Indonesia
Opportunities and barriers to inbound construction

G20 rankings & data

G20 heatmap rankings

| Construction industry health                  | Construction industry value | 13 |
| Construction industry real growth            | 4 |
| Announced spend on construction in next 3 years | 6 |

| Country financial health                      | Budget balance | 6 |
|                                              | Overall announced fiscal stimulus | 12 |
|                                              | GDP/Head | 18 |
|                                              | Credit ratings rank | 10 |

| Ease of doing business                        | Doing business overall rank | 19 |
|                                              | Dealing with construction permits rank | 12 |
|                                              | Business transparency rank | 18 |

| Tax regime                                     | BDO overall tax rank | 6= |
|                                              | World bank – paying taxes rank | 12 |

Financial metrics

- Total fiscal stimulus announced: £4.7bn
- Announced spend on construction in the next 3 years including fiscal stimulus to construction: £54bn
- Construction industry value – 2009: £22bn
- Main corporate tax rate: 30%

Construction sector metrics

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<thead>
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<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
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</thead>
<tbody>
<tr>
<td>Construction industry value, £bn</td>
<td>18</td>
<td>22</td>
<td>25</td>
<td>28</td>
<td>31</td>
<td>35</td>
<td>28</td>
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<tr>
<td>Construction industry, real growth, per cent y-o-y</td>
<td>8.7</td>
<td>7.8</td>
<td>5.8</td>
<td>5.8</td>
<td>5.8</td>
<td>6.9</td>
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<tr>
<td>Construction industry, per cent of GDP</td>
<td>7.7</td>
<td>7.4</td>
<td>7.5</td>
<td>7.6</td>
<td>7.7</td>
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BDO review of tax

- Tax rates, thin capitalisation rules and tax depreciation policies are all around the G20 averages
- Tax incentives are relatively limited

Overall scoring: 6/10

6= out of the G20

BDO ease of doing business

There are some significant barriers for inbound construction activity however it is possible to get round these

1 Very easy 2 Quite easy 3 Average 4 Quite difficult 5 Very difficult

Top construction firms

- PT Total Bangun Persada,Tbk
  1 Extremely dominant
- PT AdhiKarya,Tbk
  2 Dominant
- PT Wijaya Karya Tbk
  3 Quite dominant
- PT Surya Karya Tbk
  4 Not very dominant
- PT Astra International
  5 Not at all dominant

This dominance does not create a significant barrier to entry as these companies are mostly dominant in Government projects such as road, utilities, other facilities and Apartment residences. There are still many opportunities in the private project sector.
Opportunities and barriers

I4th overall in our G20 heatmap, Indonesia has a small but fast growing construction sector. However, local knowledge is essential as Indonesia is ranked bottom out of the G20 for ease of doing business.

Indonesia’s construction industry grew 7.76 per cent during 2008. Indonesia has one of the fastest-growing construction industries in Asia. It is expected to grow from £1.5bn in 2006 to £3.5bn by 2012. The main drivers for this growth are construction works for the rehabilitation and reconstruction of Aceh and Nias following the 2004 tsunami, construction and maintenance of roads and drainage systems across the country, and other ongoing transportation infrastructure projects such as railways, ports, and airports. Recent state initiatives to revise the policy in corporate regulation, tax, customs, labour and infrastructure are all likely to provide an impetus to the Indonesian infrastructure sector in the medium term.

The nation’s infrastructure sector has suffered from lack of spending since the economic crisis in the late 1990s. Underinvestment means much of the country’s basic infrastructure is inadequate including roads, supply of electricity and public transport.

Indonesia is expected to spend between £4.6bn and £6.4bn on infrastructure in 2009, of which up to £4.5bn will be channeled through ministries and institutions and around £1.92bn will be transferred to the provinces. This will include £781m of spending on infrastructure programs, from the government’s £4.7bn stimulus package. Priority areas for spending include communication, transport and power infrastructure. The plan will target labour intensive projects.

According to Reuters (March, 2009), Indonesia plans to put four infrastructure projects worth nearly £2.6bn up for tender in the second quarter; including a £1.3bn coal-fired power plant in Central Java. Four other projects, worth £730m in total, will be put up for tender in the second half of 2009 and early next year. These projects will be funded by the private sector and are in addition to the government’s fiscal stimulus package.

According to the World Bank, the development of roads in Indonesia has not kept pace with the country’s growth in economic activities.

In the first half of 2009, Indonesia will put four projects out to tender; all to be funded by the private sector. These include a £5.1bn railway connecting Soekarno-Hatta airport to the capital Jakarta, a £540m railway connecting Palangka Raya in Central Kalimantan, and a £75m cruise terminal in Bali. As part of the government’s planned spending, State-owned enterprises such as PT Perusahaan Listrik Negara, PT Perusahaan Gas Negara Tbk and PT Angkasa Pura will pour around £3.6bn into power plants and airports.

Indonesia has opened its infrastructure sector for foreign participation and has highlighted private sector involvement as critical to the sector’s development. The Government has attempted to address investor concerns over government guarantees and other financial support of its infrastructure projects, as well as land acquisition risks, and new PPP laws passed in the past year (2008) provide some additional legal certainty in relation to Indonesia’s PPP process.

Barriers/challenges to construction activity

- Difficult tendering and project management requirements when dealing with government projects.
- Pessimistic outlook with little announced future construction spend or lack of confidence in the economy.
- Overall difficulties in doing business in Indonesia, including a bad reputation for corruption and complex labour laws.
- Incoming Presidential elections add uncertainty to the political situation.

BDO viewpoint and advice

Pitfalls to avoid when doing business in Indonesia

- Potential mistakes for inbound activity involve misunderstanding the local environment in terms of specific regulations.
- Labour – both the laws governing labour, but also finding labour with the appropriate skill sets.
- Misunderstanding the required quality of construction.
- Getting caught up in Indonesia’s excessive bureaucracy (among Asian economies, Indonesia has the longest period (105 days) to start a business).

Practical advice for inbound construction activity

- Inbound construction companies must establish a strong understanding of the local environment and work closely with the local people.
- Partnerships with organisations already present will help this as well as using advisors who are experienced in this area.
- Work with organisations such as the “Indonesian Contractors Association” to gain practical advice on how to work in Indonesia.
- Be alert to the typical challenges confronted by the Indonesian infrastructure sector; which include project funding problems, prolonged land acquisition processes, tough labour laws, problems of transparency in funding distribution and a lack of private sector incentives.
- According to Presidential Decree No. 111/P/2007, any construction business is welcome to invest in Indonesia subject to a maximum foreign ownership of 55 per cent. Indonesia allows full earnings repatriation. There are no controls on capital or foreign exchange. Foreign investors have the right to repatriate capital and profits at the prevailing rate of exchange. There are no minimum or maximum total investment requirements.

Useful tax and other incentives for inbound construction activity

Main depreciation rates:

- Buildings – Straight line tax depreciation over 20 years (or 10 years for non-permanent buildings).
- Other tangible assets – The taxpayer may opt for tax depreciation on either a straight line or a declining balance basis. Rates vary from 50-10 per cent (declining balance) and from 25-5 per cent (straight line) depending upon the category of asset.

Other incentives:

- Reduced taxation applies on the sale of low cost housing.
- To promote and accelerate the construction of infrastructure funded by the Budget and through public-private partnerships, the Government plans to pursue a range of strategies. They include a shortening of the time required for land expropriation which currently often poses formidable obstacles to the construction sector.