Boots on the Ground: Indonesia

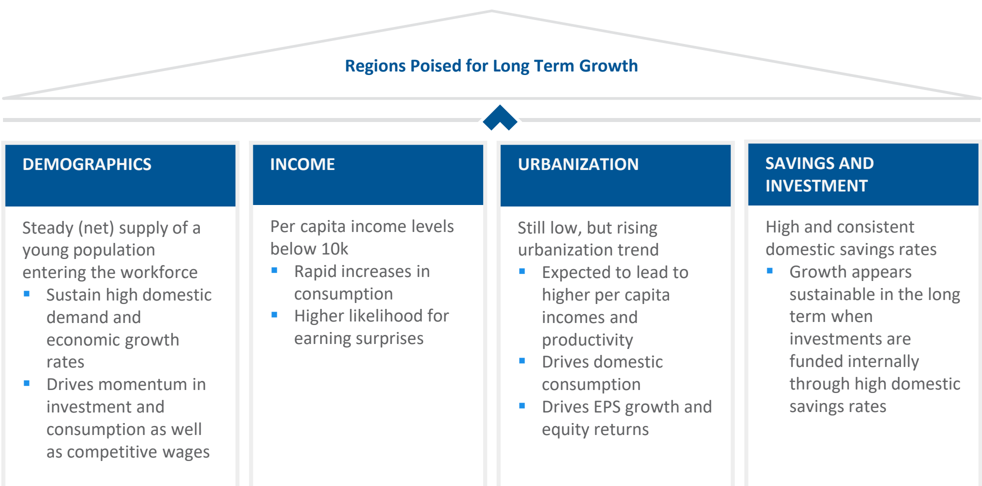
March 28, 2018

Emerging Markets Equity Perspective

Southeast Asia is a key contributor to global growth, and Indonesia is a large market engine of the region. The size and incremental contribution of the Southeast Asian economies to global demand, and the corresponding investment opportunities, remain, we believe, largely underappreciated by global investors.

Indonesia fits in our 'Four Macro Pillars' that drive long term growth, with attractive demographics of a large and young population, per capita income levels well below $10,000, rising urbanization rates and relatively high savings and investment rates. We see compelling investment opportunities in Southeast Asia, and maintain our overweight allocation with a medium and long term horizon.

Four Macro Pillars that Drive Long Term Growth



FIERA CAPITAL EMERGING MARKETS EQUITY STRATEGIES

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We spent the first full week of March in Indonesia meeting with policy makers, think tanks and senior management of Indonesian companies. Indonesian equities can provide a heavy exposure to commodities, and we wanted to assess the prospects of continued improvements in the fundamentals of the Indonesian commodity companies. We also wanted to better understand how the upcoming April 2019 General Elections may affect domestic consumption and government policy. We remain constructive on our Indonesian portfolio following our trip.

– Anindya Chatterjee, Lead Portfolio Manager, Emerging Markets

Map of Indonesia[1]

Palembang

In addition to Jakarta, we visited Palembang, Indonesia's ninth most populous city, the capital of South Sumatra province and home to 10.7mil people. Palembang's economy is dependent on commodities, such as rubber, coal and palm oil, which makes it a good proxy for Indonesia's economy. Palembang will also host the 2018 Asian Games in August.

Consumption: Better overall growth compared to 2017, with a recovery of mass market demand

Indonesia's consumer spending growth diverged in 2017. Home improvement and mid-to-high end apparel sales grew, whereas mass market apparel sales declined. In 2017, mass market consumption was hit by the removal of electricity subsidies for 19 million out of 23 million low-income households. In 2018, mass market consumption is expected to recover as the government approved a 33% increase in Indonesia's social assistance budget, and, in a partial reversal of 2017 policy, granted electricity subsidies to an additional 2.5 million households.

In Palembang, we saw mass market retailers offer 50-70% discounts to run down old inventory in preparation for the Lebaran holiday (a peak sales period in Indonesia) coming up in the second quarter of 2018. Year-to-date, the store we visited has reported 15% yoy sales growth.

50%+ retail discounts draw good traffic on a Thursday afternoon at Ramayana, a local department store

Home improvement retailers are guiding for double-digit growth[2] in 2018. In Palembang, local hardware stores are reporting 20% same-store sales growth with one-off construction and renovation boost from local venues involved in the Asian Games.

Mitra10, a local DIY retailer, seeing strong sales growth in LED lights and trash cans for stadiums, hotels and athlete accommodations in advance of the upcoming Asian games

Residential Property: Strong demand for smaller units

Indonesia's residential market has been lackluster since the commodities bust in 2014. The government's tax amnesty program in 2016 led to a short-term liquidity shortage for entrepreneurs and wealthier home buyers.

Indonesian residential developers are guiding for 0-12% increase in 2018 sales[3,4,5]. While there is strong underlying demand for low-end homes, mid-to-high end property buyers appear to be waiting on the sidelines until after the General Elections are over. We visited the CitraGrand City Palembang project, which has houses ranging from IDR 400.0 million (US$29,080) to IDR 2.0 billion (US$145,000). Sales officers confirmed strong take-up for properties under IDR 800.0 million (US$ 58,160), while properties of IDR 2.0 billion accounted for less than 20% of sales.

Infrastructure: Ambitious growth

Indonesia's lack of infrastructure has hampered growth in the past. Chart 1 shows that Indonesia's public stock per capita is below other emerging markets. Public stock is the value of government-owned assets that are used to generate economic productivity, usually infrastructure such as roads, bridges and utilities distribution. President Jokowi's National Medium Term Development Plan (RPJMN) seeks to raise public and private investment in infrastructure. Rising commodity prices will help to fund public spending in infrastructure. In 2016, 6.5% and 82.7% of the government's revenues were directly or indirectly correlated to commodities prices.[6]

Picture 8: Scale model of CitraGrand City Palembang

We witnessed part of the infrastructure construction boom as Palembang city rushed to build its Light Rail Transit (LRT) system that will connect the airport to Jakabaring Stadium for the Asian Games.

Picture 10: Palembang traffic worsens as cars share the road with LRT construction

Indonesia's public capital stock per capita is low relative to other emerging markets

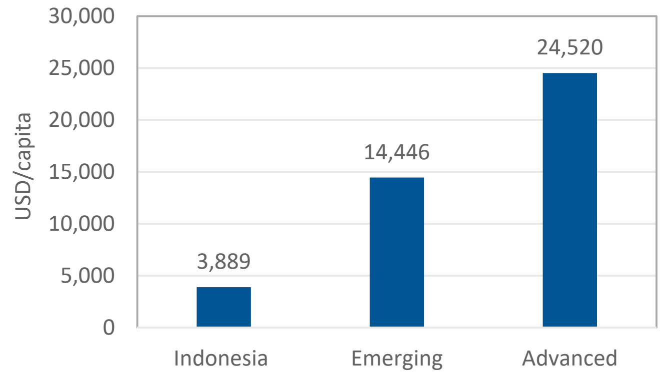

Chart 1: Source: IMF Investment and Capital Stock Dataset (2017)

Key items from President Jokowi's RPJMN:

- US$95bn investment to double power production to 464.2 terawatt hours (TWh)
- US$54bn investment to build 6,220km of additional toll roads by 2025
- US$47bn investment in ports by 2030
- US$20bn investment in public works projects (water, sanitation)

Key items from President Jokowi's Development Plan

Key Takeaways

Indonesia's economy continues to benefit from the recovery in global commodity prices and we are invested accordingly. Financial sector profits are rising after non-performing loan provisions related to the commodities down-cycle peaked in 2015-16. We are exposed to Indonesia's infrastructure growth through investments in heavy equipment and building material. Rising discretionary incomes are trickling down to mass market consumers, which supports department stores and advertising. As incomes continue to rise, we see possibility for further pick-up in property demand. We are positive on the long-term prospects of Indonesia.

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(1) https://yourfreetemplates.com/free-indonesia-editable-map/

(2) "Ace Hardware Indonesia's Sales in 2017 Exceed Expectations," last modified Jan 17, 2018, https://www.indonesia-investments.com/news/todays-headlines/ace-hardware-indonesia-s-sales-in-2017-exceed-expectations/item8509?.

(3) "BSD Targets Marketing Sales of IDR 7.2 Tln in 2018," last modified Feb 14, 2018, http://www.en.netralnews.com/news/business/read/18398/bsd.targets.marketing.sales.of.idr72.tln.in.2018.

(4) "CTRA Prepares Two Latest Projects," last modified Jan 9, 2018, https://www.ciputradevelopment.com/en/ctra-prepares-two-latest-projects/

(5) "Summarecon Agung dongkrak target marketing sales 11,11% di 2018," last modified Feb 19, 2018, http://103.7.1.142/summarecon/public/files/article/SMRA-Presentation-2018-02.pdf

(6) Ministry of Finance, Indonesia http://www.data-apbn.kemenkeu.go.id/Dataset/Details/1018 (cgo april 2017.xlsx)