



Aerial view of the world's most populous island, Bungin Island

THE LONG VIEW

Indonesia

Notes from the Road

Interesting stock valuations prompted our recent visit to Jakarta.

Our meetings provided a good example of our analysis of related party transactions in assessing alignment. We explain the considerations.

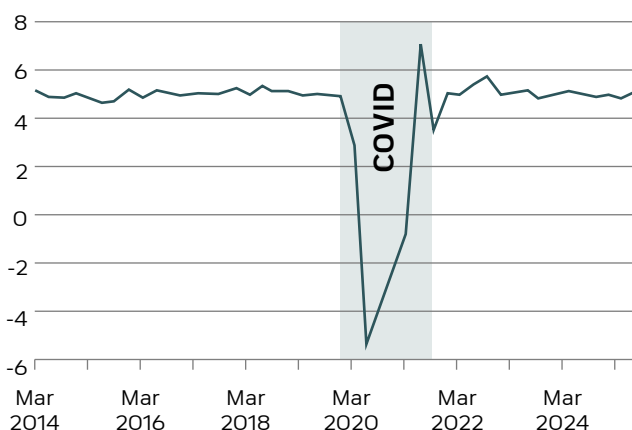
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Indonesia is the world's largest archipelago. Just how large is a matter of some debate. Over the years, estimates of the number of islands have ranged from 13,466¹, according to the country's national mapping agency, to 18,306¹, calculated by their space agency. The difference stems primarily from your exact definition of an island.

Economic statistics in Indonesia have also become a matter of debate. The remarkably consistent 5% real GDP growth of recent years stands in contrast to reports of a shrinking middle class, a declining manufacturing sector and the equity market dropping 36% from its 2024 peak to its 2025 low in USD terms (based on MSCI's Indonesia Index). This culminated in valuations of Indonesia stocks reaching interesting levels, prompting us to visit the capital city Jakarta, earlier this year.

TAKING A BOTTOM-UP LOOK AT THE ECONOMIC DATA

Figure 1: Indonesia Real GDP Growth with % yoy



Source: Bloomberg

THE LONG-TERM CASE FOR INDONESIA

Indonesia is the fourth most populous country in the world, with over 280 million people, and is home to the world's largest Muslim population. The population has been growing at approximately 1% per annum and has a young median age of 31 years². That compares to Japan's median age of 50, South Korea's 45 and China's 40. Demographics should provide a helpful long-term tailwind as the country develops.

Indonesia is also blessed with an abundance of natural resources. Palm oil and coal account for the country's largest exports, and it has the world's largest nickel reserves³ a vital ingredient for electric vehicle batteries.

BLESSED WITH AN ABUNDANCE OF NATURAL RESOURCES

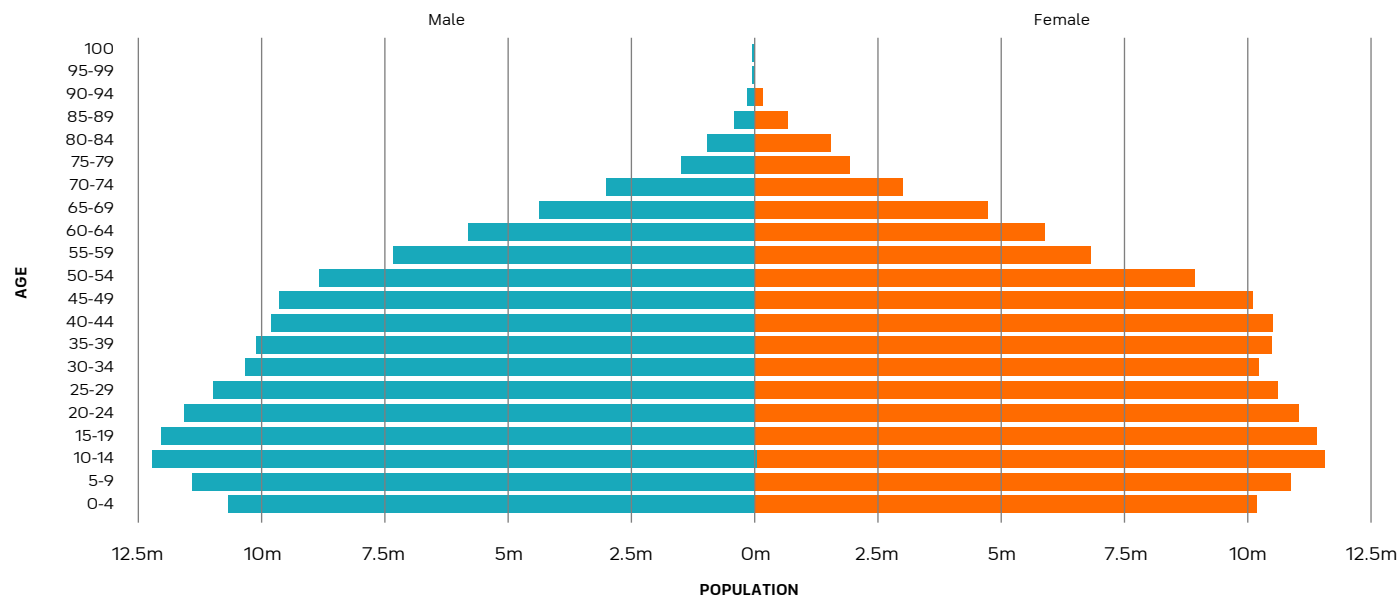
Figure 2: Global Nickel Reserves, 2024³

Indonesia	55.0m
Australia	24.0m
Brazil	16.0m
Russia	8.3m
New Caledonia	7.1m
Philippines	4.8m
China	4.2m
Canada	2.2m

Source: International Nickel Study Group)

ATTRACTIVE LONG-TERM DEMOGRAPHICS

Figure 3. Indonesia's population demographics in 2024



Source: The CIA World Factbook

SO WHY THE MALAISE?

Unsurprisingly for an emerging market, much of the reason why strong fundamentals are not translating into equity returns comes down to politics. Elections in 2024 brought former army general Prabowo Subianto to power. His links to former President Suharto's oppressive regime had seen him banned from entering the United States for many years. However, in the run-up to the election, his adoption of a stray cat that quickly became a social media sensation showed his softer side, helping him to secure the presidency.

Since then, Subianto's policies have raised alarm bells with foreign investors. The creation of a sovereign wealth fund that reports directly to the president has raised fears over the governance of \$900 billion of state-owned assets⁴. His introduction of free school meals and low-income housing programmes, although well-intentioned, exacerbate an already tight fiscal situation. They are not the reforms that are needed to promote investments in manufacturing and strengthen the consumer's purchasing power.



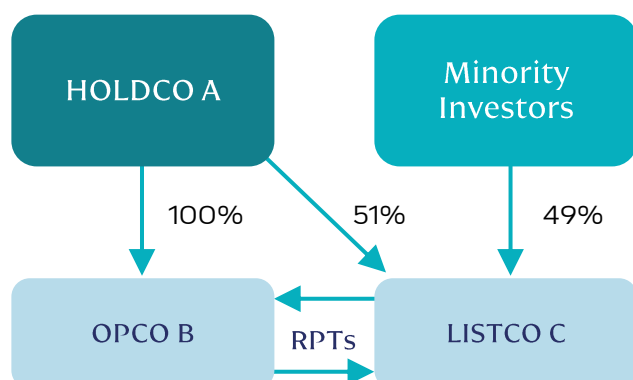
INVESTMENT PHILOSOPHY IN ACTION

We often describe our approach at Skerryvore as bottom-up but macro-aware. Despite this uncertain backdrop in Indonesia, we still believe we can find good quality companies whose franchises have weathered difficult times in the past. Indeed, when the macro worries cause investors to flee it can leave such companies trading at attractive valuations.

Finding the quality companies is the hard part, because the Indonesian corporate sector presents us with some significant challenges. Those familiar with the Skerryvore investment philosophy will know that alignment – between us acting on behalf of our clients, and the owners and managers of the companies we invest in – lies at the heart of our definition of quality.

One check on alignment is related party transactions (RPTs). These are common in emerging markets. For example, a family that has success in one business then has the capital to be successful in others. The result is a business empire encompassing multiple companies in different segments, sometimes owned by different family members or management personnel. Companies within this network may have cause to do business with one another, which is what we refer to as a related party transaction.

Figure 4. Example of how related party transactions can disadvantage minority investors.



It's not just family ownership that can give rise to RPTs. They can also occur with the listed subsidiaries of multinational corporations. In either case, a potential conflict of interest arises because of differing ownership levels. Figure 3 shows that the economic interest of Holdco A is biased towards Opco B, rather than the entity that we can invest in, Listco C. All else being equal, this creates an incentive to make the economics of any transaction between the two entities favour Opco B at the expense of Listco C, where we would sit as minority investors.

EXAMPLES OF RPTs

RPTs are common in Indonesia. Their mere presence immediately raises questions. We came across many examples that we sought to address in our meetings in Jakarta to clarify the risks that they present for minority investors. They generally fall into three buckets:

Figure 5. Types of Related party Transactions

Related Party Transaction	Example	Analysis Needed
Purchases or sales of products or services by the Listco from or to a business owned by a related party	The Listco sells a product whose brand is held outside the Listco by a related party, resulting in a royalty payment from the Listco to the related party	Has the royalty rate changed over time? What investments does the related party make to support the brand?
Acquisitions by or divestitures to the Listco from a related party	The Listco has acquired a stake in a subsidiary of the related party	How was a fair price determined for this transaction? Did minority investors get to vote on the transaction? Is the transaction the right strategy for the Listco?
Loans or guarantees made between the Listco and the related party	The Listco has been funded through a loan from a related party	What are the terms of the loan? Is this another way for the related party to extract cash flows from the Listco?

We could list many more examples. In the majority of cases, they are clearly disclosed with a governance structure that attempts to protect minority investors. However, they still represent a misalignment of interests and lead to complex or opaque financial statements.

A recent example came when the controlling shareholder of Indonesia's leading consumer food business, Indofood, pushed through the \$3 billion acquisition of Pinehill Company, a Middle Eastern manufacturer of noodles. Pinehill itself was controlled by the same shareholder, making it a related party transaction. The deal was done at a price that many minority shareholders struggled to justify. As shareholders began to voice their disapproval the board reversed a decision to allow the related party that controlled 80% of the votes to participate in the voting for the transaction, helping to get it over the line.

At their worst RPTs can be used to hide a convoluted ownership structure that seeks to maintain control and hide the true economics of a business. One of the most notorious examples of this was Enron, the US energy giant that collapsed in a fraud created via a web of special purpose entities and related party transactions. More recently, Luckin Coffee, a fast-growing US-listed Chinese coffee chain, was revealed to have used over 40 related parties to create fake coffee orders, resulting in inflated revenues and profits⁵.

INDONESIAN TAKEAWAYS

The management teams we met in Indonesia were often perplexed by our focus on RPTs over their latest update on short-term earnings. They explain that they've always done this and that they are not making money from the RPTs. Perhaps that's true today, but our point is that their existence creates an opportunity that can be exploited when needs must.

Thankfully, not all companies shared that attitude. We have long admired Bank Central Asia (BCA), the largest private bank in Indonesia, which has built a culture of trust with customers, employees and shareholders alike. BCA has a strong balance sheet and a conservative attitude to risk, positioning the bank to benefit from the huge potential for credit penetration as the Indonesian corporate and consumer sectors continue to develop. We were also impressed by an up-and-coming branded consumer company that has combined innovation with the Indonesian consumer's growing need for value for money.

We still left Indonesia feeling a little frustrated. The long-term opportunity is plain to see and some compelling valuations are now available. However, weak corporate governance continues to restrict the size of our investible universe and will continue to limit our exposure in the strategy.

1 <https://news.mongabay.com/2017/01/indonesia-adds-more-than-1100-to-the-official-tally-of-its-islands/>

2 CIA.gov. The World Factbook. Country comparisons: Median age: <https://www.cia.gov/the-world-factbook/field/median-age/country-comparison>; Indonesia: <https://www.cia.gov/the-world-factbook/countries/indonesia/#people-and-society>

3 International Nickel Study Group. The World Nickel Factbook 2024. https://insg.org/wp-content/uploads/2024/09/publist_The-World-Nickel-Factbook-2024.pdf

4 FT Article: <https://www.ft.com/content/543c2fb5-b447-4762-bccc-57ffcc54df39>

5 <https://www.caixinglobal.com/2020-10-13/related-parties-helped-luckin-coffee-fake-123-million-transactions-101613963.html>

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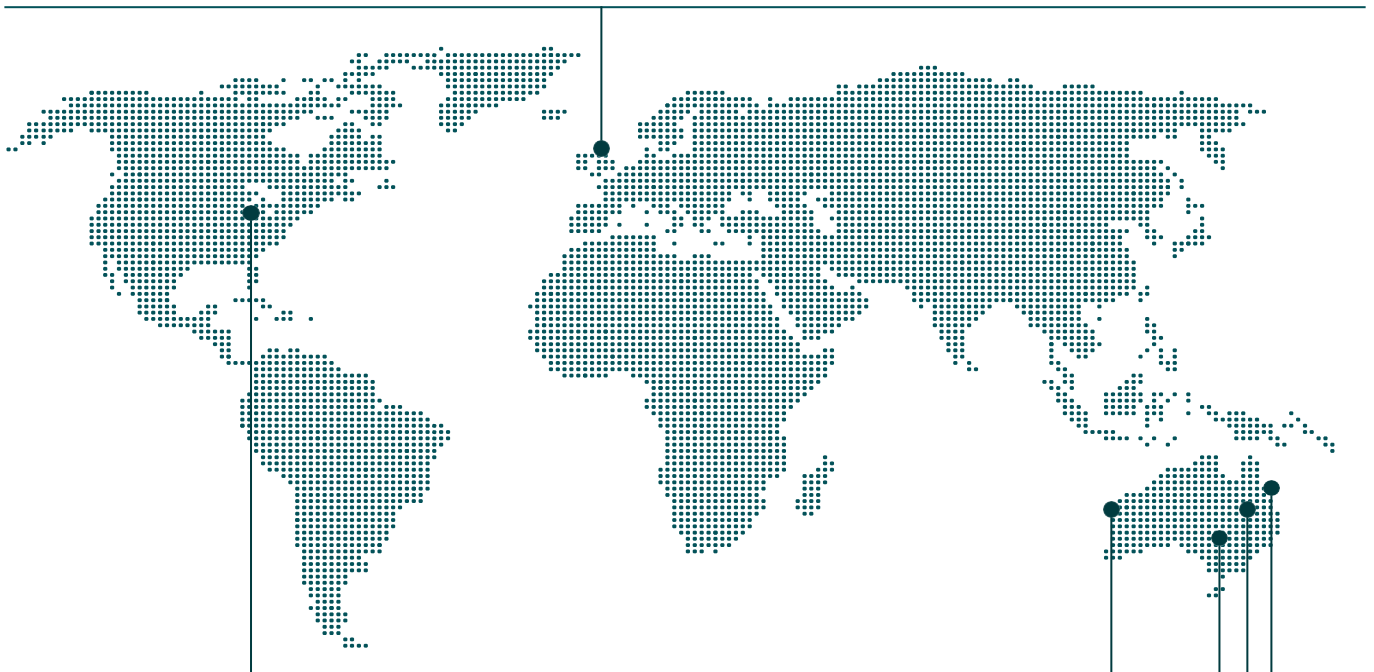
45 Charlotte Square, Edinburgh EH2 4HQ
clients@skerryvoream.com

Charles Oldmeadow
Head of Distribution

Charles.Oldmeadow@skerryvoream.com
+44 (0) 131 202 3092

Ciara Egan
Reporting and Marketing Analyst

Ciara.Egan@skerryvoream.com
+44 (0) 131 202 3079



OUR GLOBAL DISTRIBUTION PARTNERS

FRONTIER ONE LLC - USA

1033 Skokie Boulevard, Suite 260
Northbrook, IL 60062

Jason Ciaglo
jciaglo@frontieronellc.com

Bill Forsyth
bforsyth@frontieronellc.com

BENNELONG - AUSTRALIA

Level 21, 20 Bond Street, Sydney NSW 2000

Bennelong House, 9 Queen Street
Melbourne VIC 3000

Level 38, Riparian Plaza
71 Eagle Street, Brisbane QLD 4000

Level 1, 81 Stirling Highway
Nedlands, Perth WA 6009
client.experience@bennelongfunds.com