025

Sales and earnings					Target price & valuation data				
	2007	2008e	2009e	2010e					
Sales (IDR bln)	890	1610	2093	2721	Our 12-month target	3,306	(based on 14x 2010 EPS)		
sales growth		81%	30%	30%	Upside to target	63%			
EPS	50	135	167	236	Mkt cap (IDR bln)	6075	Enterprise value	6,075	
cash flow	54	140	174	244	P/sales (2008e)	3.77	EV/sales (2008e)	3.77	
fcf	40	6	152	162	P/E (2008e)	15.0	EV/EBITDA (2008e)	10.5	
cons. EPS		138	184	278	P/E (2009e)	12.1	EV/EBITDA (2009e)	7.9	
					P/E (2010e)	8.6	EV/EBITDA (2010e)	5.7	

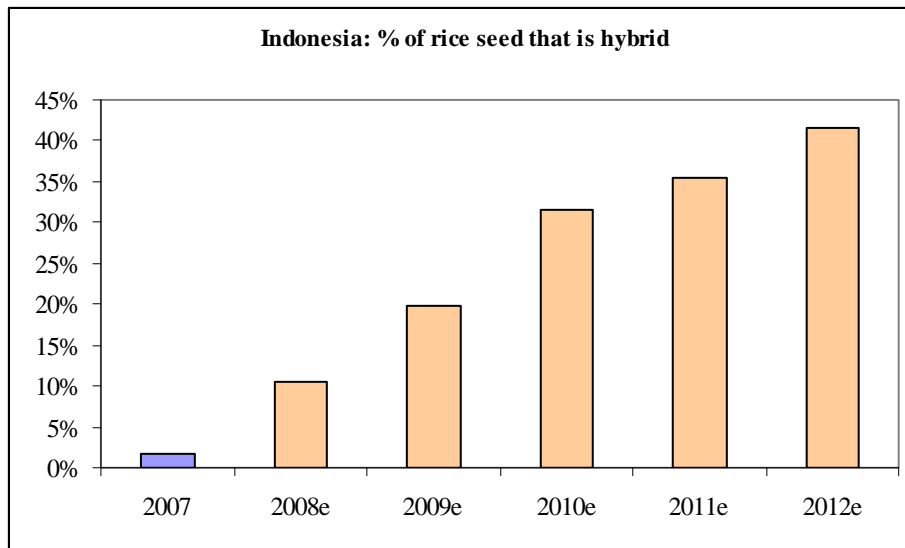
cash flow defined simply as EPS + depreciation. FCF defined as cash flow - capex.

BISI International, Monsanto's partner in Indonesia, stands to benefit from huge growth in hybrid-seed usage in the country. BISI thinks it can grow both the top and bottom lines at 30-40%/year for the foreseeable future. The stock is trading at 15x expected 2008 earnings. If we value it at 14x expected 2010 earnings, the resulting target is 3,306 rupiah/share (63% upside).

BISI gets more than 60% of its sales from hybrid corn seed, and the rest from sales of other hybrid seeds (rice, fruits, etc). BISI sells no GMO seeds (although that could change if the Indonesian government allows it). In much of Indonesia, farmers still use non-hybrid seeds, a practice which ceased in the U.S. in the 1950s. When Indonesian farmers switch to hybrid, their profit per acre can double due to higher yields. BISI's corn seed sales are expected to rise steadily in coming years (source BISI):



On the rice side the story is different: Indonesia's total seed sales should be flattish – *but the portion of seed sales that are hybrid should rise sharply (source BISI)*:



BISI spent 12 years developing a hybrid rice seed, and it has just started selling the new seed. Rice seed should be a major source of growth in coming years.

Medco Energi

Medco Energi has 750 million barrels of 2P and contingent reserves -- and an enterprise value of \$500 million. *So the market is valuing its reserves at just under 70 cents per bbl.* What's more, Medco is currently producing 70,000 bpd at a lifting cost of about \$12/bbl. The company is running slightly in the black at the current crude price.

So what's catch? Why is Medco so (seemingly) cheap? Two reasons:

- a) Its 2P reserves are declining at 5-10%/year;
- b) About 70% of its total reserves are *contingent*, which means something good still has to happen before they can be converted to 2P. The oil (and gas) *is technically proven*, but the company has been hitting snags – all of them political -- in getting contingent reserves converted to 2P.

The reserves are in three projects, Libya, Sonoro and Block A. The bull case is that if just one of the three projects gets flipped to 2P, Medco's future is pretty much secured and the stock should rise. Here are the three projects:

- Block A (Sumatra gas field development, 10,000 BOE/day) – Awaiting government approval on extension of a sales contract;
- Libya 47 (Oil field development, 25,000-50,000 BPD) – Awaiting government approval of plan of development. According to management, the Libyan field is one of the largest oil discoveries in the world in the last five years, and Medco has a 50% share of it (or 350 million barrels). The resource is still growing on continued exploratory drilling;
- Senoro (Sulawesi gas field/LNG development – 15,000 BOE/day) – Awaiting government approval of the offtake agreement.

Management rates all three projects as roughly equal in scale/importance to the company.

An additional issue with Medco is that the story takes a while to figure out. I sat in a meeting with the director of planning and it took me an hour to understand what was going on.

A third issue is that Medco is in for some tight times over the next two years: It has sold off its drilling division and some of its fields in order to get its debt level down, and it may sell off some producing fields to raise cash. That said, there is no threat to the survival of the company due to its low lifting cost and good balance sheet.

All that is left to be done now is to wait for one (or all) of the three projects to come through.

Indo Tambangraya

ITMG IJ -- \$0.83

Sales and earnings					Target price & valuation data			
	2008	2009e	2010e	2011e				
Sales (\$ mlns.)	1262	1300	1180	1386	Our 12-month target	\$1.60	(based on 10x avg '10-11 EPS	
sales growth		3%	-9%	17%	Upside to target	93%	+ \$0.12/sh. for net cash.)	
EPS	0.19	0.21	0.13	0.17	Mkt cap (\$ mlns.)	\$934	Enterprise value	\$759
cash flow	0.22	0.25	0.17	0.21	P/sales (2009e)	0.72	EV/sales (2009e)	0.58
fcf	0.08	0.22	0.14	0.18	P/E (2009e)	3.9	EV/EBITDA (2009e)	2.1
cons. EPS	0.18	0.23	0.20		P/E (2010e)	6.4	EV/EBITDA (2010e)	3.2
					P/E (2011e)	5.0	EV/EBITDA (2011e)	2.6

cash flow defined simply as EPS + depreciation. FCF defined as cash flow - capex.

As coal companies go, Indo Tambangraya is an appealing option: It is cheap, easy to understand, has lots of net cash, operates in a weak-currency country, has good 2009 earnings largely sewn up (due to contracts) and has a low-ish cash cost.

ITMG sells all thermal coal, and typically gets 80% of the Newcastle 6700 kc coal price. The Newcastle price is currently \$85/tonne, so ITMG's effective spot price is now \$67/tonne. In our model, we assume ITMG realizes the following prices:

2007: \$43/tonne;
 2008 \$73/tonne;
 2009: \$65/tonne (this could be low, since 50% was pre-sold at \$80/tonne);
 2010: \$59/tonne
 2011: \$63/tonne.

With ITMG's realized price still at \$67/tonne spot, there is room in our model for coal prices to fall some. Helpfully, the Newcastle spot price is actually *rising* at present. We have made the price target a 10x multiple of blended 2010-11 earnings. The concept is that, by 2011, coal demand and pricing both should recover, based on still-high gold prices and recovering economies. At \$63/tonne coal in 2011, we have ITMG making \$0.17/share (since production should grow to 22 million tonnes by then, from 20 million tones in 2009).

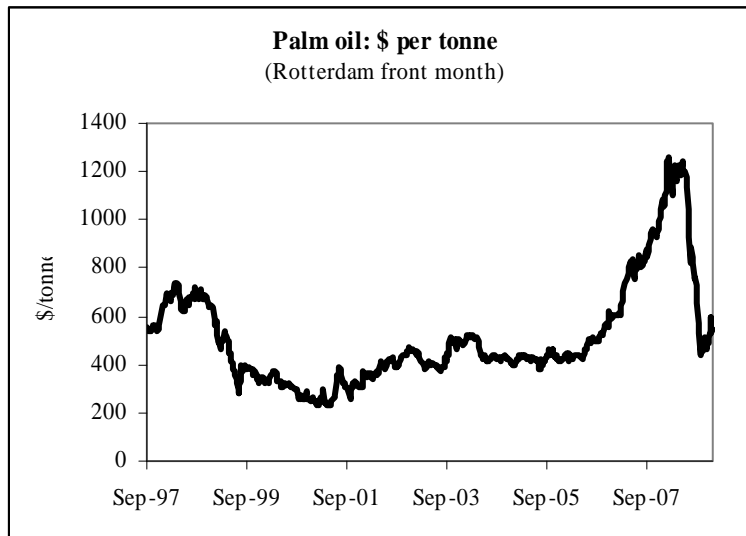
The core problem with valuing any coal company now is that the coal price is a crapshoot. One big concern for Asian coal companies is that China may become a coal exporter. And, in fact, Indo Tambang hears that China has begun exporting a bit of coal – but it is lower grade stuff. (Indo Tambang's coal customers – most of whom are in Japan, Korea and Taiwan -- use higher-grade coal.

London Sumatra:

This is an interesting plantation stock. It's fairly cheap at the current palm oil price and would be a good vehicle for playing a rebound in palm oil prices. The sales are 70% palm oil, 15% rubber and 10% seed sales. The company is being valued now at an enterprise value of \$2,820/hectare

for its producing land, including land with immature seedlings. That is below replacement cost: Management estimates that it costs roughly \$5,500/hectare (and several years of waiting time) to buy and cultivate palm oil land up to the point of production. London Sumatra traded at \$16,000/hectare at the top of the market, when palm oil was \$1,200/tonne.

Here is the Rotterdam front-month palm oil price. It is back to year-end 2006 levels (even though gold is \$50% higher now than it was at that time):



Indika Energy

Indika Energy is a holding company whose main asset is a 46% stake in an extremely low-cost coal producer Kidico Jaya (cash cost: \$28.50/tonne including royalties). Kidico has been very profitable of late – and based on forward contracts, earnings should rise in 2009. We have Indika trading at about 4.5x 2009 earnings if you exclude balance sheet cash. Indika has a \$600 million market cap and \$130 million in net cash, so its EV is \$470 million. Its share of earnings from Kidico should be \$90 million for 2008 – and \$105 million for 2009 (because its realized coal price is probably going to head upward a few dollars per tonne (based on forward sales).

None of Indika's customers (who are basically all electric utilities) has asked to renegotiate contracts. Historically, Indika has been able to sell its coal at slightly above spot because it is a reliable producer – it has never declared *force majeure*. Some smaller producers are having trouble producing due to lack of working capital. A risk (which Indo Tambang also mentioned) is that China will flood the world with coal.

Another issue is that Indika only owns 46% of Kidico. That leaves it vulnerable to moves by the majority shareholder that are not in Indika's best interests.

Indofood Sukses:

This one doesn't work. It trades at 9x expected 2009 earnings, its debt exceeds its market cap and it will have no earnings growth this year (due to the decline in the palm oil price). The business is noodles, flour, milk (via a recent acquisition) and palm oil. The noodles will get better this year, flour will be down a little, palm oil will be down a good bit and milk is still unclear. However, Indofood levered up to buy a milk producer (Indolakto) last year, and paid about 20x earnings.

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