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A memorable scene from "JALANAN" movie :

Source: "JALANAN" movie

This is certainly not the iconic Grand Hyatt Jakarta, but still the street buskers manage to keep their good sense of humor in adversity

" When you get older it is hard to have heroes, but it is sort of necessary. "

- Ernest Hemingway -

What We Learned This Quarter

Still Believe In Superheroes

When someone like the reform-minded governor of Jakarta, Basuki “Ahok” Purnama made it mandatory for his key staffs in Jakarta municipal to watch a movie “*Jalanan (Streetside)*”, we at Heyokha Brothers paid attention.

Heyokha team spent an evening watching this movie and we found it both moving and inspiring. This award winning documentary movie tells a heart-warming story of three street buskers in Jakarta, Titi, Ho, and Boni playing their own life story.



Characters in the movie. Left to right : Titi, Ho, Boni

Source: JalananMovie.com

They entertain passengers of the public buses with their bubbly personality and wonderful singing plus guitar. They collect small change just enough to cover their daily needs. Two of the three characters lived a harsh life under a bridge but nonetheless didn't stop them from adopting a positive attitude towards life.

While the movie was entertaining (with good music and emotional moments), the various issues discussed in this movie are serious: from poverty, social issues to injustice.

On what basis was Ahok's recommendation for this movie? What value or message was he trying to convey to Jakartans?

Ahok was quoted saying: "The movie *Jalanan* shows an inspiring story of the three characters who struggle to make a living. They are amongst 12 million Jakartans trying to make a living in this city."

Ahok is also hopeful that, after watching this movie, the government officials in Jakarta will be motivated to help foster prosperity and reforms in Jakarta. The story shows how the marginalized Jakartans had to risk jail, raid, and other uncomfortable treatments from the city's officials.

One main theme in the movie revolves around reform (or the lack of it). One of the leading characters Ho vocally expressed grassroots' cynical view and frustrations with politicians.

With Jakarta city officials - and also anti-corruption agency KPK officials - watching the movie, Ho is at least getting the audience he wanted.

The message is loud and clear: reform is desperately needed.

Link to the “JALANAN” movie trailer:
<http://goo.gl/UeKR49>



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No kidding. This is a bathtub under the bridge. Water is from a busted water pipe

Source: *Jalan'an Movie*

The reason that we talk about this movie is that we find it uplifting that Jakarta Governor Ahok personally hosted the screening of this movie.

We have been following Ahok closely since he was Jakarta's deputy governor.

He strikes us as someone who just "gets it". He may not be a superhero, but certainly we are hopeful and optimistic that Ahok will successfully deliver the much needed reforms and prosperity to Jakarta.

Why "Ahok factor" matters?

Reform involves taking someone else's rice bowl. As such, successful reformers always need to be radically bold, honest and clean.

Ahok has gained a reputation for being unorthodox, gutsy and outspoken (perhaps even too vocal for the culture). He has been fiercely combating status quo, red tape and corruption. He has fired corrupt school principals and applied performance based pay for Jakarta's civil servants.

To deal with Jakarta's notorious traffic, Ahok has implemented motorcycle ban for major roads in Jakarta and provided buses to transport motorcyclists free of charge.

Before you think that the policy is discriminative against motorcyclists, Jakarta government will charge cars heavy fee (ERP) to drive on major roads.

Ahok has also done what no one else has done before, from taking on street thugs to sending a letter to the Home Affairs Ministry and the Justice and Human Rights Ministry asking to disband controversial group FPI. Not bad for Jakarta's first ethnic Chinese Christian governor. And even more interesting, his popularity is rising fast.

Based on a recent survey conducted by Jakarta-based pollster the Populi Center, which involved 1,200 residents across 34 provinces, Ahok received the most positive response.

Ahok's leadership quality and courage have led us into some potential interesting themes in Jakarta.

One area that stands out is home ownership. Out of the cumulative 15-20mn estimated housing shortage in Indonesia (depending on who you are talking to), we think a big chunk of this unmet demand is in Jakarta.

To make it even tougher, the population in Jakarta is adding around 2,000 people per day! A simple Google Earth observation tells us that there is simply not much clean land available to build houses in Jakarta.

When Jakarta doesn't have that much land left and you have someone as determined and pragmatic as Ahok, it is only logical to take another look at the long delayed reclamation projects in North Jakarta.



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Heyokha Brothers understands the skepticism from the investment community on this perpetual “concept”. This project has been discussed forever, but execution has been non-existent. However, the contrarian Heyokha spirit led us to take a fresh look at the space.

Reclamation blueprint of Jakarta

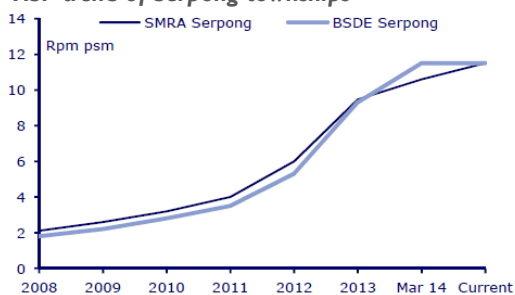


Source: CLSA

We believe the reclamation projects will really take off this time due to “Ahok factor” and get additional comfort from:

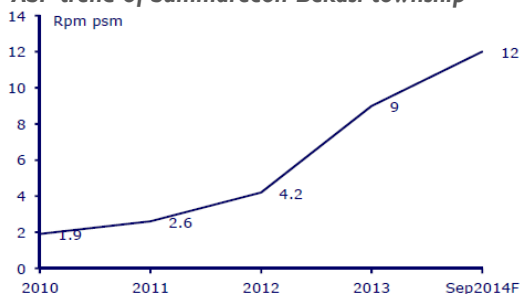
- 1) Land prices in Greater Jakarta have surged significantly higher than land prices in Jakarta in the past 5+ years. As seen below, even in the outskirts of Jakarta land prices have gone up multiple times.

ASP trend of Serpong townships



Source: CLSA, Company

ASP trend of Summarecon Bekasi township



Source: CLSA, Company

- 2) In North Jakarta around the land reclamation area around to sea, prices have now reached over Rp30mn psm. Suddenly within a few short years, the economics of reclamation makes a lot of sense (reclamation cost is about Rp5mn psm).

Seventeen man-made islands & Jakarta Giant Seawall



Source: Tempo.co

- 3) The 17 man-made islands with prime ocean view will add 7.7% to Jakarta's land area. Certainly, pragmatic and commercial minded Ahok will be very supportive.
- 4) Interestingly, presale of Pluit City reclamation project has been strong. And that is even before the project has secured all the necessary licenses and permits.

Pluit City project by Agung Podomoro



Source: Boskalis Westminster & Van Oord



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At Heyokha Brothers, we believe the potential upside from such a reclamation project is enormous. At the moment, prime CBD land transacts at around Rp100mn psm (approx. US\$8,000).

With traffic in Jakarta only getting worse, there is big demand for living in an area where it is designed and built from ground up as a modern city. There is no doubt that reclamation projects fill that demand gap.

Intiland reclamation project



Source: Skyscrapercity.com

What we are talking about is prime seafront property 20 mins away from the airport and literally next to the busiest port “Tanjung Priok” of Jakarta. We have seen such themes play out in major global cities and we believe Jakarta reclamation has a good shot.

Actual location of reclamation

Unknown to most, just a 30 min boat ride from the reclamation area are Maldives like islands “thousand islands” where Ahok also plans to develop a tourist destination. This could be new Jakarta lifestyle in the early making.

Actual Jakarta reclamation project location, this could be anywhere in the world



Source: Heyokha

This is not Maldives. This is a 30 min short ferry ride from Jakarta’s land reclamation.



Source: Heyokha

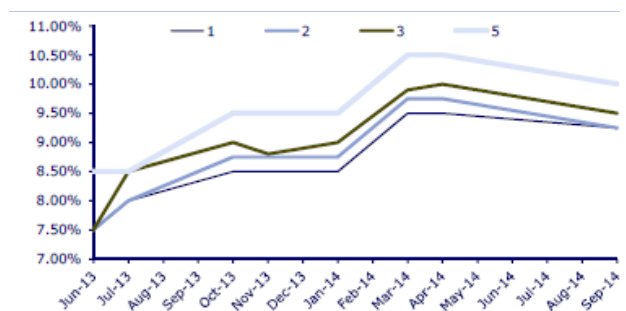
Indeed on a higher level we are seeing tailwinds for home ownership in Indonesia. The government through Minister of Public Work & Housing has recently decided that they will lower the lending rate for subsidized housing loans to 5.0% from 7.25% through house financing liquidity facility (KPR FLPP) to achieve government’s target to build 1 million low-cost apartments this year.

On the private sector side of mortgage lending, while we are seeing some headwinds in terms of transaction cost (mainly rising taxes), banks still have a lot of appetite in mortgage lending.

In fact, after cutting mortgage rate by 25-74bps in September 2014, the biggest private sector mortgage lender indicated that they are considering to cut mortgage rate further.

Note that current rates are still ~175-200bps higher than the lowest in 2012, hence there is a lot of room for further cut.

Rate movement for BCA fixed year products



Source: CLSA, Company



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National Reformasi

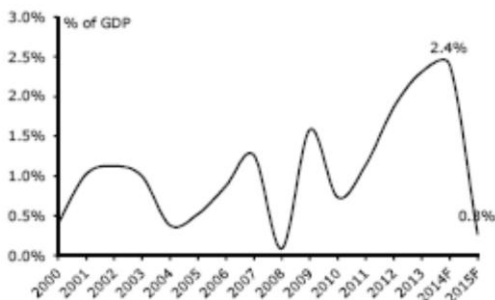
Continuing from our oil and gas reform theme discussed in our 3Q 2014 report, we are thrilled to see the government getting ready to implement reforms in many other key areas.

Indeed, reform in Indonesia is also being embraced and executed at the top level of the country's leadership and trickling down.

Indonesia's new government has hit the ground running. Within a few months since inauguration, the government launched a series of policies in-line with reform agenda – notable one is the removal of gasoline subsidy, setting the ball rolling for other reforms.

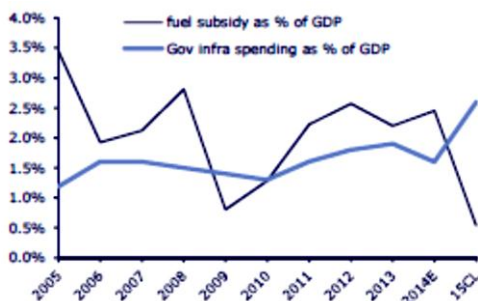
This translates to 78% or Rp216tn (US\$17bn) savings on fuel subsidy budget (from Rp276tn to Rp60tn - assuming US\$65-75/bbl). All-else equal, fiscal deficit to GDP can fall to 0.3% from 2.2%.

Fiscal deficit as % of GDP



Source: CLSA, Government of Indonesia

Fuel subsidy & government infra spending, % of GDP



Source: CLSA, Government of Indonesia

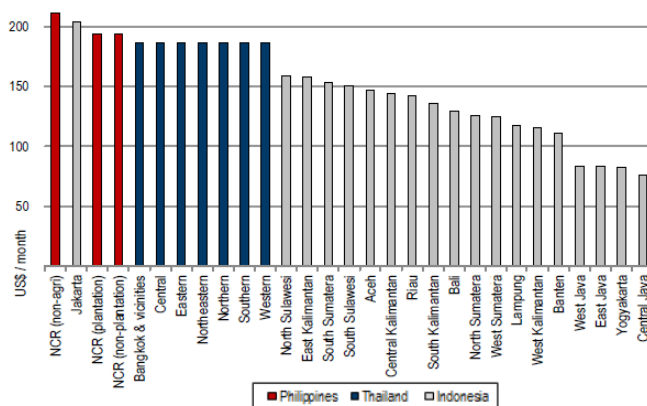
According to the Ministry of Finance, at least 50% of the savings would flow into infrastructure related ministries such as the Ministry of Transportation (increase by Rp20tn to Rp65tn), Agriculture (increase Rp15tn to Rp31tn) and Public Work & Housing (increase Rp33tn to Rp112tn).

This could potentially bring the total infrastructure budget to Rp343tn (3% GDP), from Rp236tn (2.1% GDP), which is the highest level ever.

Screening through the reform agenda, we think by far the most important item is the reform at the Ministry of Industry level. As you will see below, the cost of doing business and red tapes hamper FDI in otherwise a very attractive market:

- 1) Indonesia, other than Jakarta, is still very competitive on wages – attractive destination for FDI.

FY14 salary/month, vs Philippines (red) vs Thailand (blue)



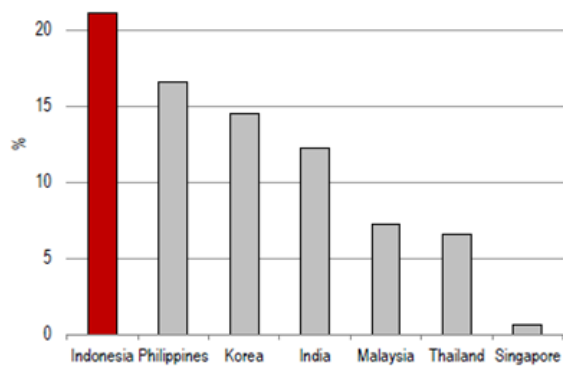
Source: CEIC, Credit Suisse



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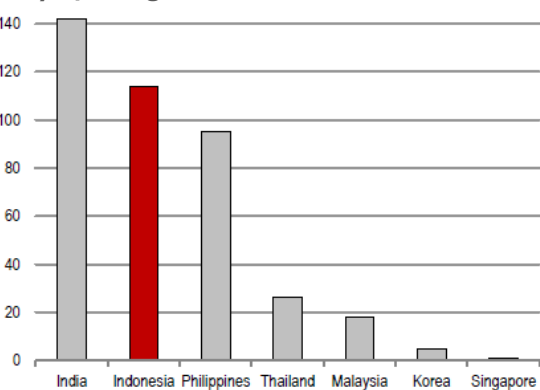
- 2) Historically, Indonesia with its vast resources, cheap labor, appealing demographics has not attracted FDI in any meaningful way. One key reason is the “mission impossible” process to get through all the bureaucracy and red tapes to get licenses/permits as such. For one industry license, a company has to wait to go through more than 4 other government ministries before it has its license issued.

Cost of business start-up (% of GNI per capita)



Source: CEIC, Credit Suisse

Easy of Doing Business Index



Source: World Bank, Credit Suisse

However, it appears that the government is determined to loosen up all the red tapes. The most telling is that the Minister of Industry has handed over licensing/permits authority to the BKPM (Indonesian Investment Authority).

This is the first time in Indonesia history that a minister has given their “power” of operating the “on / off switch” to another department.

What does this mean? Starting 2015 all the investment licensing/permits for industry will be directly handled by BKPM (a much cleaner, efficient government body) a closer step to reach the One Door Integrated Service.

This will affect at least 600 industry sectors out of 1249 industry sectors registered in Indonesia and the lead time for licenses/permits could be cut to only 73 days from currently 730 days (most case Infinity and beyond).

“The ministry is the pioneer amongst all government bodies which delegates its industrial business licensing authority directly to the Indonesian Investment Board / BKPM, which hopefully will be followed by other government bodies, be it on provincial levels or smaller municipal levels”

– Saleh Husin, Minister of Industry, Indonesia

“I don’t think about popularity. What is the benefit of popularity in my job? Nothing”

– President Jokowi, Republic of Indonesia



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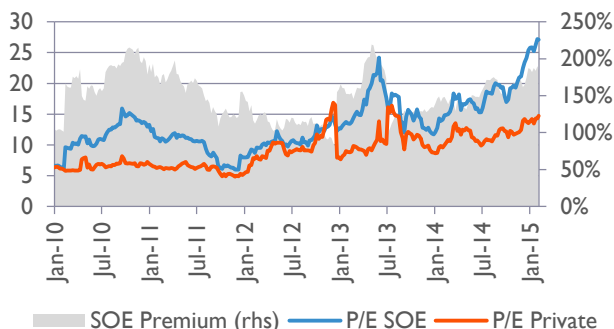
Why is this so important?

As private consumption is already 55% of Indonesia's GDP, the engine of growth for the next decade should come from investment, be it from the government spending, FDI, or DDI.

On the government side, the combination of fuel subsidy cut and falling oil price means US\$17bn windfall for President Jokowi's government.

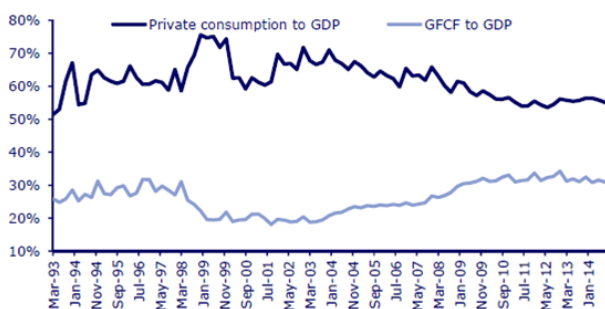
The huge outperformance of Jokowi's plays (construction and infrastructure, see chart below) suggests that much of this windfall has been priced in, but a diligent search into other reform themes led us into looking at other interesting investment ideas described in this letter.

Historical P/E ratio of private & SOE contractors



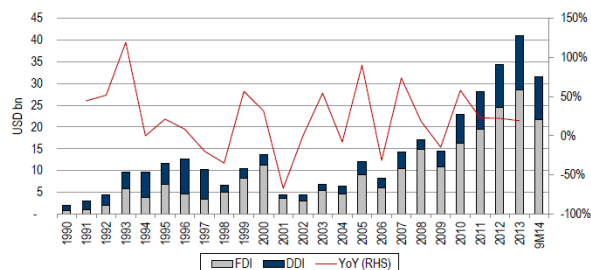
Source: CIMB, Heyokha

GDP breakdown by consumption vs. GFCF



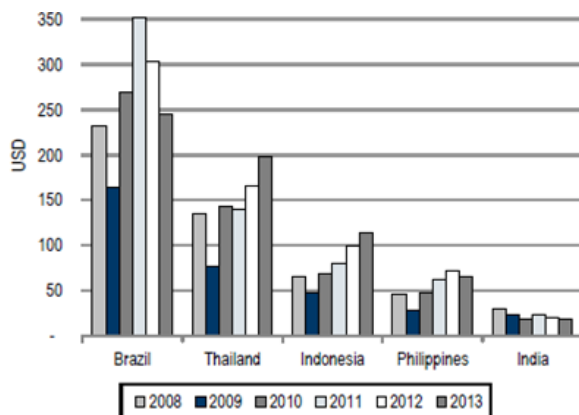
Source: CLSA, Government of Indonesia

FDI & DDI in Indonesia, 1990-2013 & YoY Growth



Source: CEIC, Credit Suisse

FDI Per Capita in Indonesia, 2008-2013



Source: CEIC, Credit Suisse

Government Policy Risks, Bigger Government

On a side note, we would like to add that some investors are justifiably worried about bigger government thwarting economic growth. Recent government's plan to inject Rp72.9tn (US\$ 5.8bn) into SOEs (to be further channeled into infrastructure spending) is one example. We at Heyokha are not convinced that the government's main responsibility and expertise is to run businesses.

Heyokha Brothers is hopeful that public scrutiny will be allowed to make sure that the investment process is transparent and most of this investment will be done via more transparent publicly listed SOEs. Heyokha Brothers is also particularly concerned that a number of policies adopted by the new Indonesian government has socialist aroma.



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For example, in January 2015 President Jokowi gave the instruction to SOE company Semen Indonesia (SMGR IJ) to lower price by around 5%.

As SMGR has about 45% market share in the cement industry, the rest of the industry players decided to follow the price cut to defend their market share. This is particularly true since the price cut by SMGR happened in the first quarter of the year, when seasonality is not on the cement makers' side.

Heyokha Brothers understands that President Jokowi's main intention is to break the oligopoly structure. One of the reasons for the sustainably high ROE in many sectors in Indonesia is the cartel-like structure in many industries.

Breaking up the oligopoly is good in the long run since it will force market mechanism to function. Indonesian Inc. will have to focus more on innovation to create values and margins, instead of relying on oligopolistic behavior.

However, Heyokha Brothers believes that simply relying on market mechanism to work will eventually (this is the key word, as the government may not have all the time in the world) sort out the oligopoly.

What is needed is new supply or more competition, i.e. making the investment license easier. Bigger government will only discourage new players from entering the cement market here.

Hence in the longer run, intervention will only help to preserve the oligopoly.

The 2015 tax revenue target of Rp1,484tn or US\$117.8bn is up 30% YoY. Meantime, expenditure in the budget is set at 12% higher compared to the previous year, or Rp1,984tn. This translates into 1.9% budget deficit.

There has been discussion on how to achieve the revenue objective. Private jet and yacht owner wannabes will have to pay more taxes, but it is not just the uber luxury segment feeling the tax pinch. Property and cigarette tax discussions have also rattled the market.

The big government monster captured by contemporary Indonesian artist, Eko Nugroho



Source: Heyokha

And from tax office officials canvassing Jakarta textile center Tanah Abang to the requirement to show tax number (NPWP) when one is making a purchase of a bag worth more than USD8k, investors in Indonesia will have to ask a question: *which sector is the next one to be affected by the tax hunt?*

Fortunately, it is not one sided. We understand that Ministry of Finance is currently working on a proposal to launch another round of tax amnesty program as part of the government's effort to expand the tax base. Indonesia has around 30 million people with tax numbers but only a small fraction pays tax accordingly.



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There is also a discussion to lower the tax rate for individuals and corporates alike. The talk is that max tax rate for individuals will be lowered from 30% to 18%, while the corporate tax will be slashed by 7% from 25% to 18%. This will make Indonesia very competitive compared to Singapore.

Certainly, we think that lowering the tax rate will generate more tax revenue as Indonesia's tax rate now is way too far out on the "Laffer curve". Lower tax rates stimulate economic activities and draw more tax payers out.

Overall, the government will tax the rich more and re-allocate the money for various social programs and infrastructure. Heyokha Brothers identifies sectors or companies that will benefit from the whole redistribution of wealth program, and invest accordingly in Indonesia.