

mineIndonesia 2006*

review of trends in the Indonesian mining industry

December 2006



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PricewaterhouseCoopers was engaged by the Indonesian Mining Association and the Indonesian Coal Mining Association to prepare the survey, and is very grateful for the support of all the respondents without whose assistance this report could not have been completed. We would also like to thank the Indonesian Mining Association and the Indonesian Coal Mining Association (the "Associations") for their encouragement and co-operation in making this survey a success.

This report is based on a survey of data provided by several respondents, which has not been verified by PricewaterhouseCoopers or the Associations. PricewaterhouseCoopers and the Associations accept no liability (including liability in negligence) and take no responsibility for any loss or damage which users of this publication or any third party may suffer or incur as a result of reliance on this publication.

Current year respondents who did not participate in last year's survey have reported their prior year figures when completing this year's questionnaire. Also, some respondents corrected prior year figures. These figures have been revised accordingly in the historical presentation of results. Thus in some cases, figures for 2004 and earlier years appearing in this report differ from the figures in previous reports.

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Cover: These pictures illustrate the contribution of the mining industry to the wider Indonesian community.



**MINISTER OF ENERGY AND MINERAL RESOURCES
REPUBLIC OF INDONESIA**

I commend to you with pleasure the eighth PricewaterhouseCoopers report on trends in the Indonesian mining industry. PricewaterhouseCoopers, IMA and ICMA are well known to government, business and investors for their continued commitment and support to the Indonesian mining industry.

The Indonesian mining industry is a significant contributor to economic development and growth in Indonesia. In addition to the substantial direct impact on economic development and growth, there is an even larger indirect flow of benefits seen through the development of remote areas of Indonesia. The Government of Indonesia remains committed to the growth of the mining sector and encourages all private investors, both foreign and domestic, to take advantage of the significant geological potential of Indonesia, and at the same time support the development of the country.

The government is aware that there are still some uncertainties affecting the level of new investment in the industry. It is hoped that the new mining law currently before parliament will address some of these concerns. I have an expectation that with the passing of the new mining law and the continued strong demand for mining products, the Indonesian mining industry will attract new investment and become an increasing contributor to the economic development of Indonesia.

Again, I commend this publication to you and hope that it is of use to all stakeholders in the Indonesian mining industry. I congratulate PricewaterhouseCoopers, IMA and ICMA and the participating mining companies on their valuable contributions.

Jakarta, 22 January 2007
Minister of Energy and Mineral Resources

A handwritten signature in black ink, appearing to read 'Purnomo Yusgiantoro', written in a cursive style.

Purnomo Yusgiantoro



Jakarta, 22 January 2007

It is a great pleasure to present to you the eighth PricewaterhouseCoopers report on trends in the Indonesian mining industry. On behalf of IMA, ICMA and the mining industry, we congratulate PricewaterhouseCoopers and thank them for their continued commitment and support to the industry.

The mining industry is important to Indonesia. It is a substantial provider of export earnings, economic activity and employment, and supports regional development.

IMA and ICMA continue to work with their members, the government and other parties towards achieving the best regulatory environment to promote further exploration and investment in mining.

Arif Siregar
Chairman
Indonesian Mining Association

Jeffrey Mulyono
Chairman
Indonesian Coal Mining Association

Executive Summary



The mining industry again had a spectacular year in 2005, both in Indonesia and globally. Globally investor confidence in the sector and its prospects has continued to rise, fuelled by a sustained rise in commodity prices, and as witnessed by a year of significant growth in market capitalisation. In Indonesia profits in the sector have continued to increase in line with the rise in commodity prices, however the country continues to lag behind the global trend of new investments. While the industry in Indonesia continues to be very profitable, new investment is needed to sustain it into the long term.

Another booming year for commodities

For the companies analysed in Indonesia, revenue has increased by 37% over 2004 and net profits increased by a substantial 71%. This is consistent with the global trends. Based on a survey of 40 of the world's largest mining companies (referred to as the global 40ⁱ) revenues increased by 25% and profits increased by 59% in 2005.

Other profit measures also show that, both in Indonesia and globally, 2005 was a year of increasing returns.

| Key Ratios | Top 40 Companies-Global ⁱ⁾ | | Indonesia | |
|-----------------------------------|---------------------------------------|-------|-----------|-------|
| | 2004 | 2005 | 2004 | 2005 |
| EBITDA Margin | 29.7% | 36.3% | 38.4% | 43.1% |
| Net profit margin | 15.2% | 20.1% | 19.1% | 23.9% |
| Effective tax rate | 25.0% | 27.0% | 46.4% | 44.1% |
| Return on capital employed | 13.7% | 18.4% | 13.3% | 19.8% |
| Return on equity | 18.9% | 25.0% | 27.4% | 38.6% |
| Net debt to equity ratio | 25.4% | 36.0% | 42.9% | 50.9% |

i) Aggregated results of 40 of the largest mining companies as per PwC mine*

Indonesian miners compare favourably with the global 40 on these measures. However, it needs to be noted that this sustained increase in profitability since 2002 stems largely from the continuing commodities boom.

Commodity prices, particularly for copper, nickel, gold and coal, continued their upswing in 2005, primarily on the back of increased demand worldwide, especially from emerging giants such as China and India.

However, these improvements in profitability mask substantial increases in operating costs which have accompanied the surge in commodity prices, particularly over 2004 and 2005. The industry will face a challenge to sustain margins should commodity prices fall.

(see page 14)

Balance sheet strength across the industry has provided “war chests” for investment

The continuation of strong profits and operating cash flows has led to an increasingly strong industry balance sheet. This is particularly so for the global industry, with debt to equity ratios having decreased significantly over the last few years. Cash and cash equivalents of the global 40 stood at nearly US\$32 billion at the end of 2005. Current assets of the Indonesian miners surveyed have also increased by 34% from 2004 to US\$4.9 billion.

Global companies are re-investing a significant portion of their operating cash flows in capital projects and acquisitions. Key decisions about the destination of the next generation of minerals development are now being made. Unless attractive new developments or acquisitions present themselves, shareholders will demand additional distributions through dividends and share buy-backs.

The question remains whether Indonesia’s potential projects, no matter how geologically prospective they may be, are attractive enough commercially to reap the rewards of the next wave of global spending.

(see page 36)

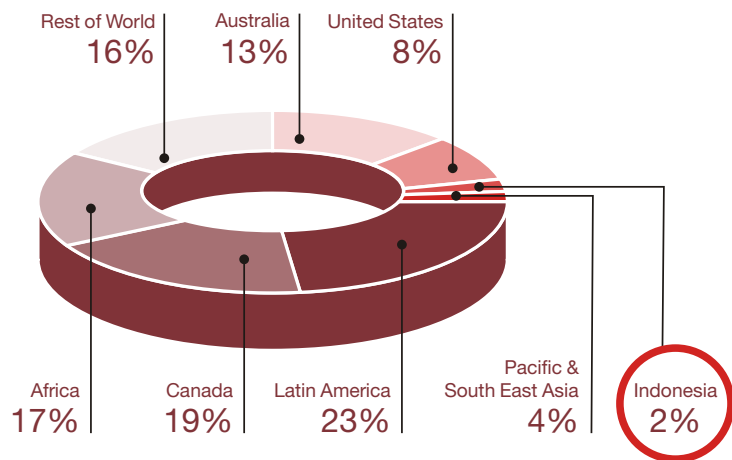
Global mining companies still rate Indonesia’s investment conditions poorly relative to other countries

The real indication of whether Indonesia is viewed as an attractive investment destination, despite its very good mineral prospectivity, is the level of exploration spending undertaken in Indonesia.

Exploration activity in Indonesia remains at low levels despite an increase in 2005. In contrast, the level of global exploration expenditure has continued to increase in 2005 (up 34%ⁱⁱⁱ from 2004).

According to Canada’s Metals Economics Group (MEG), budgeted worldwide exploration in 2005 is US\$5.1 billion (up US\$1.3 billion from 2004). The current exploration spend in Indonesia is approximately 2% of the global total. However, this is an improvement on the 2004 level of less than 1.5% of global exploration spending.

Worldwide exploration spending 2005



Source: Metals Economics Group

The survey data for Indonesia continues to show that inconsequential investment in greenfields exploration is occurring. While there has been some expansion of production at existing mines in 2005, particularly in coal, most other investment spending is primarily for replacement plant and equipment to maintain existing operations.

This would indicate that there is not significant re-investment of the large profits and operating cash flows being generated as a result of continued high commodity prices. This is despite the fact that there is no doubt that Indonesia is a very mineral prospective country (rated in the top 7 according to the Fraser Institute). Whilst there has been some activity on the part of local investors and junior mining companies, the low level of exploration expenditure by large global mining companies will continue until they are satisfied that investment conditions have improved.

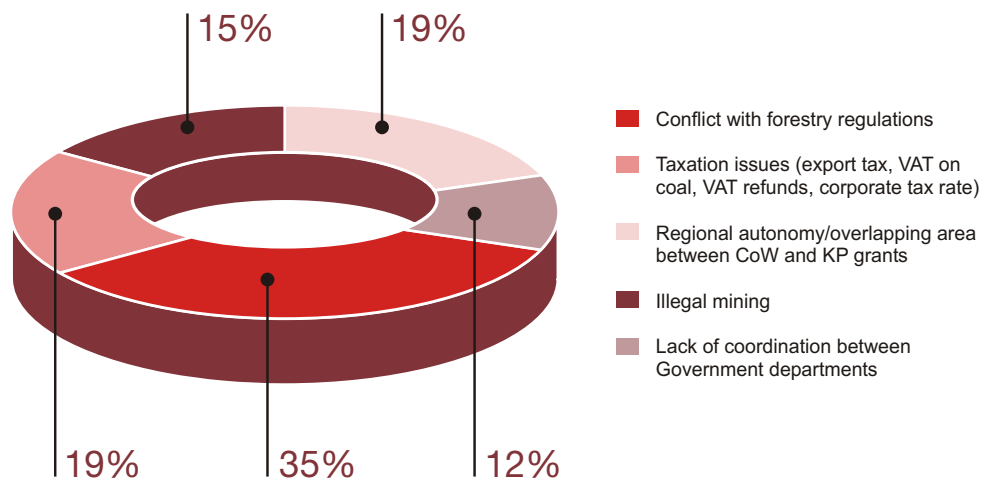
While it is understood that several existing producers are looking to expand operations, these investments were not yet reflected in the survey results for 2005. Time will tell whether these projects will ultimately come to fruition.

(see page 26)

The industry's opinion – What issues are holding up investment in the Indonesian mining industry?

Survey respondents have highlighted the following key issues for the mining industry, which require immediate attention.

Top five issues for the Indonesian mining industry



The “Top 5” issues are consistent with the seven priorities to improve investment conditions highlighted by the mining industry, as detailed in *mineIndonesia 2005**. These are listed in the following page with a comment on progress to date as well as the survey respondents’ rating of progress since December 2005.

| mineIndonesia 2005* - seven priorities to improving investment conditions | Progress to date | Survey respondents' rating of progress** |
|--|--|--|
| <ul style="list-style-type: none"> Restoring long-term certainty in the Contract of Work (CoW) system, including tax stability (locking in tax conditions for the CoW term). | <ul style="list-style-type: none"> The draft mining law has been before parliament for some time, but it is unclear when it will be passed. The current draft indicates that the CoW system will cease to exist for new projects, which is not favoured by foreign investors. | C |
| <ul style="list-style-type: none"> Improving the competitiveness of the taxation and royalty system relative to other prospective countries, including restoring VAT refunds for gold and coal producers. | <ul style="list-style-type: none"> Tax reforms appear to be heading in the right direction. Under the proposed new tax laws the corporate tax rate may reduce to 25% by 2010 and most mining products are to be VATable again (coal will be a VATable product but the reforms do not appear to extend to gold bars). The taxation of oil and gas companies and mining companies will be set by government regulation. A negative factor was the attempt in 2006 to impose a 5% duty on the value of coal exported, which was subsequently withdrawn. | B - C |
| <ul style="list-style-type: none"> Resolving conflicts between CoW terms and forestry regulations, without imposing additional financial or other burdens on mining companies. | <ul style="list-style-type: none"> In August 2005 the Constitutional Court confirmed the status of Law No.19/2000 allowing mining in protected forests. However it permits only 13 existing concessions to mine in such forests. In March 2006, the Forestry Ministry issued Regulation No.14/2006 which imposes additional requirements on mining companies, including potential for additional royalties. | B - C |
| <ul style="list-style-type: none"> Reduce illegal mining. | <ul style="list-style-type: none"> The government has acknowledged the need to clean up illegal activities, and there appears to have been some success to date. | B |
| <ul style="list-style-type: none"> Minimise potential for 'over regulation' in proposed changes to regulations affecting mining, including regulatory duplication between central and regional governments. | <ul style="list-style-type: none"> No significant progress noted. The industry still notes a lack of coordination between government departments and between the central and regional governments. A recent trend of regional governments issuing <i>Kuasa Pertambangan</i> (KP), or mining rights, on areas already covered by a CoW, is of some concern. | B - C |
| <ul style="list-style-type: none"> Ensure fairness in divestment of foreign interest and mine closures. | <ul style="list-style-type: none"> No significant progress noted. | C |
| <ul style="list-style-type: none"> Improving certainty of legal interpretation of CoWs and regulations. | <ul style="list-style-type: none"> No significant progress noted. It is hoped that the passing of a new mining law will assist in improving legal certainty. | B - C |

** Survey respondents were asked to rate progress against these issues on a scale of A - C. A – Significant progress; B – Some progress; C – No progress. This is an average of those ratings.

(see page 32)

The mining industry is an important contributor to the Indonesian economy

The mining industry contribution to the overall Indonesian economy increased significantly in 2005 in comparison with previous years. Owing to the high prices of 12 major commodities, mining products accounted for approximately 2% of the total Indonesian GDP (Source: Badan Pusat Statistik/BPS-Statistics Indonesia).

The industry also continues to make significant contributions to regional and community development – Rp771 billion in 2005 based on survey respondents, or an increase of 65% from the previous year. Total government revenues (taxes and royalties) from the survey respondents increased 62% to US\$2.7 billion, a record for the last 10 years.

The total number of Indonesian national direct employees has remained relatively stable at 35,801 in 2004 and 35,517 in 2005, with the slight decrease due mainly to cessation of Kelian's mining operations in 2005.

Given the continuing global mining boom and the potential for new projects or expansions in coming years, the job market in the mining industry continues to look favourable.

The total economic benefit to Indonesia is significantly greater than the direct benefits captured by the survey. This is because of the indirect multiplier effect that the mining industry's direct contribution has on other economic activity, which is particularly beneficial in the regional and remote areas where the industry operates.

(see pages 40 and 44)

Outlook

2005 was another spectacular year for the global mining industry. The global mining boom has continued into 2006 and looks certain to continue for some time yet. Whilst the Indonesian mining industry's financial results are robust and are likely to continue to be so because of continued high minerals prices and global demand, the concern is the longevity of a lucrative mining industry if significant new investment is not made in Indonesia.

Indonesia continues to be recognised by mining companies as being highly prospective and mining companies would be willing to increase their exploration activities if the investment conditions are improved. These improvements need to be significant and swift, if Indonesia is not to miss out on the investment dollars being generated in the current boom. However, the comments of survey respondents as well as anecdotal evidence, unfortunately indicates that there continues to be impediments to a rapid change in investors' opinions.

Of particular concern is the slow pace of finalizing the draft mining law, which has been before parliament for several years. Due to the significant changes to the regulatory environment proposed in the draft law (some of which are not supported by mining industry participants), investors have been reluctant to commit significant funds to new projects, until the landscape is more certain. It is hoped that the new mining law will provide legal certainty with respect to licensing, land acquisition and security, as well as improve coordination between the different arms of government.

Coordination between government institutions, as well as between the central and regional governments, continues to be a key concern of investors, who often suffer the impact of contradictory and inconsistent rulings. Several examples of this have arisen in the last year, including the issuance of the decree of the Ministry of Forestry No. 14/2006, and the attempted imposition by the Ministry of Finance of a 5% export levy on coal sales. This lack of coordination within the government may in part be due to the absence of a comprehensive blue print or road map for the development of the mining industry, as has been prepared for some other sectors of the Indonesian economy. The Indonesian Mining Association, among others, has begun a process of dialogue to redress this situation. The success of such a project will of course need the buy-in of all stakeholders, including the mining companies, as well as the government and the parliament. Time will tell whether this is achievable in the short term, so that investment in the sector can meet its full potential.

Whilst some improvement in investment conditions has been noted and there is more confidence that the Government is committed to continue improving the investment conditions, the concern is whether this is occurring quickly enough, and addressing investors' specific concerns, to ensure Indonesia benefits from the current wave of global exploration spending.

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PricewaterhouseCoopers is the leading adviser to the mining industry, working with more explorers, producers and related service providers than any other professional services firm to ensure we meet the challenges of the mining industry into the future.

Our strength in serving the international and Indonesian mining industry comes from our skills, our experience, and our seamless global network of dedicated professionals who focus their time on understanding the industry and developing solutions to mining industry issues.

Our commitment to the mining industry is unmatched and demonstrated by our active participation in industry associations around the world and our thought leadership on the issues affecting the industry. Through our involvement with the Indonesian Mining Association and Indonesian mining companies, we help shape the future of the industry.

Our strength in the mining industry is one of which we are proud. This means we are the most committed firm to achieving mining clients’ needs and actively participate in the industry in all countries in which mining occurs. We work closely with our mining clients, offering the benefits of our experience, to help achieve their goals.

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Indonesian Mining Association



IMA is a non-governmental, non-political, and not-for-profit national mining organization, established in Jakarta on 29 May 1975.

Membership is open to both organizations and individuals actively participating in the Indonesian mining industry.

The association serves as a link between Government and the mining industry; organizing lectures, seminars and training activities for the members; organizing periodic conferences on mining in Indonesia; publishes proceedings and mining information; and represents the Indonesian mining industry at national and international meetings.

IMA is a founding member of the Asean Federation of Mining Associations (AFMA) and currently provides the secretariat for the Federation. The aims and objectives of IMA are to support the Government in its policies to encourage the mining industry development and to disseminate non-confidential and non-proprietary information to promote the exploration, mining, beneficiation and metallurgical aspects in Indonesia through:

- a. fostering mining development;
- b. facilitating professional and business exchange of know-how and experience of experts active in the industry;
- c. cooperation with similar organization all over the world in promoting mining business and technology.

The association has 102 company members.

Indonesian Coal Mining Association



APBI-ICMA is a non-political and non-profit oriented organization for companies in the coal business sector. APBI-ICMA was established on 20 September 1989 and was registered as a member of the Indonesian Chamber of Commerce on 16 October 2004.

The objectives of APBI-ICMA are to participate in developing the business climate in the coal mining sector which enables the broad involvement of all members and to share a significant role for the national economic development.

The association facilitates a communication and a consultation forum among its members and also serves as a link between the Government and the coal industry. APBI-ICMA also cooperates with other associations, companies or any related parties nationally and internationally for the development of the coal sector in Indonesia.

Currently APBI-ICMA has 50 companies registered as members.



