

ASEAN Investment Flash Indonesia

July 2012



Evolution & Growth Prospects





Chairman's Message

Dear Readers,

It is Reciprocus' mission to advise on growth acceleration opportunities throughout the Asia Pacific by relying on local expertise. To that end, we are leveraging our research capabilities to launch a monthly publication aimed at providing key insight into important strategic markets. It is my pleasure to introduce to you our inaugural issue *ASEAN Investment Flash Indonesia* with the hope you find the content both useful and interesting.



David Emery
Founder and Chairman
Reciprocus International Pte Ltd

Letter from the Editor

Indonesia has continued its emergence as one of Asia's most attractive tigers in 2011 following a highly positive growth trajectory, suggesting it may not be long until the dynamic archipelago establishes itself as Asia's newest economic heavyweight. Having weathered the recent global economic crisis well, Indonesia's increasingly favourable business climate is breaking new barriers as illustrated by Moody's and Fitch's recent move to lift debt ratings to investment grade, Standard & Poor's BB+ rating and an *Ease of Doing Business Ranking* of 129 out of 183 countries. Now positioned as UNCTAD's 7th top host economy in terms of estimated FDI inflows for 2011-13, the central government is undertaking proactive efforts such as stabilizing currency rates and maintaining a competitive tax regime in order to position itself as South East Asia's most welcoming frontier market.

Indonesia's immense cross the board progress since the end of the 1998 Asia Financial Crisis and the fall of President Suharto's regime is not without continued challenges, chief among these being a weak infrastructure and a significant portion of the population living in poverty. However, despite



Indonesia is now
UNCTAD's 7th top host economy
in terms of FDI for 2011-13

obstacles extending far beyond Jakarta's notorious traffic jams, these challenges have proved manageable by companies and investors with GDP levels pushing new heights with an expected US\$ 936 bn in 2012, more than double that of 2007 levels at US\$ 432 bn. In no small part due to government reforms over the last decade, Indonesia's annualized 5% economic growth since 2000 and recent flood of foreign investment, over 50% growth in 2010, indicates reason for cautious optimism for the years ahead.

Following these waves of government reform and decentralization, Indonesia's leadership has taken a long-term and conservative approach to ensuring that industries continue to attract investment across a wide range of sectors. In the near term, we see massive opportunities in consumer consumption, retailing, healthcare, education, transportation and micro-financing in addition to the respective adjacent spaces. Mining and energy remains an interesting sector, though there is an indication that the coal space is overheating as valuations are encroaching on the high-side at the moment. Nevertheless, well vetted opportunities with a long-term perspective on returns are likely to prove attractive, especially in areas of contiguous natural resources, while alternative energies are presenting tremendous up-sides.



Robert MacPherson Vice
President and Editor Reciprocus
International Pte Ltd

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INDONESIA

Country Profile

Map

Indonesia is the world's largest archipelagic state, located in South-East Asia between the Indian Ocean and the Pacific Ocean.



Figure: 1

Flag

Two equal horizontal bands of red (top) and white; the colors are derived from the banner of the Majapahit Empire of the 13th-15th centuries; red symbolizes courage, white represents purity.



Figure: 2

About Indonesia

Languages

Bahasa Indonesia (official, modified form of Malay), English, Dutch, local dialects (of which the most widely spoken is Javanese)

Major cities & Population

JAKARTA (capital) 9.121 million; Surabaya 2.509 million; Bandung 2.412 million; Medan 2.131 million; Semarang 1.296 million

Religions

Muslim 86.1%, Protestant 5.7%, Roman Catholic 3%, Hindu 1.8%, other or unspecified 3.4% (2000 census)

Administrative divisions

30 provinces, 2 special regions and 1 special capital city district

Population

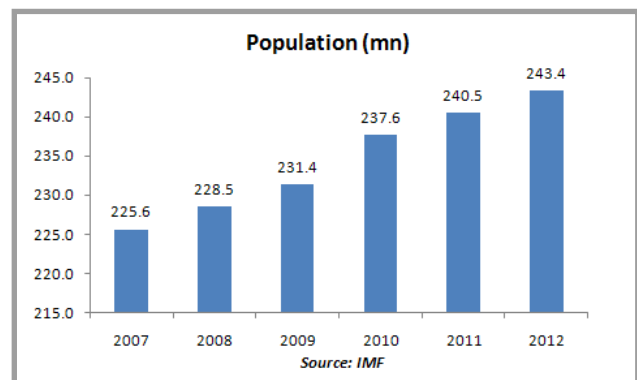


Figure: 3

Fourth most populous country in the world

Age structure:

0-14 years: 27.3% (male 34,165,213/female 32,978,841)

15-64 years: 66.5% (male 82,104,636/female 81,263,055)

65 years and over: 6.1% (male 6,654,695/female 8,446,603)

Economy

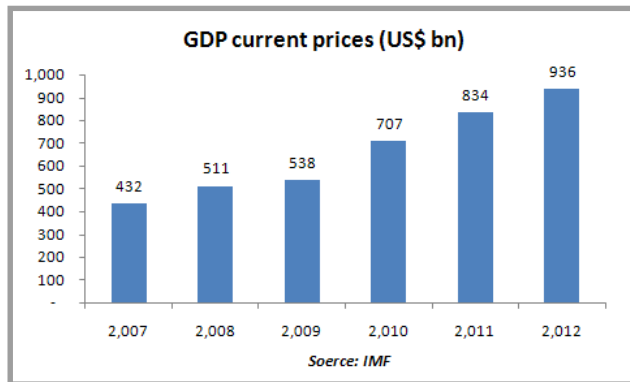


Figure: 4

Main industries

Petroleum and natural gas, textiles, apparel, footwear, mining, cement, chemical fertilizers, plywood, rubber, food, tourism

Oil production

1.03 million bpd

Natural gas production

82.8 billion cu m

2012 Budget

- Forecast revenues: IDR 1,292 tn; Expenditure: IDR 1,418.5 tn, (increase of 7.4% y-o-y)
- Capital expenditure to jump 19.3% to IDR 168.1 tn; Civil servant salaries to increase 10%; underpinning private consumption which is one of the drivers of economic expansion
- The number of people classified as living in poverty would fall from 12.5% to 10.5-11.5%

World Rankings

International Organization Participation

ADB, APEC, ARF, ASEAN, BIS, CICA (observer), CP, D-8, EAS, FAO, G-11, G-15, G-20, G-77, IAEA, IBRD, ICAO, ICC, ICRM, IDA, IDB, IFAD, IFC, IFRCS, IHO, ILO, IMF, IMO, IMSO, Interpol, IOC, IOM (observer), IPU, ISO, ITSO, ITU, ITUC, MIGA, MONUSCO, NAM, OECD (Enhanced Engagement), OIC, OPCW, PIF (partner), UN, UNAMID, UNCTAD, UNESCO, UNIDO, UNIFIL, UNMIL, UNWTO, UPU, WCO, WFTU, WHO, WIPO, WMO, WTO

Ease of Doing Business in 2012

129 out of 183 countries

Competitiveness in 2011

44 out of 139 countries

Enabling Trade Index 2010 (World Economic Forum)

Rank 68

Government effectiveness indicator (World Bank) 2010

Percentile rank 47.8

Control of Corruption (World Bank) 2010

Percentile rank 27.3

INVESTING IN INDONESIA

FDI Inflows into Indonesia

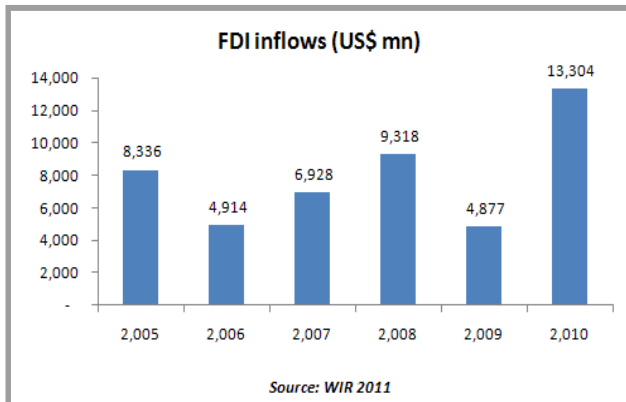


Figure: 5

- Rapid growth of the economy and a stable political environment have created opportunities for FDI
- Moody's and Fitch have lifted debt rating to investment grade; Standard & Poor's have improved credit rating to BB+
- Indonesia entered the top 20 for the first time in terms of inflow of FDI in 2010
- UNCTAD has listed Indonesia as the 7th top host economy in terms of estimated FDI inflows during 2011-13

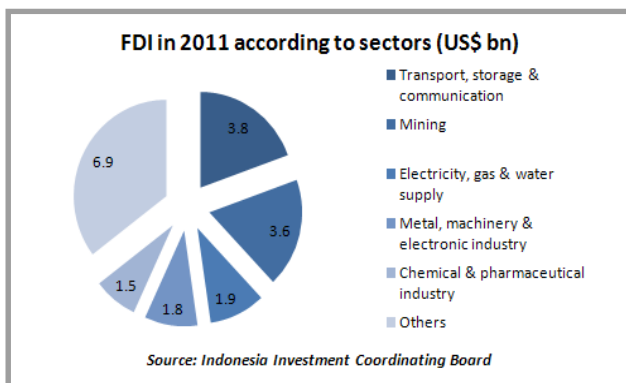


Figure: 6

- Gaining ground as a low-cost production location, especially for low-end manufacturing
- Not only has Indonesia been liberalizing its industries, it has improved its FDI related procedures
- Industries that attracted the most international investments were transportation, mining and utilities

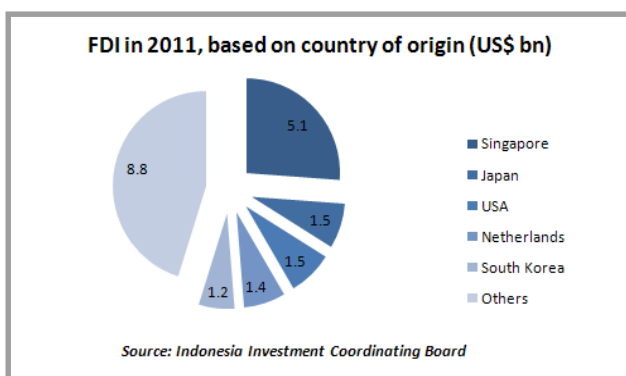


Figure: 7

- Indonesia could draw even more big-ticket investments if further economic reforms are passed
- Investors are increasingly willing to overlook the country's shortcomings to get access to its vast natural resources and large consumer market of more than 200 million people



Factors Driving Investment in Indonesia

Strong macroeconomic fundamentals



Figure: 8

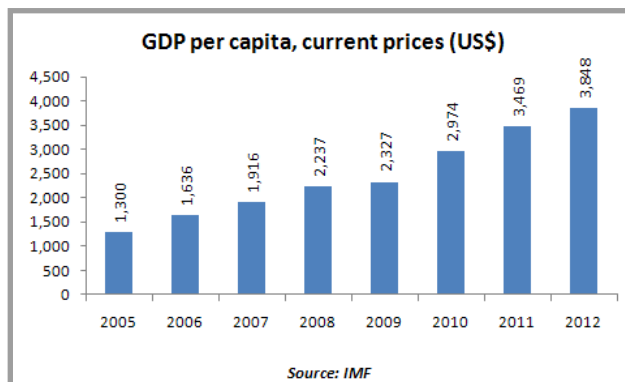


Figure: 10

- Strong GDP growth
- Avoided recession during 2007-09 crisis
- Resilience reflects prudent macroeconomic policies pursued over the last decade
- Government instituted economic reforms have led to a substantial reduction in the country's debt-to-GDP ratio
- Inflation has been steady between 5 & 6%
- Per capita GDP has been steadily rising
- Total investment as a percentage of GDP has been increasing
- Unemployment rate has been decreasing

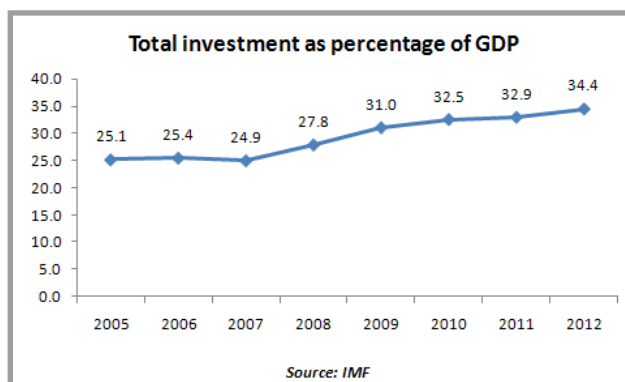


Figure: 11

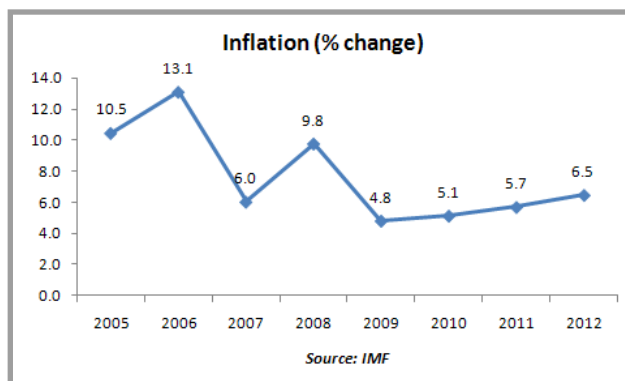


Figure: 12



Figure: 9

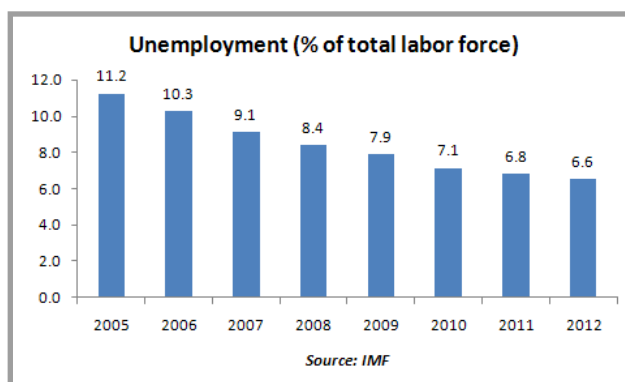


Figure: 13

Rich natural resources and strong exports

- Large oil and metals deposits provide a substantial base of resources for domestic production
- World's largest producer of tin
- Second largest natural gas reserves
- Third largest coal reserves
- Commodity exports play a large role in the Indonesian economy
- Large domestic oil reserves means that the economy is mostly insulated from the wild price swings and productivity costs

| Main exports of 2011 | (US\$ mn) |
|---|-----------|
| Textile and textile products | 13,353 |
| Nickel ore | 1,390 |
| Palm oils | 19,577 |
| Coal | 27,044 |
| Base metal products | 11,875 |
| Bauxite | 766 |
| Copper ore | 4,800 |
| Crude oil | 14,167 |
| Processed rubber | 14,128 |
| Natural gas | 17,996 |
| Processed wood products | 3,260 |
| Coffee | 1,030 |
| Oil products | 4,786 |
| Tea | 136 |
| Chemical | 4,651 |
| Spices | 430 |
| Electrical apparatus, measuring instruments & optical | 11,546 |

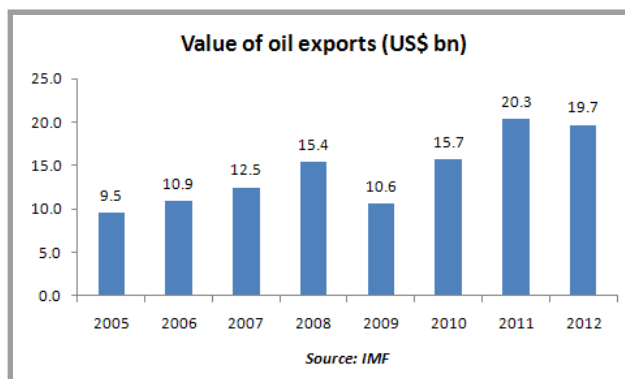


Figure: 14

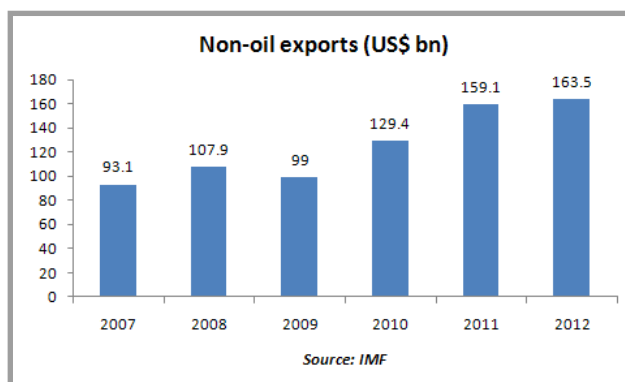


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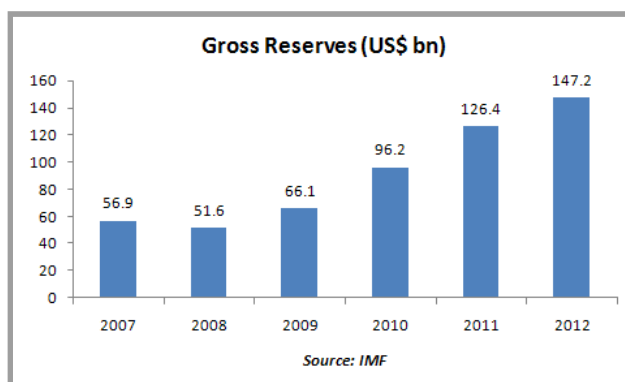


Figure: 16

Population

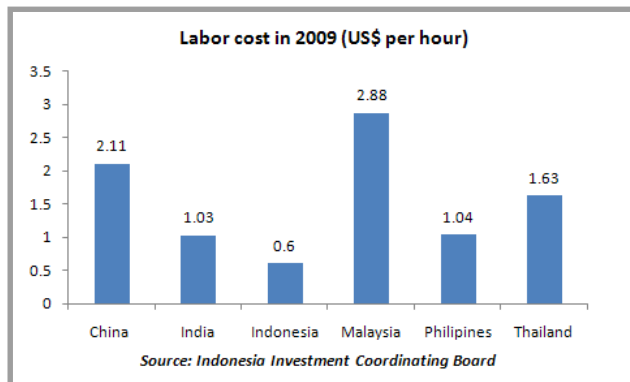


Figure: 17

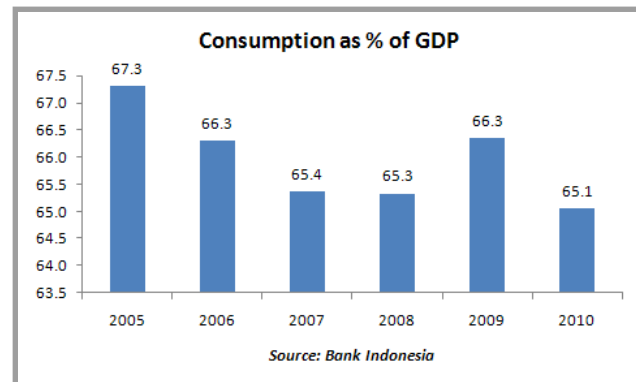


Figure: 18

- World's 4th most populous nation
- Provides ample domestic demand and a large pool of low-cost laborers to fuel productivity
- The dependency ratio is declining and will continue in the next decade as the working age population is projected to start peaking
- The country has a relatively skilled workforce and a quality education system
- Robust consumer driven economy due to a large middle class
- More than half (55%) of the population is under the age of 30, and one-third under the age of 15; as these citizens age, they will reach their top earning years in the near future
- Consumption levels as a percentage of GDP are at 63%, which has helped to insulate the country from the recent downturn in developed markets

Strong investment climate

Investment Law No. 25/2007

- Redefines “capital investment” as all investments, whether by domestic or foreign investors, for the first time offering equal treatment to all investors.
- There is no longer a limit of 30 years on foreign investment permits. Additionally, the new law allows for the unimpeded repatriation of capital.

One-stop-shop (PTSP) and National Single Window (SPIPISE)

- BKPM has launched PTSP service and an electronic automation platform for investment licenses and non-licensing services (NSWi)
- This reduces the number of procedures and amount of documentation needed to invest in Indonesia
- Also bypasses the need to physically come to the offices to apply for certain services

FINANCIAL MARKETS IN INDONESIA

Origin & Development

Origin of the Indonesian capital market can be traced back to 1912 when the Dutch Colonial government established a stock exchange. After several closures and restoration attempts, the Capital Market Operation Board (Badan Pengawas Pasar Modal or Bapepam) was established under the aegis of the Ministry of Finance with an intention to develop Indonesian financial markets and private sector participation in 1976.

The Jakarta Stock Market was reopened under the newly formed Bapepam in 1977. During the 1980's the government started reforming regulations in order to create appropriate conditions to attract investors to the capital markets. For instance, the Pakdes package of 1987 relaxed government regulation of the market licensing and had a major effect on the market development.

The Pakdes package adopted in 1990 reformed the institutional structure of the capital market along with various other reforms such as foreign ownership up to 49% of listed shares, removing fluctuation trading limit and introducing parallel bourse to allow medium scale companies (December 1987). Meanwhile corporate bonds were introduced in the year 1983. Considering the rapid expansion of the market Surabaya Stock Exchange was established in the year 1989 and Jakarta Stock Exchange was privatized in the year 1992 under the ownership of Jakarta Exchange Inc.

The next breakthrough came in 1996 with the Capital Market Law in January 1996 as Bapepam assumed a greater role with the enforcement of powers as an independent market regulator and supervisor. Open ended investment funds were also introduced during this time.

The Asian crisis of 1997 had an impact on the Indonesian economy following which the Indonesian Bank Restructuring Agency (IBRA)

was established in the year 1998 mainly to focus on restructuring banking mechanism. IBRA created a restructuring mechanism under the IMF, however, since this was done independent of the Bank of Indonesia and the government; it failed to attract enough support and was dissolved in 2004. Other measures undertaken by the government include the banking sector restructuring policy of 1998 which injected public funding into the banking sector and other capital injections conducted in 1999 by issuing government bonds to inject funds into the banking system.

The Indonesian government exited from the policy management program from the IMF and restored autonomy in establishing economic and developmental policies. In 2004, Bank Indonesia issued new regulations on foreign loans and has supervised the New Central Banking Law of 2004.

In 2007, the Finance Ministry of the nation merged the two exchanges Jakarta Stock Exchange (JSX) and Surabaya Stock Exchange to form the Indonesia Stock Exchange. JSX Composite Index and the Jakarta Islamic Index are the two primary indices on the Indonesia Stock Exchange. **(Refer Figure: 19)**

Structure of the Indonesian Financial System

- According to IMF estimates, Indonesia's total financial assets stood under 60% of the nation's GDP in 2009. The Indonesian financial system has struggled post the Asian crisis of 1997 where more than 50% of the banking sector assets were written-off forcing companies to fund operations through their retained earnings.
- The Indonesian financial system is largely dominated by banks which accounted for 80% of the financial system and 50% of the nation's GDP in 2009. According to the statistics published by Bank Indonesia and

the Ministry of Finance, the banking industry continues to dominate the Indonesian financial landscape with 78.2% of financial institutions' assets belonging to the banking sector in December 2010.

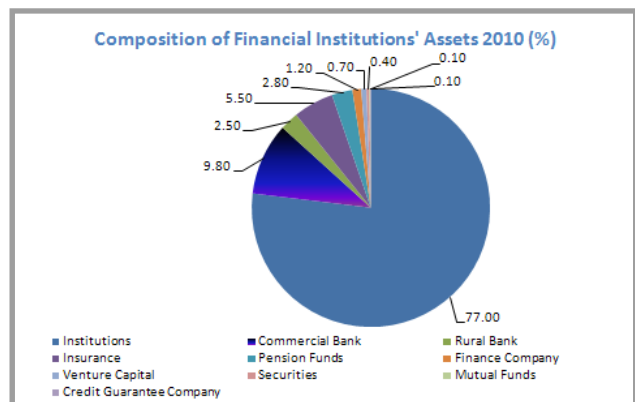


Figure: 20

- Indonesia's unique financial structure is a result of dominance of the banking sector units in the form of a number of institutions especially rural banks.
- With time, foreign banks are also playing an important role. This has helped in enhancing competition especially in segments such as SME banking and retail banking thereby strengthening the capital base.
- Recent statistics by Bank Indonesia reveals the following trends in the funding and liquidity patterns:
 - Bank funding is largely reliant on deposits while other sources such as interbank funding stand at 5.84% during the first six months of 2011.
 - Loans and SSB accounted for 1.17% and 0.91% share.
- Bond market: At the end of 2009, bond market capitalization accounted for 12% of GDP and SOE debt.
- The non-bank financial market accounted for about 10% and the insurance sector accounted for about 3% of the nation's GDP in 2009.
- Investment Management industry and various funds include equity investment fund, fixed income fund, money market investment fund, balanced investment fund, capital protection investment fund, index investment fund, exchange traded funds, private equity funds & asset backed securities.
- Finance companies are playing and increasingly pivotal role in providing funding. The industry assets increased to reach IDR 230.3 tn in 2010 marking a 32% increase compared to 2009.
- Venture Capital Companies: In 2010 there were 79 venture capital companies with a total asset value of IDR 3.96 tn up 7% from 2009.
- Guarantee companies: A company whose primary activity is to guarantee financial obligations fulfillment of a debtor or Sharia based financing for financial institutions or banks.
- Indonesia Export Credit Agency (Indonesia Exim Bank): primary objective is to support exports by offering export related financing, insurance and guarantee.
- Infrastructure Finance Companies
- Secondary mortgage facility
- Insurance Industry
- Pension Fund Industry: issuing pension programmes

(Refer Figure: 21)

- **Capital market and Sharia NBF Industry:** comprises of Sharia Capital Market, Sharia Insurance Industry, Sharia Finance Company Industry and Sharia Pension Fund Industry

| Institutions | Numbers |
|---|---------|
| Commercial Bank | 121 |
| Rural Banks | 1,682 |
| Insurance | 142 |
| Pension Funds | 282 |
| Finance Company | 192 |
| Venture Capital | 71 |
| Securities | 113 |
| Mutual Funds (Investment Collectives, not institutions) | 642 |
| Credit Guarantee Company | 4 |
| Pawn Broker | 1 |

Figure: 22

Regulatory Authorities & their Roles: Bank Indonesia

Bank Indonesia is an independent and a fully autonomous state institution holding a status and a position free from the government or external parties. As an independent state institution and a central bank, Bank Indonesia formulates and implements tasks and authorities stipulated in the new Central Bank Act the UU No. 23/1999. This Act was primarily enacted on 17th May 1999 and has been amended on 15th January 2004.

As the central bank, its primary objective is to maintain stability of the currency value. This covers two vital aspects - exchange rate stability against other currencies and exchange rate stability against goods and services.

The Bank's strategic approach can be broadly classified into two major approaches viz. Crisis prevention mechanism & Crisis resolution mechanism. The Bank plays a role of a coordinator at all times for the internal banking system as well as towards international organisations and forums. **(Refer Figure: 23)**

Indonesian Capital Market and Financial Institutions Supervisory Agency (Bapepam-LK)

The primary mission of Bapepam is to emerge as a trusted and a highly professional capital market regulatory authority with a vision to nurture and preserve capital market environment conducive for growth.

Strengthening of the capital market indicates strategic measures taken by Bapepam along with industry participants in 2010. These are commonly applicable to the entire capital market and NBF institutions which include insurance industry, pension funds, venture capitalist organisations, PE companies, stock markets, bond market, etc. **(Refer Figure: 24)**

Recent Trends

- Market capitalization of the Indonesian equity market has improved 211% at the end of November 2011 compared to the end of December 2008.
- Contribution of total securities market capitalization has increased from 33.8% in 2008 to 65.49% in November 2011.
- In the bond market, contribution of corporate bonds to the nation's GDP has increased from 1.47% to 2.05% for the same period while that of the government bonds stands at 10.61% and 11.3% respectively.
- For the mutual fund industry the net assets have increased 120% from 2008 till November 2011 while the insurance sector assets have registered an increase of 64% during the same period. **(Refer Figure: 25)**

PRIVATE EQUITY IN INDONESIA

Introduction

The concept of Private Equity (PE) has been on the rise over the past few years across the globe. In recent years, private equity investments, specifically in Asia, North America and in Europe have attracted investors on the back of robust economic growth and continued financial and economic liberalization. With a GDP of US\$ 1.8 tn, the ASEAN – comprising Indonesia, Malaysia, the Philippines, Singapore, Thailand, Brunei, Burma, Cambodia, Laos and Vietnam - is the tenth largest economy in the world.

Indonesia in the Limelight

Indonesia stands as one of the largest economy in Southeast Asia, with a population of almost 250 million people. While Indonesia has not been a busy PE market historically, there have been nine deals of more than US\$ 100 mn in the past five years. High-profile transactions have raised investor optimism of PE in Indonesia.

PE requires

- Interesting businesses in which to invest
- Access to equity stakes with influence over the business

Benefits of PE

- Private equity ownership provides the ability to gain connectivity to the outside world through a greater knowledge of new markets as well as technological and management capabilities
- Restoring companies to going-concern value rather than liquidation
- Removes the financial and management burdens from the banking sector

- Allocating resources more efficiently, improving the prospects to realize values

An Over view of Indonesia 's Private

Equity Landscape

Southeast Asia accounts for a relatively small part of PE in Asia (13% during 2003–2008). But it is growing quickly; the region's private investments grew at a rate of 36% annually during the same period. Indonesia, with its surging economy, growing levels of domestic consumption, stable political scene and strategic positioning in South-East Asia, is uniquely appealing as a destination for private equity investment, and interest in the market is strong. However, overall private equity investment into the country remains relatively small compared to other ASEAN nations as there are many challenges associated with this complex market, with a scope for more growth. The local Big Four private equity firms are – Ancora Capital Management, Northstar Pacific Capital, Quvat Management, and Saratoga Capital.

- High valuation of the recently announced transactions such as Carlyle investment in Garuda Food: Private equity firm Carlyle Group closed a 25% buying stake in the Indonesian consumer firm Garudafood for about US\$ 200 mn. The deal marks Carlyle's first-ever direct investment in Indonesia.
- The headline event of 2011 was the fundraising success of Northstar Pacific, which raised US\$ 840 mn for its third fund, an Indonesia-focused PE fund.

According to data from mergermarket, the target sectors for private equity investments are the consumer, energy & mining and financial services sectors.

(Refer Figure: 26)

Hiccups in the sector

- In spite of the momentum in this sector, the ratio of conversations regarding private equity investments in Indonesia to the number of deals that actually close is relatively low.
- Doing deals in Indonesia requires knowledge and experience which means that deals in Indonesia requires a certain degree of appreciation of local perspectives.
- Many of the target companies are run by first-generation ownership, who have very strong attachments to their businesses and who would have a high value expectation
- Due diligence can be a problem and investors need to check books very carefully as accounts are often not reliable and may have been structured to minimize tax liabilities.

SWOT Analysis of the PE Industry

Strengths

- Large, young and growing middle-income population
- Abundance of natural resources
- Political stability and ambition to develop the economy
- Tax system addresses double taxation on income and supports subsidies.

Weaknesses

- Inadequate infrastructure in some areas
- Legal system comparatively less developed than in other markets and perceived widespread corruption
- Larger companies tend to be state or family owned
- Physical infrastructure is considered sub-standard. Moreover, the archipelagic nature of the country makes it difficult to weave national infrastructure together

Opportunities

- Valuations are more attractive than in other major Asian countries
- Large untapped potential for natural resource exploration and infrastructure development
- The government is targeting a 15% increase in investment from US\$ 23 bn

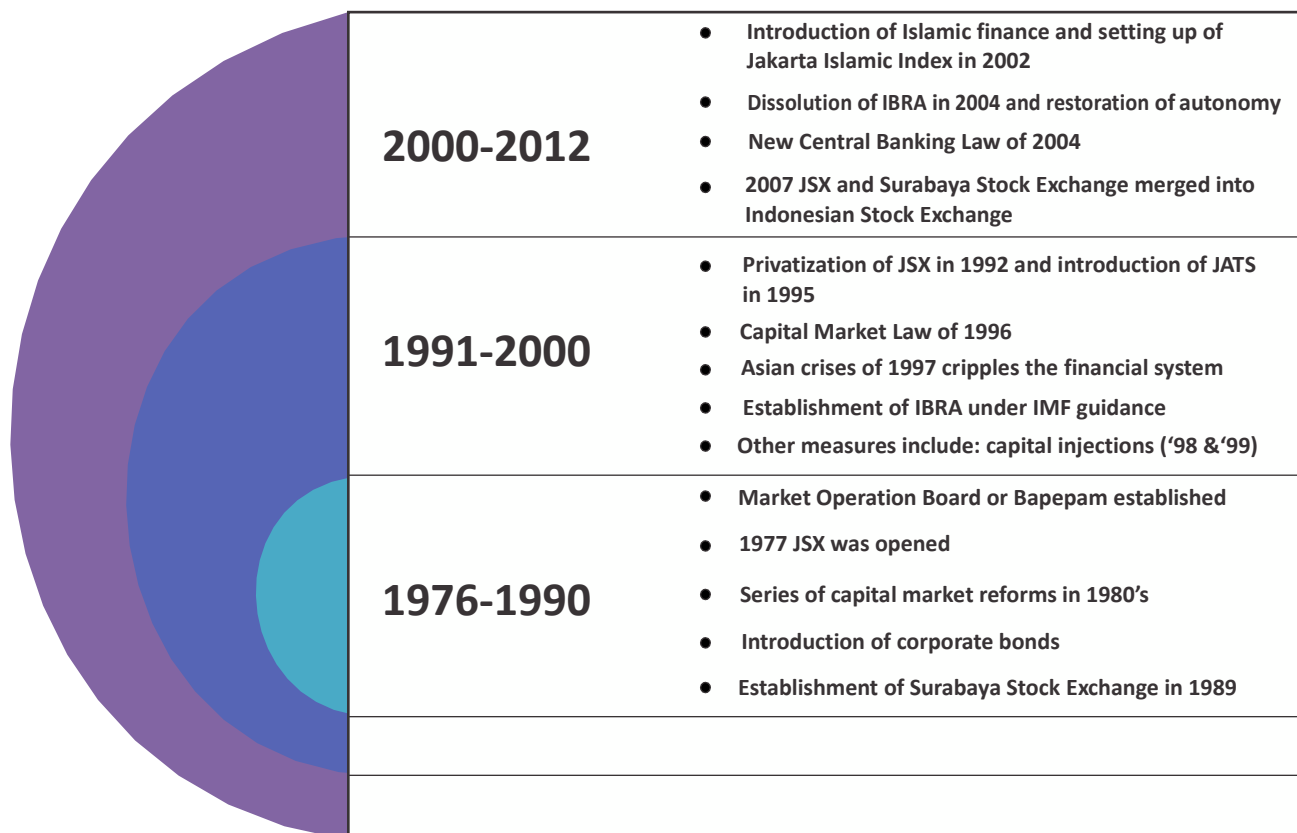
to US\$ 27 bn, of which 65% is from foreign investors; in 2010, total investments increased by 54.2%, with 424 projects worth US\$ 3.8 bn realized in Q1 2010 alone

- Core sectors remain energy, mining, plantations and infrastructure, with retail, communications and pharmaceuticals likely to experience fast growth
- If reforms to land laws are implemented, this will lead to many investment opportunities in the property market
- Indonesia has reached investment grade, improving access to finance
- Robust growth, underpinned by strong domestic demand
- PE markets will probably continue to develop quickly as the competition from Indonesia's neighbors is increasing

Threats

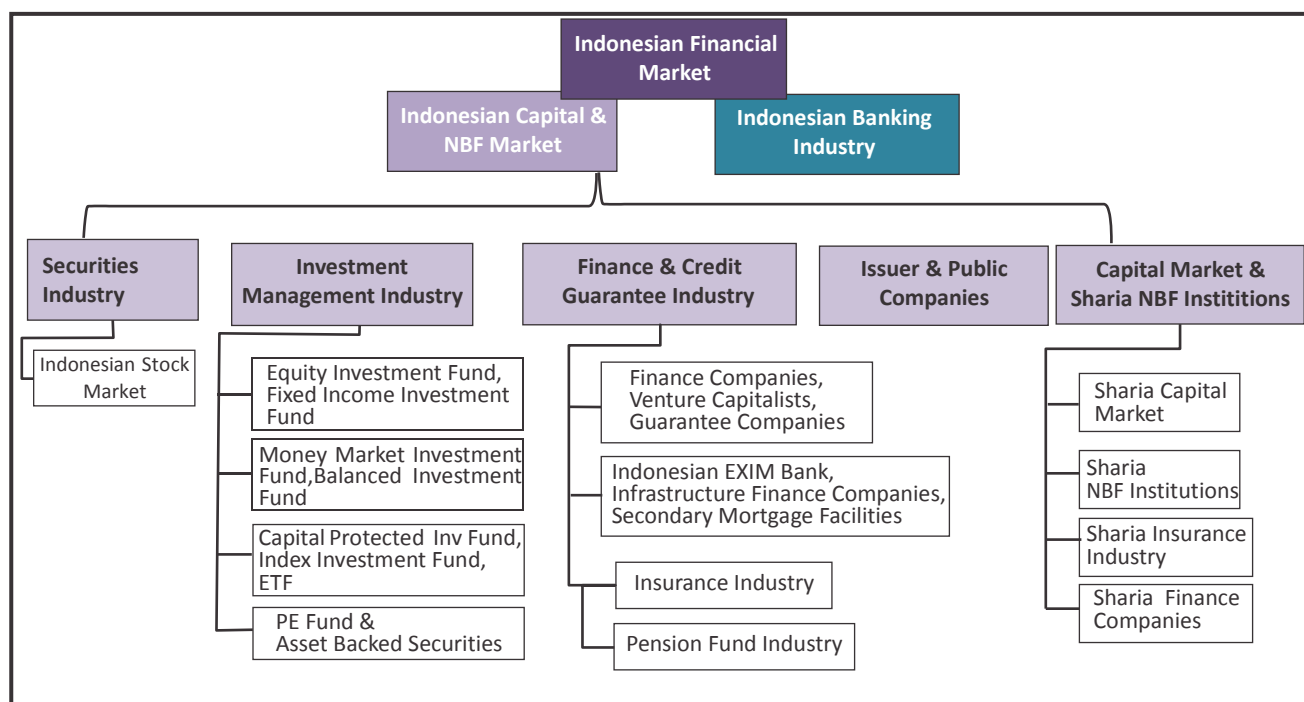
- Concerns that the outcome of the 2014 presidential elections may result in a potential shift of the current business and investment landscape
- Continuous amendments in Investment's Negative List may discourage foreign investors
- Unpredictable and contradictory Government policies and regulations

Appendix



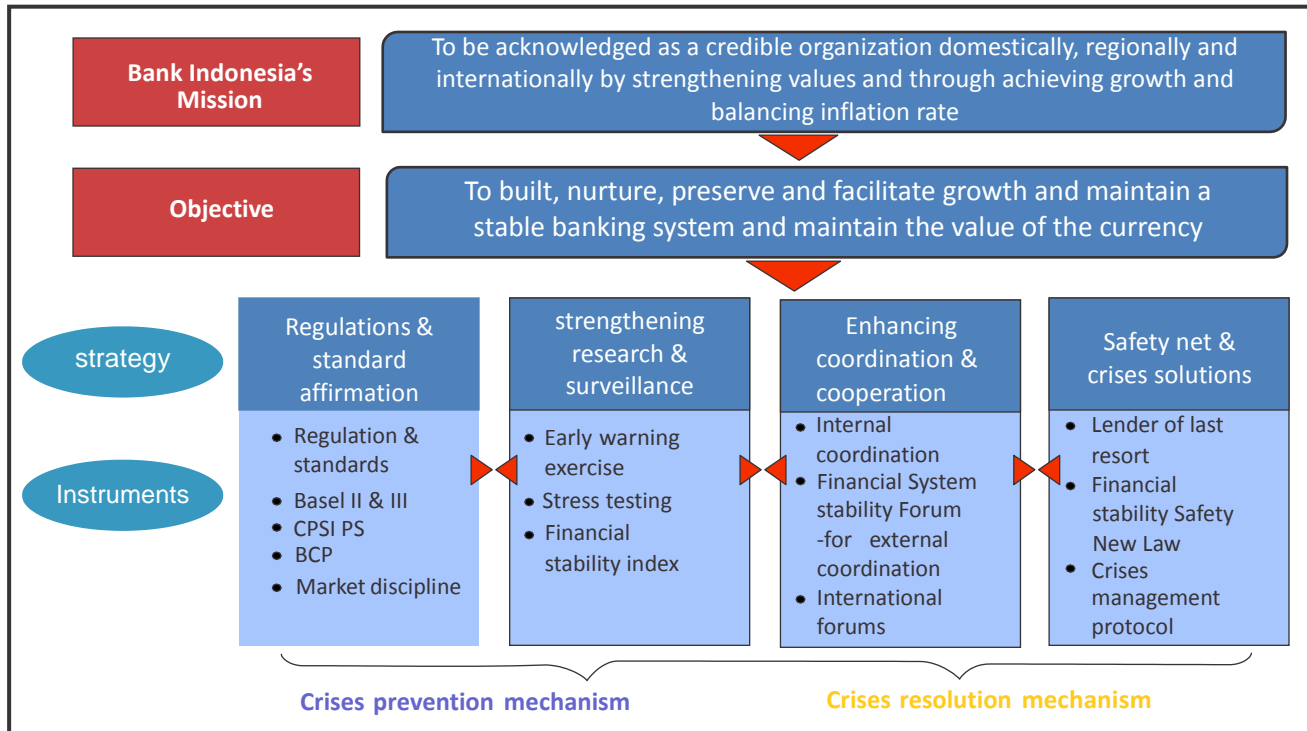
Source: Bank Indonesia

Figure: 19



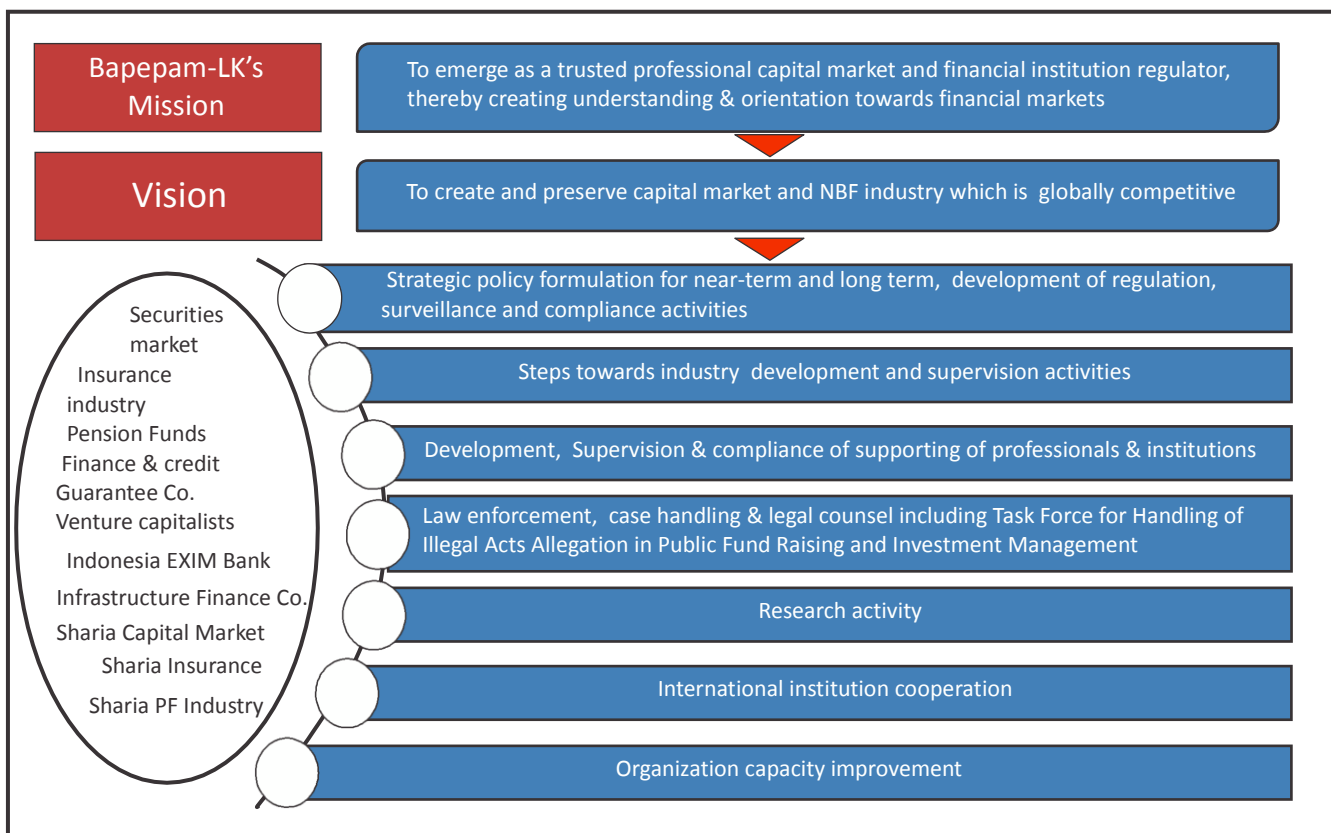
Source: Bank Indonesia

Figure: 21



Source: Bank Indonesia

Figure: 23



Source: Bapepam-LK

Figure: 24

| | 2008 | 2009 | 2010 | Nov 25 th , 2011 | Change (%) YTD |
|---|----------|----------|----------|-----------------------------|----------------|
| Indonesian Composite Index | 1,355.41 | 2,534.36 | 3,703,51 | 3,637.19 | -1.79 |
| Equity Market Capitalization (Trillion IDR) | 1,076.49 | 2,019.38 | 3,247.10 | 3,348.75 | 3.13 |
| Corporate Bonds Outstanding (Trillion IDR) | 73.41 | 88,33 | 115.35 | 131.98 | 14.42 |
| Government Bonds Outstanding (Trillion IDR) | 534.46 | 574,66 | 641.21 | 725.56 | 12.06 |
| Total Securities Market Capitalization to GDP (%) | 33.8 | 47,78 | 62.33 | 65.49 | 5.06 |
| Equity Market Cap to GDP (%) | 21.73 | 35,97 | 50.55 | 52.14 | 3.13 |
| Corp. Bonds to GDP (%) | 1,47 | 1,57 | 1.8 | 2.05 | 14.42 |
| Gov. Bonds to GDP (%) | 10.61 | 10,24 | 9.98 | 11.3 | 13.15 |
| Net Asset Of Mutual Fund (Trillion IDR) | 74.07 | 112,98 | 149.1 | 162.83 | 9.21 |
| Number of Mutual Funds | 567 | 610 | 558 | 647 | 15.95 |
| Number of Issuers: | | | | | |
| Equity (Emiten) | 476 | 491 | 515 | 534 | 3.69 |
| Bonds (Emiten Corporate) | 179 | 184 | 188 | 197 | 4.79 |
| Net Asset Pension Fund (Trillion IDR) | 90,35 | 112.5 | 130.48* | - | 0 |
| Multifinance Asset (Trillion IDR) | 168,5 | 174.4 | 230.3* | 266,46** | 15.7 |
| Insurance Asset (Trillion IDR) | 243.23 | 321.09 | 347.49 | 399.69* | 15.02 |

*) Per Semester II – 2010

**) Per Dec - 2010 unaudited

***) Per Quarter IV-2010 unaudited

Source: Bapepam-LK, Bloomberg, IDX E Monitoring

Figure: 25



Source: Asian Venture Capital Journal

Figure: 26

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