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Medco Energi Internasional

In late 2004, Hilmi Panigoro, President and CEO of Indonesian oil and gas company PT Medco Energi Internasional Tbk, and his brother Arifin, who had founded the company back in 1980, faced a difficult challenge: how to regain majority control of the company, which they had lost five years before. They had only until February 14, 2005 to put together a deal, or else a controlling stake in Medco would be sold to a new owner.

Over its 24 years in existence, Medco had grown to be the largest domestic oil company in Indonesia with annual revenues of $550 million. The company went public in 1994 but remained majority-owned by the Panigoro family until 1999, when a liquidity crunch caused by the Asian financial crisis pushed Medco to the brink of insolvency. The Panigoros were able to restructure Medco's debt, but the restructuring came at the expense of losing majority control of the company to Credit Suisse First Boston (CSFB) and to Thai state-owned oil company PTT Exploration and Production (PTTEP).

In October of 2004, Temasek Holdings, the Singapore Government's investment arm, made an attractive offer to CSFB and PTTEP for the majority of their combined stake, which would give Temasek effective control of Medco. The Panigoros had a right of first refusal, but had only four months to raise the capital needed to head off Temasek's bid.

In January 2005, the Panigoros, along with bankers from Merrill Lynch and United Overseas Bank (UOB), devised an innovative two-stage financing plan: a leveraged buy-out, to be followed by a secondary equity offering that would enable the family to repay the debt while retaining an ownership stake just above 50%.

With time running out, the Panigoros had to quickly decide: Was the Merrill Lynch-UOB plan too risky? Or should they allow Temasek to take over as majority owners—and, most likely, as managers too—and content themselves with a passive minority shareholder's role? Or maybe they too should sell their stake to Temasek and simply walk away?

Professor Belén Villalonga, Professor Raphael Amit of the Wharton School, and Research Associate Chris Hartman prepared this case. Access to the company was facilitated by the Asia-Pacific Research Center. HBS cases are developed solely as the basis for class discussion. Cases are not intended to serve as endorsements, sources of primary data, or illustrations of effective or ineffective management.

The Indonesian Petroleum Industry

Oil was first produced commercially by Dutch-owned companies in Indonesia—at the time a Dutch colony—in 1885. A member of the Organization of Petroleum Exporting Countries (OPEC) since 1962, in 2004 Indonesia was the world's 17th-largest oil producer (accounting for about 2% of world production) and remained the only OPEC member in Asia. It was also the world's sixth-largest natural gas producer and the leading exporter of liquefied natural gas.[i] After peaking in 1981, petroleum's relative importance to the Indonesian economy had declined. A sharp production slowdown, exacerbated by a decline in exploration investment that coincided with the Asian financial crisis, began in 1998. Investment in oil exploration dropped from $2 billion in 1998 to $300 million in 2004, when, for the first time, Indonesia became a net oil importer.[ii]

The Government of Indonesia owned all oil and other hydrocarbons in the ground. Until 2001, however, most oil exploration and production in Indonesia was done by private firms under Production Sharing Contracts (PSCs) with the state-owned petroleum company Pertamina. In 2001, a new Oil and Gas Law was enacted to deregulate the industry over a six-year period. Under the new regime, Pertamina was forced to compete with private-sector oil companies in both the upstream (exploration and production) and downstream (refining, transport, and marketing) businesses, although it continued to be 100% state owned.

Medco's History

In 1980, Arifin Panigoro founded the Meta Epsi Pribumi Drilling Co., or "Medco," the first-ever Indonesian-owned oil drilling contractor. Panigoro had worked as a self-employed electrician and welder since graduating from the Bandung Institute of Technology in 1973, and saw opportunities in the oil business while doing repair and maintenance work on drilling rigs. In 1980, at the height of a global oil boom, Panigoro decided to get into the oil drilling business himself. Helped by the Indonesian central bank and Pertamina, he persuaded the Japanese trading house Nissho Iwai to guarantee a $4.5 million loan. With the loan and $300,000 of his own money, Panigoro traveled to the United States and bought a second-hand drilling rig from a U.S. drilling company.

Over the next three years, Panigoro expanded Medco's fleet to four rigs and, in 1984, began drilling offshore using a submersible swamp barge rig designed for use in shallow waters. Contract drilling proved lucrative. "We worked, and five or six years later we were the biggest drilling company in Indonesia. We had a controlling market share." Panigoro recalled. But as a drilling contractor, his company was paid a flat daily rate. It saw none of the huge profits that came along with a major oil discovery. At the time, Panigoro wondered, "Now that we know more about oil, can we go further, into exploration?" In 1992, Medco purchased drilling rights from the U.S. firm Tesoro for an oil field in Kalimantan (Borneo). The production was small, about 5,000 barrels a day, but now, for the first time, in addition to providing drilling services to foreign oil companies, Medco was producing and selling its own oil.

In October 1994, Medco went public on the Jakarta Stock Exchange as PT Medco Energi Corporation Tbk., becoming the first Indonesian oil and gas company to trade publicly.[1] Public investors held 21.7% of the new corporate entity, while the Panigoro family retained the remaining 78.3% ownership through several holding companies. Between 1994 and 1998, the family trimmed its stake only slightly, from 78.3% to 76.6%, with the remainder held by the public.

[1] PT" stands for Perseroan Terbatas, which translates as "Limited Liability Company" in the Indonesian language, and "Tbk." is short for "Terbuka," which literally means "open" and indicates that the company is publicly traded.

Throughout the 1990s, Medco continued to expand its new business in oil and gas exploration and production. The company bought oil drilling rights on the island of Sumatra from Exxon and Mobil Oil in 1995 and made a major oil discovery there in 1996. In 1997 Medco entered the downstream petroleum processing arena, signing an agreement with Pertamina to operate a methanol plant on Bunyu Island. At the plant, natural gas piped from the nearby Medco gas field on Tarakan Island was converted to methanol, a type of liquid alcohol with a variety of industrial uses. **Exhibit 1** shows a map of Medco's working areas in Indonesia.

By the late 1990s, the company that had started out drilling oil owned by others had transformed itself into the largest domestic oil and gas producer in Indonesia. Forty-nine percent of Medco's 1997 revenues came from oil and gas sales, while 36% came from the original business, drilling services, and another 15% from its newest business, the management of the Bunyu methanol plant. **Exhibit 2** summarizes the major milestones in Medco's history.

In June 1998, with Indonesian politics in flux, Arifin Panigoro left the post of President Commissioner (equivalent to Chairman) of Medco to enter the political arena. He was elected to parliament the following year. After Arifin's departure, Medco's CEO, a professional manager who was not part of the Panigoro family, moved up to chairman, and Arifin's younger brother Hilmi was appointed CEO. Hilmi had joined Medco in 1997 after a long career in Indonesia as a petroleum geologist and executive with the U.S. oil company Huffco (later Vico). Arifin insisted that Hilmi was the best person for the job, regardless of family connections. In fact, Arifin made a point of telling people that he didn't want Medco to be run as a family business. "This is something that I have to tell new people that we recruit," he said. "We want professionals, the best people in the world. Maybe today it is my brother, but tomorrow it is somebody from Alaska, or somebody from London. We don't want to have the family enter the management. As an owner, yes. My sister is on the board. As for the management itself, it is professional." Management also included CFO Soegiharto, who in 2005 became Indonesia's Minister of State Owned Enterprises.

The Panigoros Lose Control of Medco

The Asian Financial Crisis

The Asian financial crisis began in the spring of 1997 with a speculative attack on the Thai baht that eventually forced the Thai central bank to devalue the currency on July 2nd. The devaluation instantly increased the indebtedness of Thai companies with loans denominated in dollars, pushing many of them into default. Panicked investors moved quickly to get their capital out of Thailand, which only worsened the crisis, and before long foreign investors had lost confidence in the entire region. To illustrate the pace of the crisis, in 1996, $93 billion in foreign capital flowed into Indonesia, Malaysia, the Philippines, South Korea, and Thailand. In 1997, $12 billion flowed out—a $105 billion reversal in one year.[iii] The contraction devastated the economies of the region, threw millions of people into poverty, and led to widespread social unrest. In Indonesia, where the poverty rate rose from 10% in 1994 to as high as 40% in 1998, the crisis toppled the government.[iv]

In August 1997, the Indonesian Rupiah came under attack from speculators, and the currency lost 30% of its value in two months. By January of 1998, the Rupiah had declined another 55% and Indonesians faced higher prices, food shortages, and increasing unemployment. Citizens took to the streets to denounce President Suharto for agreeing to an International Monetary Fund bailout plan that reduced government subsidies and raised food prices by 80%. In May 1998, following another round of food and energy price hikes, Indonesian troops fired on peaceful student protestors in

Jakarta, killing six. A week of riots followed across the country, prompting parliament to force Suharto from office and end his 33-year rule.

The Effects of the Crisis on Medco

Medco's 1998 Annual Report spelled out the effects of the Asian Financial Crisis on Indonesian businesses: declining liquidity, volatile exchange and interest rates, declining share prices, tightening credit, and a slowdown in construction projects. But as the financial crisis spilled onto the streets of Jakarta and Suharto was ousted, Medco pressed ahead. The company boosted annual oil production from 4.4 million to 11.7 million barrels, improved efficiency at the Bunyu methanol plant, and kept its five offshore drilling rigs running non-stop all year. However, this effort was not enough to overcome some serious headwinds: sharply reduced demand for onshore drilling services and lower oil and methanol prices. Overall, revenues declined 17% in U.S. dollar terms, from $225 million in 1997 to $187 million in 1998.

One major challenge faced by many Indonesian companies was their dollar-denominated debt, which often was not hedged against currency risk because, until September 1997, the Indonesian Rupiah had been linked to the dollar. Working in Medco's favor was the fact that, even though it had over $200 million in outstanding dollar-denominated debt, as an oil producer, 95% of its cash flow came in dollars, and its cash flow remained strong compared to other Indonesian companies.

But to international creditors, such details were of lesser importance. Their mandate was to get their money out of Indonesia as soon as possible. Finding it impossible to borrow money on a short-term basis, Medco was forced to finance operations with its own cash flow, which left the company no cash to service its debts. By 1999, Medco had $216 million in unsecured debt and the company was failing to maintain the financial ratios required by loan covenants.

In response, Medco slashed costs, stopped hiring, and laid off foreign workers. But Medco's creditors could not be assuaged. As Hilmi recalled, "Most financial institutions before the crisis were queuing in front of the CEO's door begging us to take their money. When [the crisis] came they simply came and said 'We want our money back.' We had no choice: we had to restructure."[v]

The Debt for Equity Swap

In 1999, CSFB, whose distressed debt subsidiary had been buying up Medco's debt from anxious creditors for pennies on the dollar, approached the Panigoro family with a restructuring proposal. In exchange for canceling $150 million of debt and refinancing an additional $66 million, CSFB would take a majority ownership stake in Medco.

The two sides inked the deal in November of 1999. Medco issued 379,236,000 new shares at a price of IDR 3,500 per share in an 11:10 rights issue. Under the terms of the rights issue, existing shareholders could buy 11 new shares for every 10 shares they owned currently. As directed by the restructuring agreement, the Panigoros immediately transferred to CSFB all their rights to acquire new Medco shares. Rather than owning the Medco shares directly, CSFB set up a holding company called New Links Energy Resources, which owned 85.44% of Medco equity. CSFB owned 59.9% of New Links, with the remaining 40.1% held by the Panigoros through a vehicle called Encore Ltd. The arrangement gave CSFB a 51% stake in Medco, while the Panigoros retained just 37% (34% through New Links plus 3% directly).

PTTEP Buys Part of CSFB's Stake in Medco

On December 12, 2001, CSFB sold a 40% stake in New Links, representing 34% of Medco, to PTTEP, a subsidiary of the state-owned Thai oil company, PTT, for $223.32 million.[vi] The sale represented a 250% return on CSFB's investment and left CSFB with a 17% stake in Medco.[vii] Meanwhile, the Panigoros continued to own 37%, and the remaining 12% was held by the public or as treasury shares. **Exhibit 3** shows Medco's ownership structure before the restructuring and after the entry of CSFB and PTTEP as major shareholders.

As the Indonesian economy recovered, Medco continued to explore for oil and gas throughout Indonesia, acquiring new exploration blocks and concluding joint exploration agreements with other firms. Its drilling services subsidiary Apexindo expanded its drilling fleet to five offshore and nine onshore rigs and executed a successful initial public offering on the Jakarta Stock Exchange in 2002, with Medco retaining 77.5% of the equity. In 2004, Medco entered the power generation business, opened a new Liquefied Petroleum Gas plant in South Sumatra, and even pulled off a $250 million hostile takeover of Novus Petroleum, an Australian oil company with operations around the world.

2004: Medco in Play

During the summer of 2004, rumors began circulating that CSFB and PTTEP were looking to sell their stakes in Medco. PTTEP had decided to focus solely on oil production within its home country of Thailand. For CSFB, it had been a purely financial play all along and, with Medco seemingly back on track, it now looked like a good time to cash in. **Exhibits 4, 5, and 6** show Medco's financial statements for the period 1994-2004. Exhibit 4 also reports Medco's 1P (proven) and 2P (proven and probable) reserves.[2] **Exhibit 7** shows the evolution of Indonesian and regional stock market indices over the same period.

Temasek's offer

By the fall of 2004, CSFB and PTTEP were entertaining offers from three state-owned foreign firms: Indian Oil Corporation, PetroChina, and Temasek Holdings. Temasek had been organized in 1974 by the Singapore Ministry of Finance, which remained its sole shareholder.[3] Temasek's CEO and executive director in 2004 was Ho Ching, the wife of Prime Minister Lee Hsien Loong, who was also the son of Singapore's first Prime Minister Lee Kuan Yew. Temasek held ownership stakes in public and private companies in a wide variety of industries, within as well as outside of Singapore. Its global investment portfolio at the time of the Medco offer was worth S$90 billion (US$53.4.billion), with annual revenues in 2003 of S$56.5 billion (US$33.5 billion).[viii]

On October 14, 2004, PTTEP and CSFB announced that they had selected Temasek as the preferred bidder for a 44.9% stake in New Links, which represented a 38.4% stake in Medco. Medco shares closed the day at IDR 2,050 per share, up 17% from the previous day's close of IDR 1,750. Temasek's offer price was later disclosed to be approximately IDR 1,840 per share, or $257.7 million. **Exhibit 8**

[2] According to international petroleum reserves reporting standards adopted by the Society of Petroleum Engineers, oil and gas reserves are classified according to the probability that the indicated quantity is commercially recoverable. The classification "1P" or "proven" means that there is at least a 90% chance of recovering the indicated quantity. The classification "2P" or "proven plus probable" means that there is at least a 50% chance of recovering the indicated quantity. Medco converts its gas reserves into barrels of oil equivalent (BOE) at the rate of 5,850 cubic feet of gas per barrel of oil.

[3] "Temasek" means "sea town" and is the historical name of old Singapore.

shows the evolution of Medco's share price and volume since it started trading. Under the plan, Temasek was to buy 324 New Links shares from PTTEP and the remaining 125 shares from CSFB.[ix]

If the Temasek bid went through, Hilmi and Arifin would almost surely lose control of the company they had built. They had only four months, until February 14, to exercise their pre-emptive rights to block Temasek's bid and buy out PTTEP and CSFB themselves.

The Panigoros' Response

On November 3, 2004, Hilmi Panigoro announced that his family would fight Temasek's bid.[x] Yet, with a 34% stake in Medco that was at the time worth about $290 million, they had difficulty finding a bank that would lend them the capital needed to outbid Temasek. After several attempts to arrange financing for a counter-offer, Hilmi and Arifin Panigoro came up with a two-stage plan: a leveraged buy-out (LBO) followed soon after by a secondary equity offering. Because the company's free-float at the time was only 5%, the offering would actually amount to a "re-IPO."

The plan was for the Panigoro family, through their investment vehicle Encore Ltd., to borrow money to buy out CSFB and PTTEP and regain control of Medco. Then, after a few months, the Panigoros would sell to the public a portion of their Medco shares at a price that would enable them to use the proceeds to pay off the loan, while retaining majority ownership of the company.

To raise the $478 million needed to buy out CSFB and PTTEP, the Panigoros turned to two partners: Singapore-based United Overseas Bank (UOB) and Merrill Lynch. UOB investment bankers Ati Sugiharti and Michael Sng provided a hard commitment and agreed to lend $278 million to the Panigoros, collateralized on a pro-rata basis with the shares that Encore held in Medco through New Links. Meanwhile Merrill Lynch investment bankers Soofian Zuberi (Harvard MBA 1998) and Roger Suyama began working the phones and setting up meetings with potential investors to raise the remaining $200 million.

Medco played a leading role in the process by orchestrating the two sides of the facilities, which were different in nature. UOB's loan was more direct, with a structure commonly used for equity financing, while Merrill Lynch's facility was structured as a syndicated loan to attract fund managers and high-yield emerging markets creditors. To bridge the different requirements set by the bankers, Medco took the lead in synchronizing the requirements into one interconnected facility agreement, and arranging the pro-rata sharing of the collateralized securities.

The Merrill Lynch team approached a select group of sophisticated lenders and discussed various ways to address risks of lending directly to the Panigoro family and prospects that the equity offering would actually happen as planned. In fact, the whole deal really hinged on the success of the offering. Zuberi believed that concentrating decision-making in the hands of a single leader with a growth strategy hinging upon undervalued assets like Apexindo, the drilling company, the market would eventually recognize the as-yet unrealized value of the company. With three parties at the table for every single management decision (CSFB, PTTEP, and Medco), merely agreeing on where value might be realized was itself often too cumbersome a process.

Merrill Lynch's optimistic view was supported by their valuation of the company. A sum-of-the-parts analysis of Medco's discounted future cash flows, summarized in **Exhibit 9**, suggested a Net Asset Value of $1,113 million, well above the equity value implied by its stock price. **Exhibits 10a and 10b** provide information about comparable companies.

The two bankers' sales job was successful. They assembled a syndicate of nine lenders to provide a $175 million loan, also collateralized with Encore's Medco shares plus another $25 million cash in exchange for Medco equity.

The transaction was divided into two tranches. Tranche A, worth $125 million, matured in two years and came with a floating interest rate of LIBOR plus 10%, rising to LIBOR plus 10.5% in the second year. Tranche B, worth $50 million, came with a floating interest rate of 7% plus LIBOR, rising to 7.5% plus LIBOR in the second year.

To sweeten the deal for the Tranche B lender, Merrill Lynch offered an equity kicker in the form of call options on up to $10 million worth of Medco shares. If the lender exercised the options, Encore would pay the lender the difference between the settlement price, defined as the volume-weighted average price of a Medco share over the prior 10 days, and the base price of $0.1987 per share. When Medco officials expressed concerns about an uncapped option, Merrill Lynch put in place a maximum settlement price of 150% of the base price, limiting the equity upside to 50%.

Of the $478 million in total financing, $343.5 million was to be used to buy out the other two owners in New Links: $114.1 million for CSFB and $229.4 million for PTTEP. The remaining $134.5 million would be held in escrow and used to pay interest on the loan until the principal was repaid with the proceeds of the equity offering.

With no time left to consider alternative financing plans, Hilmi and Arifin Panigoro had to decide whether to go ahead with the plan or lose control of Medco to Temasek. From the beginning, the Panigoro brothers always believed in Medco's growth potential. However, the loan had a very high cost, and there was no guarantee that the "re-IPO" that would enable them to repay the loan could be completed in a timely fashion. After all, this would be the first equity offering involving a private-sector firm in Indonesia since the Asian financial crisis, and investors might prove reluctant to sign on.

Notes

[i] U.S. State Department, Bureau of East Asian and Pacific Affairs, "Background Note: Indonesia," http://www.state.gov/r/pa/ei/bgn/2748.htm, accessed March 2006.

[ii] "Indonesia: A Self-Imposed Oil Drought," *Asiamoney,* November 2005, via ProQuest, ABI/Inform, www.proquest.com, accessed March 2006.

[iii] Nicholas Kristof with David Sanger, "How U.S. Wooed Asia to Let Cash Flow In," *New York Times on the Web,* February 16, 1999, http://www.nytimes.com/library/world/global/021699global-econ.html, accessed April 2006.

[iv] PBS, *Frontline,* "Timeline of a Panic," June 1999, http://www.pbs.org/wgbh/pages/frontline/shows/crash/etc/cron.html, accessed April 2006.

[v] Chris Leahy, "Medco Shows the Way Ahead for Indonesia," *Euromoney,* March 28, 2005, via Factiva, accessed April 2006.

[vi] "PTTEP in Indonesia—Medco Purchase Now Completed," *The Nation* (Thailand), December 14, 2001, via Factiva, accessed April 2006.

[vii] "Special Report: Stars of Asia: Financiers," *Business Week,* June 9, 2003, p. 55.

[viii] Siti Rahil, "Singapore's State Investment Firm Files First-ever Public Annual Report," Knight Ridder Tribune Business News, October 12, 2004, via ProQuest, ABI/Inform, www.proquest.com, accessed April 2006.

[ix] "Medco Deal in Doubt," *International Petroleum Finance,* December 10, 2004, via ProQuest, ABI/Inform, www.proquest.com, accessed April 2006.

[x] Edhi Pranasidhi and Linda Silaen, "Indonesia Encore To Buy Back Medco Shares From New Links," *Dow Jones International News,* November 3, 2004, via Factiva, accessed May 2006.

Exhibit 1 Medco Energi Working Areas in Indonesia, 2004

Legend: Exploration and Production Methanol Plant LPG Plant Power Plant

Source: Company documents.

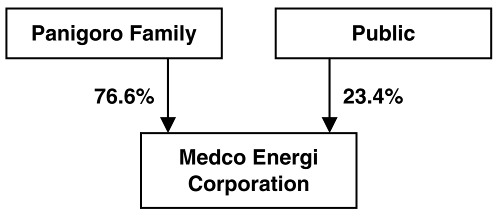
Exhibit 2 Milestones in Medco's History

1973	Arifin Panigoro graduates from the Bandung Institute of Technology and begins working as a self-employed electrician.
1980	Arifin Panigoro founds Meta Epsi Duta Company (Medco), Indonesia's first private sector drilling services contractor.
1984	Medco begins contract drilling for oil offshore.
1992	Medco enters the oil exploration and production business, acquiring a small oil field on the island of Borneo from the U.S. firm Tesoro.
1994	Initial public offering of 22% of Medco Energi Corporation on the Jakarta Stock Exchange raises $64 million. The Panigoro family retains a 78% stake.
1995	Medco acquires drilling rights on the island of Sumatra.
1996	Medco discovers the huge Kaji / Semoga oil field on Sumatra.
1997	Medco begins operating a methanol plant in Bunyu Island owned by Pertamina.
1998	Asian monetary crisis forces many Indonesian firms into bankruptcy.
	Arifin Panigoro leaves post as Medco's President Commissioner and enters politics. His brother Hilmi Panigoro takes over as CEO.
1999	Arifin Panigoro is elected to parliament.
	Medco restructures $216 million in debt with a debt-for-equity swap that makes CSFB the majority owner of Medco. Panigoro family ownership is reduced to 37%.
	Medco Energi Corporation is re-named Medco Energi Internasional.
2000	Medco acquires three new exploration blocks on the islands of Java, Sulawesi, and Borneo.
2001	CSFB sells a 34% stake in Medco to the Thai oil company PTT Exploration and Production (PTTEP).
2002	IPO of Medco's drilling services subsidiary Apexindo on the Jakarta Stock Exchange.
2003	Medco enters joint venture with Australian firm Santos to explore for oil at Jeruk, off the coast of Java.
2004	Medco opens new Liquefied Petroleum Gas plant on Sumatra.
	Begins co-managing a gas-fired power plant on Batam Island.
	Acquires Australian oil exploration and production firm Novus Petroleum Ltd.
	Major shareholders PTTEP and CSFB announce intention to sell their stakes in Medco Energi to Temasek Holdings.
	Hilmi Panigoro announces intention to counter Temasek's offer.

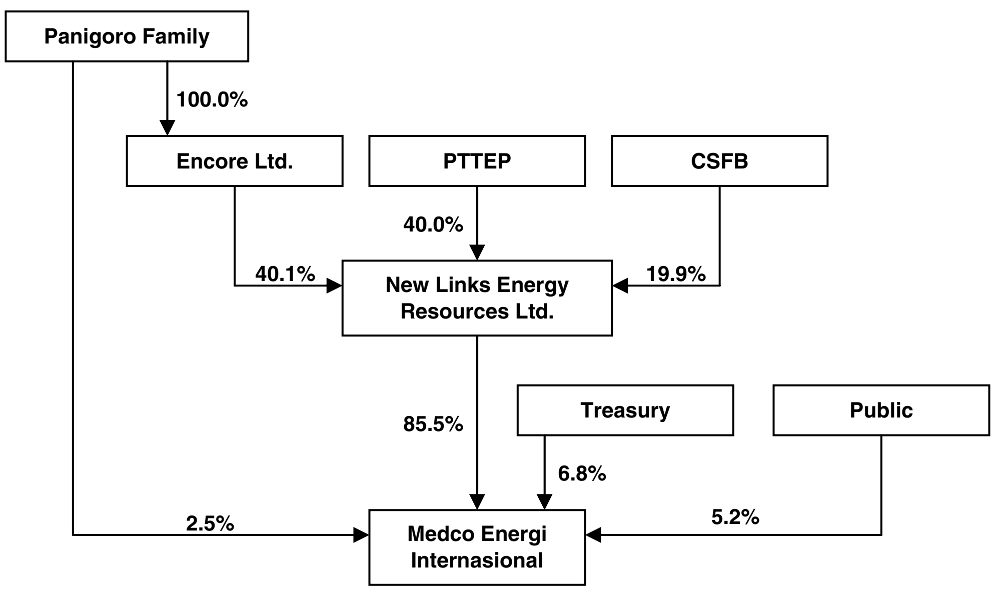
Source: Casewriters.

Exhibit 3 Medco Energi Ownership Structure Before and After the 1999 Restructuring

A. 1998: Pre-restructuring



B. 2002: Sharing ownership with CSFB and PTTEP



Source: Company documents.

Exhibit 4a Medco Energi Balance Sheets 1994–1998 (in $ thousands, as of Dec. 31)

	1994	1995	1996	1997	1998
ASSETS					
Cash and cash equivalents	17,022	27,203	74,511	16,859	15,319
Short-term investments	-	-	-	-	647
Notes receivable	-	4,950	4,196	-	-
Accounts receivable	11,363	44,580	40,114	79,037	52,076
Inventories	11,258	16,822	23,072	28,670	25,080
Prepaid taxes	652	738	3,921	3,867	4,087
Prepaid expenses and deposits	856	2,298	5,668	4,257	947
Total Current Assets	**41,151**	**96,592**	**151,481**	**132,689**	**98,157**
Property & Equipment, Net	**80,608**	**78,981**	**95,351**	**70,755**	**60,474**
Oil & Gas Properties, Net	**15,108**	**98,886**	**125,373**	**173,290**	**196,745**
Leased Assets, Net	**258**	**-**	**-**	**-**	**-**
Security deposits	16,044	4,103	3,752	53,214	57,628
Project advance payments	-	-	-	3,864	1,029
Deferred stock issuance cost	2,870	2,178	1,552	509	130
Restricted cash in banks	-	-	1,730	2,333	2,622
Long-term accounts receivable	-	-	-	-	35,713
Deferred tax assets - net	-	-	-	-	2,405
Other assets - net	352	860	6,333	8,770	1,785
Total other assets	**19,266**	**7,141**	**18,077**	**68,691**	**101,310**
Total Assets	**156,392**	**281,600**	**390,283**	**445,425**	**456,686**
LIABILITIES AND STOCKHOLDERS' EQUITY					
Short-term borrowings	9,582	45,564	159,179	45,739	23,015
Accounts payable	5,465	10,245	42,643	53,629	46,793
Accrued expenses	420	2,372	1,120	1,029	3,570
Current maturities of long-term liabilities	12,654	16,627	37,885	16,532	117,758
Lease liabilities	80	49	37	29	39
Swap liabilities	-	-	-	-	56,478
Total current liabilities	**28,202**	**74,858**	**240,863**	**116,958**	**247,654**
Taxes	-	-	-	-	11,129
Long-term debt	-	70,000	13,239	140,271	48,508
Property and equipment purchase contracts	31,227	24,308	-		610
Lease liabilities	96	11	10,151	21,304	19
Swap liabilities	-	-	-	38,705	-
Other long-term liabilities	34	23	48	30	-
Total long-term liabilities	**31,358**	**94,342**	**23,439**	**200,310**	**60,267**
Negative goodwill, net	**392**	**8,010**	**7,366**	**3,576**	**1,955**
Minority interest in subsidiaries	**4,042**	**4,737**	**6,141**	**5,602**	**6,625**
Capital stock, net of treasury stock	46,091	43,934	72,337	37,071	21,480
Additional paid-in capital	33,500	31,932	1,141	585	339
Revaluation increment in property and equipment	1,384	1,319	1,278	655	379
Foreign exchange translation adjustments	766	2,293	4,497	45,232	57,842
Retained earnings	10,657	20,175	33,221	35,435	60,145
Total stockholders' equity	**92,398**	**99,653**	**112,474**	**118,978**	**140,186**
Total Liabilities and Stockholders' Equity	**156,392**	**281,600**	**390,283**	**445,425**	**456,686**
Note: Figures converted from Rupiah to dollars using end-of-year exchange rates:	2200	2308	2383	4650	8025
PETROLEUM RESERVES in million barrels of oil equivalent					
1P: Proven	45.29	135.00	174.83	221.98	240.27
2P: Proven and probable	133.94	221.09	250.52	322.99	360.52

Source: Company documents.

Exhibit 4b Medco Energi Balance Sheets 1999–2004 (in $ thousands, as of Dec. 31)

	1999[a]	2000	2001	2002	2003	2004
ASSETS						
Cash and cash equivalents	23,619	66,826	55,324	74,969	129,976	215,302
Short-term investments	1,449	1,850	1,448	3,042	51,833	30,413
Accounts receivable	78,084	79,101	83,288	112,548	117,311	120,766
Inventories	22,159	19,308	26,182	34,065	38,219	31,671
Prepaid taxes	4,149	4,364	8,757	16,501	23,068	17,569
Prepaid expenses and deposits	659	756	832	3,081	21,167	20,906
Other current assets	-	-	-	-	-	195,498
Total Current Assets	**130,120**	**172,205**	**175,831**	**244,207**	**381,573**	**632,125**
Property & Equipment, Net	**57,454**	**90,023**	**122,755**	**205,597**	**252,261**	**271,996**
Oil & Gas Properties, Net	**199,591**	**206,688**	**241,029**	**286,028**	**312,291**	**480,583**
Restricted cash in banks	480	333	1,089	3,966	26,530	22,362
Long-term accounts receivable	82,185	35,608	1,515	1,970	1,401	11,508
Deferred tax assets - net	1,303	679	120	129	2,650	37,194
Investments in shares of stock and projects	-	785	3,544	1,764	1,723	8,014
Other assets – net	2,567	2,392	2,904	8,140	6,014	8,464
Total Other Assets	**86,535**	**39,797**	**9,172**	**15,968**	**38,318**	**87,543**
Total Assets	**473,700**	**508,713**	**548,788**	**751,800**	**984,442**	**1,472,247**
LIABILITIES AND STOCKHOLDERS' EQUITY						
Short-term borrowings	-	-	-	-	-	150,000
Accounts payable	36,044	52,913	50,330	86,555	89,883	93,250
Accrued expenses	2,725	2,806	4,744	40,057	16,516	20,685
Current maturities of long-term liabilities	20,868	4,616	5,032	2,500	24,976	30,863
Lease liabilities	30	-	-	-	-	-
Deferred income	-	-	-	-	-	1,261
Swap liabilities	-	-	-	-	-	1,046
Total current liabilities	**59,666**	**60,335**	**60,106**	**129,112**	**131,375**	**297,104**
Taxes	10,327	5,340	14,184	9,486	10,584	106,714
Employee benefits obligations	-	-	-	3,069	4,528	3,634
Long-term debt	75,556	32,675	5,922	96,228	308,142	518,435
Swap liabilities	-	-	-	-	3,250	3,989
Other long-term liabilities	-	-	1,541	-	997	4,571
Total long-term liabilities	**85,882**	**38,016**	**21,648**	**108,783**	**327,500**	**637,343**
Negative goodwill, net	**2,078**	**5,949**	**5,547**	**6,416**	**7,007**	**1,799**
Minority interest in subsidiaries	**8,223**	**12,428**	**17,416**	**34,499**	**30,908**	**35,926**
Capital stock, net of treasury stock	46,936	100,749	95,433	97,916	97,964	97,964
Additional paid-in capital	136,325	131,388	115,773	121,863	122,056	122,056
Revaluation increment in property and equipment	429	100	100	100	100	100
Effects of changes in equity transactions of associated cos.	-	1,880	29,164	27,788	27,837	27,837
Foreign exchange translation adjustments	41,395	(39)	(32)	9	-	(741)
Retained earnings	92,765	157,907	203,633	225,315	239,695	252,860
Total stockholders' equity	**317,850**	**391,985**	**444,072**	**472,990**	**487,651**	**500,075**
Total Liabilities and Stockholders' Equity	**473,700**	**508,713**	**548,788**	**751,800**	**984,442**	**1,472,247**
PETROLEUM RESERVES in million barrels of oil equivalent						
1P: Proven	210.21	204.08	178.26	172.80	160.19	159.65
2P: Proven and probable	295.34	355.37	671.69	741.93	546.45	327.32

Source: Company documents.

[a]Note: Figures for 1999 converted from Rupiah to dollars using end-of-year exchange rate of 7100.

Exhibit 5 Medco Energi Income Statements 1994–2004 (in $ thousands, as of Dec. 31)

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Revenue	**50,466**	**53,196**	**153,474**	**224,601**	**187,081**	**208,553**	**349,842**	**384,849**	**420,717**	**448,989**	**550,115**
Cost of Sales	28,564	28,251	96,569	123,569	88,716	101,700	151,535	158,776	213,072	243,570	296,643
Gross Profit	21,902	24,944	56,905	101,032	98,364	106,853	198,307	226,073	207,645	205,419	253,472
Operating Expenses	11,689	10,884	19,527	16,714	14,004	24,865	34,734	32,422	46,327	61,413	74,208
Net Operating Income	10,213	14,060	44,916	84,318	84,360	81,988	163,572	193,651	161,318	144,006	179,264
Net Interest Income (Expense)	(1,827)	1,628	4,601	110	10,594	(6,891)	(3,933)	843	(6,522)	(19,160)	(37,684)
Gain (Loss) on Sales of Securities	-	430	(4)	-	-	-	-	-	-	(3,477)	1,082
Gain (Loss) on Sales of Property	3,419	28	(18,566)	23	443	32	50	1,602	79	-	-
Foreign Exchange Gain (Loss)	(1,146)	(1,120)	1,151	(31,085)	(14,441)	(2,907)	(1,806)	3,347	1,688	49	(6,884)
Provision for doubtful accounts	-	-	-	-	-	(18,518)	(32,211)	(34,509)	-	-	-
Other Income (Expense)	(147)	1,062	-	(561)	(3,698)	2,334	1,064	816	4,785	2,111	(5,662)
Net Income Before Tax	10,511	16,087	32,098	52,804	59,133	56,037	126,737	165,750	161,348	123,529	130,116
Tax	1,091	2,379	13,087	16,949	17,220	32,587	75,929	87,045	79,012	68,629	55,139
Extraordinary Income	-	-	-	-	-	-	9,938	219	-	-	-
Net Income After Tax	9,421	13,708	19,011	35,855	41,913	23,449	60,746	78,924	82,335	54,890	74,977
Minority Interest Income (Expense)	(895)	(1,197)	(1,887)	(3,274)	(3,666)	(916)	228	(733)	220	(817)	(1,127)
Net Income	**8,526**	**12,511**	**17,124**	**32,581**	**38,248**	**22,533**	**60,974**	**78,192**	**82,556**	**54,083**	**73,850**
Note: Figures for 1994-99 converted from Rupiah to dollars using year-average exchange rates:	2160	2253	2348	2945	9814	7809	-	-	-	-	-

Source: Company documents.

Exhibit 6a Medco Energi Cash Flow Statements 1994–1998 (in $ thousands, as of Dec. 31)

	1994	1995	1996	1997	1998
CASH FLOWS FROM OPERATING ACTIVITIES					
Net income	8,526	12,511	17,124	32,581	38,248
Adjustments to reconcile net income to cash flow from operating activities:					
Depreciation and amortization	8,454	7,723	15,372	18,865	17,218
Loss (gain) on sale of property and equipment	(3,419)	(28)	4	(23)	(443)
Unrealized foreign exchange loss on swap contract	-	-	-	-	22,428
Decrease (increase) in notes receivable	-	(5,071)	(4,417)	(763)	2,450
Decrease (increase) in accounts receivable	7,688	(34,573)	3,109	(75,883)	(26,340)
Decrease (increase) in inventory	(155)	(6,239)	(6,880)	(18,674)	(3,600)
Prepaid taxes	(349)	(120)	(3,253)	(2,852)	(1,522)
Prepaid expenses	(243)	(1,518)	(3,493)	2,445	746
Increase (decrease) in accounts payable	(1,860)	4,482	31,514	35,854	3,317
Taxes payable	190	677	1,694	5,477	7,921
Import duties payable	(173)	2,019	-	-	-
Accrued expenses	(445)	-	(1,195)	862	1,391
Others	(179)	-	-	(79)	(1,315)
Net cash flow from operating activities	**18,036**	**(20,137)**	**49,578**	**(2,190)**	**77,717**
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchases of property and equipment	(42,483)	(1,971)	(9,283)	(13,029)	(9,168)
Sales of property and equipment	4,101	28	11	23	642
Increase in development cost	(9,612)	(70,395)	(10,729)	(22,620)	(23,746)
Decrease (increase) in development cost under construction	3,511	(16,273)	(25,507)	(28,624)	(13,482)
Increase in deferred shares issuance cost	(3,077)	-	-	-	-
Increase (decrease) in deferred gain on sale - leaseback	35	(10)	-	-	-
Increase in deferred charges	-	-	-	(367)	(563)
Increase in pre-operating expenses	-	(632)	-	-	-
Additions to construction in progress	-	(6,950)	(18,791)	(3,456)	(266)
Placement in time deposits	-	-	-	-	(529)
Decrease (increase) in security deposits	(15,734)	11,464	225	(80,295)	(21,909)
Decrease (increase) in project advance payments	-	-	(4,780)	(2,290)	-
Increase in excess of net assets over cost of investments in subsidiaries	141	7,822	-	-	-
Decrease (increase) in other assets	(391)	(780)	(559)	(6,156)	990
Net cash flow from investing activities	**(63,508)**	**(77,698)**	**(69,414)**	**(156,813)**	**(68,031)**
CASH FLOWS FROM FINANCING ACTIVITIES					
Additions to (payment of) property and equipment contracts	23,173	(4,364)	(10,653)	(8,084)	(7,045)
Additions to (payments of) lease liabilities	173	(112)	(79)	183	(19)
Proceeds from (payments of) loans	(28,810)	77,786	(46,917)	217,931	697
Proceeds from (payments of) notes payable	-	35,513	127,476	(95,006)	33,842
Proceeds from (payments of) swap payable	-	-	-	42,553	-
Withdrawal (placement) of restricted cash in banks	-	-	(1,756)	(2,090)	(1,097)
Increase (decrease) in minority interest in subsidiaries	(1,374)	906	1,576	3,876	4,041
Increase in foreign exchange translation adjustments	531	1,601	2,310	-	-
Proceeds from issuance of capital stock	43,935	-	-	-	-
Increase in additional paid-in capital	34,120	-	-	-	-
Dividends paid	(17,593)	(2,250)	(3,239)	(3,512)	-
Net cash flow from financing activities	**54,156**	**109,080**	**68,718**	**155,851**	**31,116**
Increase (decrease) in cash and equivalents	8,683	11,245	48,882	(3,153)	40,802
Effect of foreign exchange rate changes	(315)	(1,064)	(1,574)	(54,499)	(42,342)
Cash and equivalents, beginning of year	8,654	17,022	27,203	74,511	16,859
Cash and equivalents, end of year	**17,022**	**27,203**	**74,511**	**16,859**	**15,319**
Note: Figures converted from Rupiah to dollars using year-average exchange rates:	2160	2253	2348	2945	9814

Source: Company documents.

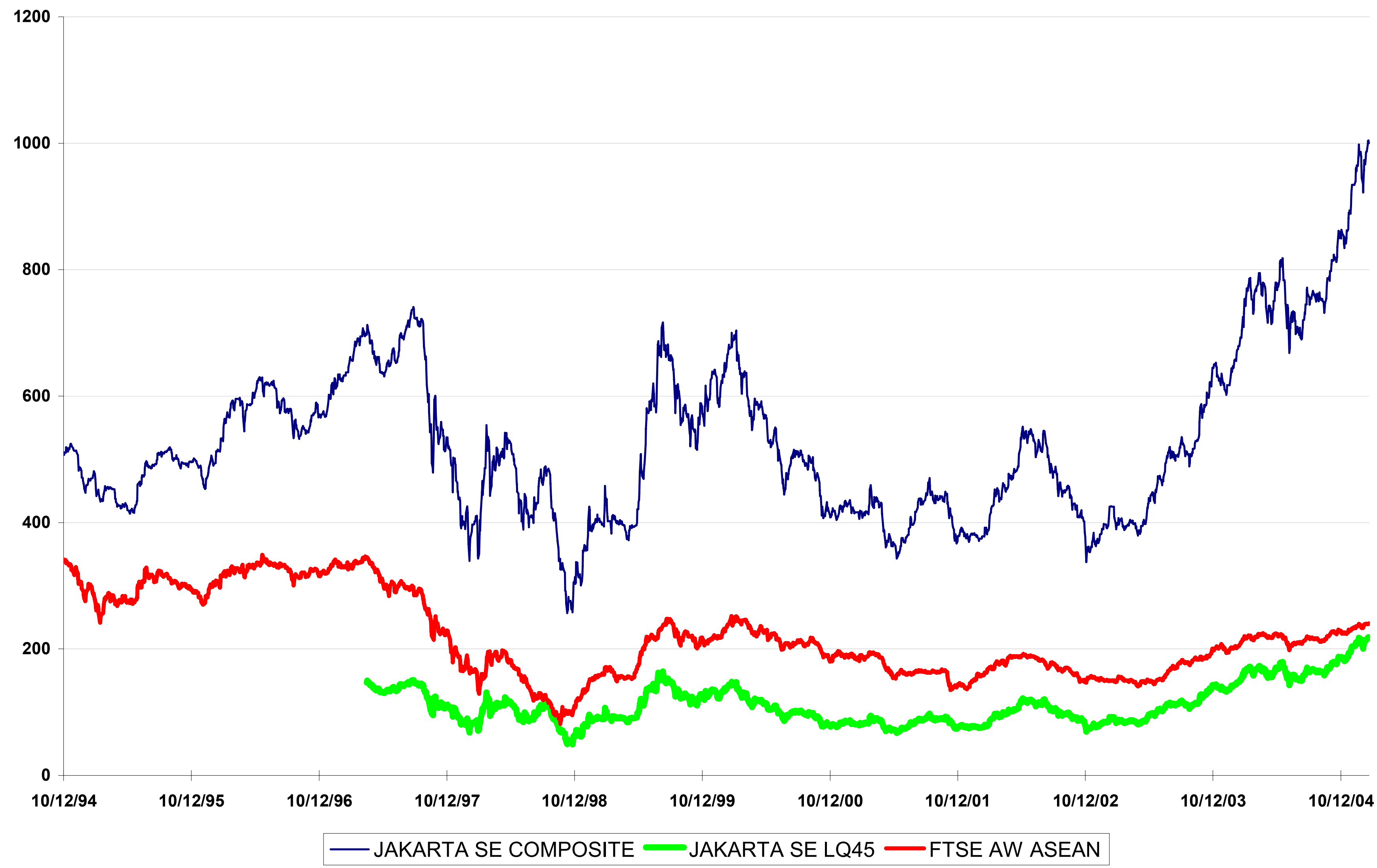
Exhibit 6b Medco Energi Cash Flow Statements 1999–2004 (in $ thousands, as of Dec. 31)

	1999[a]	2000	2001	2002	2003	2004
CASH FLOWS FROM OPERATING ACTIVITIES						
Cash receipts from customers	186,779	358,501	383,687	411,443	471,473	537,411
Cash paid to suppliers and employees	(101,032)	(143,861)	(157,513)	(144,436)	(286,185)	(267,942)
Cash generated from operations	85,748	214,639	226,174	267,007	185,287	269,469
Interest and financial charges paid	(3,668)	(3,527)	(4,954)	(5,122)	(13,278)	(52,124)
Income tax paid	(37,599)	(79,075)	(86,338)	(78,950)	(70,241)	(81,071)
Net cash flow from operating activities	**44,461**	**132,037**	**134,882**	**182,936**	**101,769**	**136,274**
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchases of property and equipment	(4,673)	(11,520)	(5,180)	(81,695)	(101,477)	(45,564)
Sales of property and equipment	2	116	143	1,215	4,117	406
Purchases of oil and gas properties	(30,283)	(21,642)	(57,344)	(84,240)	(77,592)	(188,158)
Proceeds from (placements in) short-term investments	(678)	(401)	401	(1,594)	(48,149)	22,502
Investments in shares of stock	-	(875)	-	(260)	-	(6,000)
Interest received	853	456	3,574	1,572	4,018	8,668
Receipt of (addition to) security deposits	1,399	(82)	-	36	235	-
Proceeds from (increase in) accounts receivable	(7,439)	11,735	(415)	(455)	2,992	(8,702)
Payment of advances to projects	(899)	-	-	-	-	-
Acquisitions of new subsidiaries	-	(1,037)	(1,600)	(33,299)	(3,055)	(120,244)
Receipt of insurance claim	238	-	-	-	15,199	-
Deductions from other payables	-	-	-	-	8,514	15,079
Deductions from (additions to) other assets	-	-	(1,332)	(5,272)	1,891	(473)
Net cash flow from investing activities	**(41,480)**	**(23,251)**	**(61,753)**	**(203,991)**	**(193,308)**	**(322,484)**
CASH FLOWS FROM FINANCING ACTIVITIES						
Payment of property and equipment contract payables	(5,357)	(611)	-	-	-	-
Payments of lease liabilities	(34)	(30)	-	-	-	-
Proceeds from (payments of) loans	(8,828)	(14,007)	(4,617)	(8,455)	72,746	128,661
Proceeds from (payments of) long-term notes	-	(44,514)	(21,501)	96,228	239,952	145,446
Proceeds from (payments of) of treasury notes	-	-	-	-	(88,471)	15,000
Withdrawal (placement) of restricted cash in banks	2,258	(161)	(756)	(2,877)	(38,378)	(2,307)
Issuance of capital stock	12,122	-	-	-	-	-
Sale (acquisition) of treasury stock	-	(1,757)	(29,202)	(7,767)	242	-
Dividends paid	-	(4,501)	(28,555)	(36,428)	(39,545)	(19,877)
Net cash flow from financing activities	**162**	**(65,580)**	**(84,631)**	**40,701**	**146,545**	**271,536**
Increase (decrease) in cash and equivalents	3,143	43,206	(11,502)	19,645	55,007	85,326
Effect of foreign exchange rate changes	5,158	-	-	-	-	-
Cash and equivalents, beginning of year	15,319	23,619	66,826	55,324	74,969	129,976
Cash and equivalents, end of year	**23,619**	**66,826**	**55,324**	**74,969**	**129,976**	**215,302**

Source: Company documents.

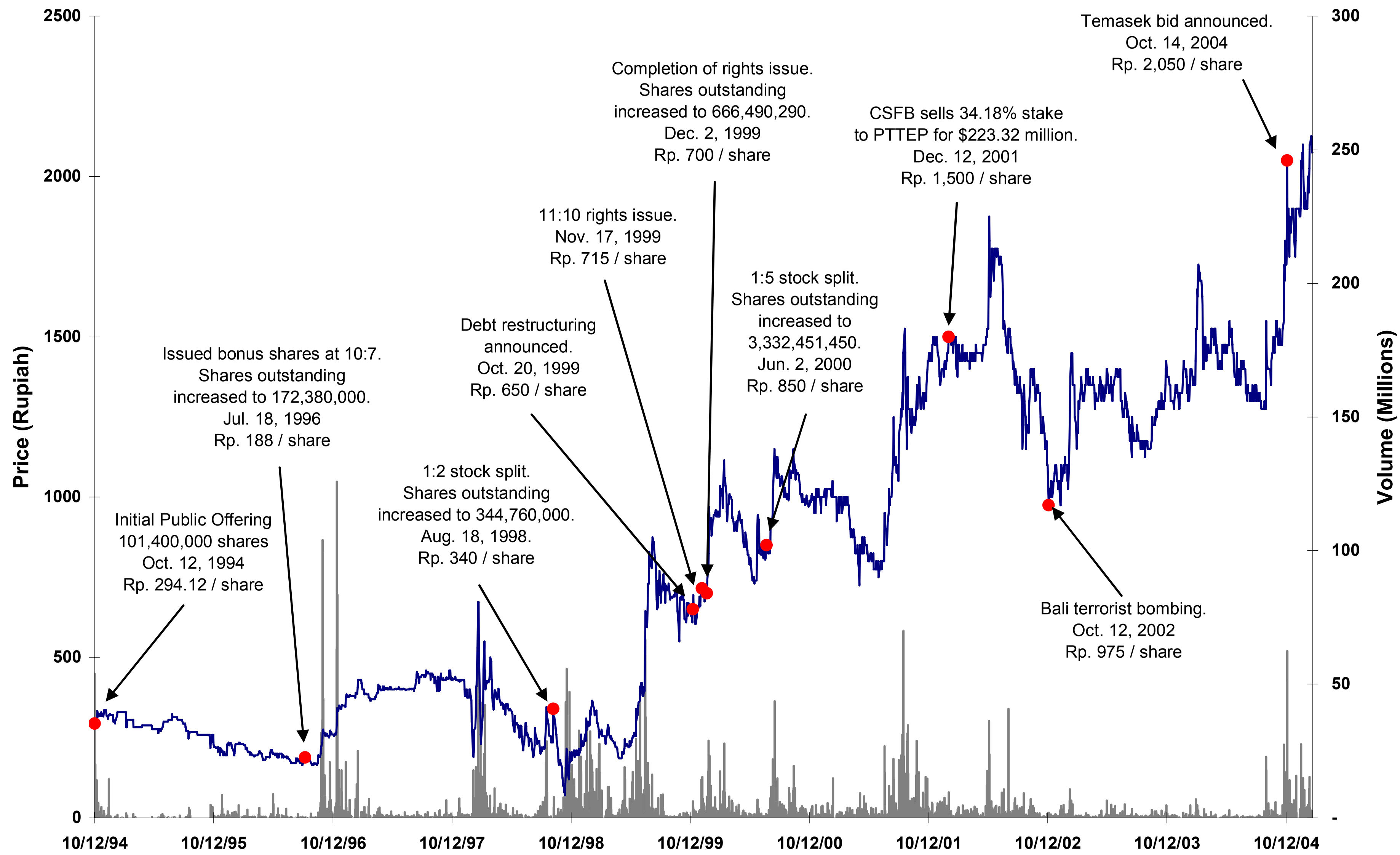
[a] Figures for 1999 converted from Rupiah to dollars using year-average exchange rate of 7809.

Exhibit 7 Indonesian and Regional Stock Market Indices 1994–2004



Source: Datastream International.

Exhibit 8 Medco Energi Share Price and Volume 1994–2004



Source: Datastream International and company documents.

Exhibit 9 Merrill Lynch's Sum-of-the-Parts Valuation of Medco

	US $/BOE	MMBOE	US$ Millions	IDR/Shr
Indonesian Production	4.71	142	607	2,232
US Production	9.62	13	125	416
Undeveloped Gas Reserves	1	251	245	815
Total Reserves	**2.56**	**407**	**1,040**	**3,464**
Exploration			100	333
Methanol			22	74
Power			10	33
Apexindo			135	449
Jeruk Payment[a]			158	526
Other Balance Sheet Items			68	226
Minus: Net Debt			(420)	(1,398)
Net Asset Value (NAV)			**1,113**	**3,707**

Source: Merrill Lynch estimates.

[a] Estimated payment to be received by Medco from its recent discovery of the Jeruk oil field

Exhibit 10a Comparable Companies Description

Company	Country of Origin	Business Description	Locations of Operations
CNOOC Ltd.	China	Oil and gas E&P, oil refining, natural gas processing, refined and processed products marketing.	Offshore China, Indonesia
Petrochina	China	Oil and gas E&P, oil refining, petrochemicals, natural gas pipelines, retailing.	China
Sinopec (China Petroleum & Chemical)	China	Oil and gas E&P, crude oil processing, petrochemicals, oil products trading, transportation, distribution, marketing, retailing.	China
PTT Exploration and Production	Thailand	Oil and gas E&P, oil refining, natural gas processing, petrochemicals, transportation, marketing, retailing.	Thailand, Vietnam, Cambodia, Laos, Myanmar, Malaysia, Philippines, Hong Kong
PTT Pcl.	Thailand	Oil and gas E&P, gas transportation, gas pipeline, power generation.	Thailand, Vietnam, Myanmar, Indonesia, Algeria, Oman
ONGC (Oil & Natural Gas Corp.)	India	Oil and gas E&P, gas pipelines, oil refining, petrochemicals.	India, Vietnam, Russia, Myanmar, Iraq, Iran
Australian Worldwide Exploration	Australia	Oil and gas E&P.	Australia, New Zealand, Argentina
Oil Search	Papua New Guinea	Oil and gas E&P, mining.	Papua New Guinea, Egypt, Yemen, Libya
Origin Energy	Australia	Natural gas E&P, gas and electricity retailing, power generation, gas distribution and pipelines, water.	Australia, New Zealand
Santos	Australia	Oil and gas E&P, gas processing.	Australia, United States, Indonesia, Papua New Guinea, Vietnam, Kyrgyzstan, Egypt
Tap Oil	Australia	Oil and gas E&P.	Australia, New Zealand
Woodside Petroleum	Australia	Oil and gas E&P, LPG and LNG production.	Australia, Iraq, Kenya, Libya, Algeria, Canary Islands, Mauritania, Sierra Leone, Liberia, United States
PGAS (Perusahaan Gas Negara)	Indonesia	Natural gas transmission and distribution.	Indonesia
Medco Energi Internasional	Indonesia	Oil and gas E&P, drilling services, methanol production, power generation.	Indonesia, Oman, Iran, Libya, United States

Source: Annual Reports.

Exhibit 10b Selected Financial Data about Medco and Comparable Companies (in US $ millions, as of 12/31/2004)

Company	Shares Outstanding (millions)	Stock Price (US $)	Market Value of Equity	Interest Bearing Debt	Sales	EBITDA	Net Income	Cash Flow	EBIAT	Net Asset Value per Share ($)	Proven (1P) Reserves (MMBOE[a])
CNOOC Ltd.	41,052	0.54	22,073	1,703	4,454	3,225	1,954	2,613	2,100	0.67	2,230
Petrochina	175,824	0.53	93,860	6,557	46,926	22,658	12,428	17,960	11,495	0.82	18,366
Sinopec (China Petroleum & Chemical)	86,702	0.41	35,689	10,147	72,109	11,724	4,349	8,254	2,616	0.56	3,773
PTT Exploration and Production	653	7.42	4,851	450	1,188	899	394	596	335	13.36	899
PTT Pcl.[b]	2,797	4.43	12,389	4,573	16,022	2,077	1,557	2,149	1,423	6.91	899
ONGC (Oil & Natural Gas Corp.)	1,426	18.80	26,812	(426)	13,316	6,698	3,196	4,833	2,175	26.39	7,107
Australian Worldwide Exploration	312	1.40	437	53	5	(15)	4	8	(13)	1.59	NA
Oil Search	1,114	1.41	1,571	105	416	318	151	213	108	2.81	89
Origin Energy	689	5.21	3,588	298	2,514	339	146	291	62	5.45	NA
Santos	586	6.60	3,867	768	1,106	679	280	663	365	8.46	348
Tap Oil	158	1.31	207	(16)	94	68	35	53	13	1.93	NA
Woodside Petroleum	667	15.65	10,436	642	1,590	917	798	1,002	612	19.88	951
PGAS (Perusahaan Gas Negara)	4,379	0.20	896	589	499	174	53	115	25	0.49	NA
Medco Energi Internasional	3,106	0.22	694	651	550	260	74	151	19	0.40	160

Source: Standard & Poor's Compustat© data via Research Insight℠, accessed May 2006, and company documents.

[a] MMBOE = Million Barrels of Oil Equivalent

[b] PTT Pcl's proven (1P) reserves were held by subsidiary PTT Exploration and Production. PTT owned 63% of PTT Exploration and Production.