

**"The Role of PERTAMINA as the National Oil and Gas Company
in Maximizing Indonesia's Gas Utilization"**

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Excellencies, Distinguished Conference Participants, Ladies and Gentlemen

It is a great pleasure for me to join you today and I would like to thank the Indonesian Gas Association and the Organizing Committee of the 4th International Indonesia Gas Conference and Exhibition for inviting me to speak at this important event.

My topic is on "The role of PERTAMINA as the National Oil and Gas Company in Maximizing Indonesia's Gas Utilization," definitely is in line with the theme of this conference: "Maximizing Indonesia's Gas Utilization from Opportunities to Rewards."

Let me start from pointing out that although as the result of the new Oil and Gas Law (No. 22/2001) Pertamina is just one of the players in the upstream oil and gas industry in Indonesia, it is the only company in this country that is owned one-hundred percent by the government. The new Oil & Gas Law has also resulted in Pertamina becoming a limited liability company starting in September 2003.

As such, like any other state-owned enterprises, Pertamina succumbs to the Law of Limited State-Owned Enterprises (Law No. 19/2003) as well as to the Law of Limited Liability Company (Law No. 40/2007).

Although both Laws provide the legal basis that Pertamina should operate as a profit oriented company, including when the company is tasked with Public Service Obligation by the government, the implementation of it is not always straight forward. For example, in supplying the (supposedly) non-subsidized 12 and 50 kgs LPG, Pertamina has for a long time been incurring substantial losses because of the company not being able to charge economic prices. This explains why there are no other players that are competing to supply the 12- and 50-kgs LPG cylinders, even though the market is theoretically open.

With respect to the distribution of the subsidized fuels such as regular gasoline, gasoil, and kerosene, the fixed margins or "alpha" of 8% above MOPS amid the current low oil price regime, will certainly result in Pertamina incurring losses in its task of Public Service Obligation in 2009.

Indeed as an integrated oil and gas company, Pertamina is characterized by its heavy burden as the supplier of last resort in the fuel distribution for both petroleum products and LPG in Indonesia, irrespective of the economics. Indeed, to the best of my knowledge, there are no other National Oil Companies in the world that have these responsibilities, certainly not in the coverage and sheer volumes similar to ours.

I shared with you all of the above with the intent to put the role of Pertamina in Indonesia's oil and gas sector in the proper context. With its challenging responsibilities in the fuels' distribution to all over Indonesia and all the way to all remote areas, the company's upstream revenues and profits, which actually are the value driver of the company, have often been used to off-set the losses incurred by distributing certain products in the downstream sector of the business.

As a state-owned company that is one-hundred percent belongs to the government, we realize that there will be many tasks entrusted upon us as a representation of the government policies. However, as you all can appreciate, it is difficult for us to avoid the trade-off consequences, such as efficiency, opportunity loss, and other economic distortions.

Ladies and gentlemen

As you are all aware, Pertamina has long been a significant gas supplier in the domestic market, an important global LNG marketer, and more recently a company that is responsible to undertake the ambitious Government's Kerosene to LPG conversion program.

The following is an overview of our gas related operations. On the upstream side of the business, Pertamina is currently the second largest gas operator in Indonesia after Total Indonesia. We produce around 1.1 billion SCFD of gas, almost all of which is destined for domestic consumption. Although many of our fields are maturing and hence face natural production decline, there are new fields that are ready for development, as well as potential upside from other existing

fields, through production optimization as well as from Improved / Enhanced Oil Recovery (IOR/EOR). As such, we are optimistic that we can maintain production and actually increase it.

As to our LNG activities, Pertamina is the operator of LNG plants in Arun and Bontang, from which, in 2008, we produced and marketed as much as 20 million tons. It has to be noted that the LNG production from these facilities have been in decline – since it was peaked at 29 million tons in 1999 – mostly because of declining gas reserves.

With the intent of expanding Pertamina's LNG operation, we are in the process of finalizing investment decision to construct a 2 million tons LNG plant in Sulawesi Island, which will take the gas from Donggi-Senoro fields, a Joint Operation Area of Pertamina and Medco and also from Pertamina-operated Matindok fields.

Unlike Arun and Bontang LNG Plants, which were constructed under the upstream scheme, and hence they were part of the cost recovery of the total upstream development, the Donggi-Senoro LNG Plant will be developed under the downstream scheme, and therefore it will be a stand-alone joint venture operation separated from the upstream PSC contract.

Under the downstream scheme, the government will not be burdened by the need for up-front investment nor providing the guarantee for the financing of the project. In this downstream scheme venture, Pertamina and Medco are partnering with Mitsubishi Corporation, which will be the majority shareholder and therefore bringing in a significant foreign direct investment to the country.

In the efforts of undertaking the kerosene to LPG conversion program, we have distributed 3-kg cylinders LPG since late 2007 to more than 15 million low-income households. Currently, the Greater Jakarta Area is free from subsidized kerosene and all Java Island is targeted to be free of subsidized kerosene as early as by end of 2009. This program will no doubt increase the country's LPG consumption tremendously in the coming two years, from the demand of about 1.1 million tons in late 2007 and currently about 2.2 million tons to more than 4 million tons annually in 2010, which will result in reducing government subsidies significantly.

While Pertamina has done and will continue to do its best efforts to materializing this policy, it is no doubt that it will not be easy, especially with respect to making sure the availability of the infrastructure to support the rapid many-folds increase of the consumption. As you all can appreciate there are potential problems and challenges that are beyond Pertamina's control in distributing this rapidly increasing commodity so that they can always delay the materialization of the infrastructure in certain areas.

Distinguished Guests, Ladies and gentlemen

Despite the many expectations from our stake holders other than being a profit oriented company, we are optimistic that with the appropriate support from our stake holders, and most notably from the government, Pertamina will not only survive but will actually strive as a company that can continue to have sustainable growth, while continue supporting government policies.

Indeed, Pertamina has an aspiration to become a world-class national oil company, which will be at par with other NOCs that have been very successful such as StatoilHydro, Petrobras, and Petronas. We have a long-term road map that plan to achieve the objective of Pertamina becoming a world-class oil national oil company within 15 years.

In charting our journey to become a world-class national oil company, we realize that we will never achieve it without a strong upstream performance. Despite a relatively decent current performances – especially in noting that our production have trended up amid the country's overall production stagnation, we have to admit that we still have some weaknesses and deficiencies, both in technical capabilities as well as may not having the sufficient appropriate mindset and performance culture. As we are working very hard to becoming a "true" upstream operator, we are addressing these issues very seriously.

In particular, we are building partnerships and strategic alliances with companies which we believe will accelerate Pertamina acquiring management best practices and cutting-edge technology. We especially seek partnerships with companies that not only possesses the qualities that Pertamina can learn from but also the ones that have empathy for our aspirations; for example, in Pertamina becoming the operator of joint-owned fields as soon as is feasible.

Simultaneously, we are aware of certain important assets or projects that can leverage us to move to the next level. In this case,

we have the Natuna D-Alpha development in mind. We currently may not have the technology to handle the difficult high CO₂ content nor the full financial capability, but during the course of the project, we should be able to move up the ladder towards operatorship while also acquiring the knowledge on how to handle such a complex and difficult project.

To achieve the above objective, we realize that Pertamina needs to put the emphasis on investing, both on asset expansion as well as on its human resources who will bring the company to where it wants to be. Steady growth of project investment will have to be done even during the current discouraging global financial situation. I am pleased to inform you that in line with this intent, in 2009, Pertamina is planning to have a capital expenditure of up to about Rp 20 trillion, a significant increase from a planned investment of Rp 17 trillion last year.

In terms of the investment in natural gas business, Pertamina as an investor would certainly like to emphasize on the sufficient returns. Economic gas prices will ensure that we get the fair returns on our investment and as such providing the incentives for upstream development, including, and especially, the need for hydrocarbon reserve replacement that is critically needed for our sustainable growth. This does not mean that Pertamina cannot be flexible, especially in supporting government policies, as long as the anticipated potential losses or surpluses are recognized by the share holder, and will be settled in the dividend calculations.

With this flexibility, Pertamina can actually be the strategic instrument in increasing and thus maximizing domestic gas utilization. Ideally, Pertamina's flexibility and especially its willingness to make sacrifices to support government policies are treated reciprocally by the government by providing empowerment for the company in its journey to become a world-class national oil company, a situation which we believe brings about the pride of the country as a whole.

For example, we would argue that the government needs to support us in increasing our hydrocarbon resource base, by giving us the opportunity of direct selection on acquiring the whole or part of expiring PSCs, as well as acquiring new block areas in pre-emptive manner, with the intent that Pertamina should be the eventual operator of those fields.

We believe that the involvement of Pertamina in the tendering of new block areas will actually make the industry in an awkward position. With our status of a state-owned company that is 100 percent belongs to the government, and acknowledging Pertamina's aspirations to become a world-class national oil company, many PSCs may think it would not be fair to compete with Pertamina, which should be gotten the support of the government in acquiring new block areas. It is true that Pertamina will not be able to acquire all areas, and as such there will be plenty of potential blocks available after Pertamina is given the privilege of choosing the few blocks in which it will concentrate in exploring and operating them.

It is to be recognized that in its journey to become an aspiring world-class national oil company, Pertamina will not be able, at least initially, to instantly acquire cutting edge technologies as well as being a first-rated operator in difficult and challenging areas, such as deep sea waters. In this case, and as it is common practice in risks sharing in the industry, Pertamina will need to do it in partnership with other companies. In this case, our business partners will transfer the operational excellence, management best practices, as well as technological know-how to us. Again, this is with the intent that Pertamina will be the eventual operator of the field. Pertamina will ensure that the (potential) partners will not free ride on us; on the contrary, they will have to commit to transfer the above plus the opportunity of Pertamina getting involved in their operations world-wide. Indeed, we have secured these commitments from companies such as StatoilHydro and Shell, to name a few. We will certainly welcome other first-rated international and national oil companies to work with us on this type ventures, including the possibility of working together with us in Natuna D-Alpha block.

Last but not least, Pertamina will continue to take advantage of its extensive experiences in LNG development and marketing. However, unlike in the past in which we concentrate more on the marketing segment, we would now like to be involved in the whole value chain of the business—all the way from upstream, operating LNG plants, as well transporting the LNG, as exemplified in our venture in Donggi-Senoro LNG. Again, we would certainly like to be partnering with reputable partners.

Distinguished guests, ladies, and gentlemen,

In conclusion, it is indeed our wish that Pertamina will become **the** aspiring national oil company that is fully supported by its stake holders, and especially by the government, who will see the benefits of the country in having a world-class national oil company and thus share our vision and mission.

In this regards, the government can be provided with a road map with a clear time table for Pertamina to achieve certain milestone targets in conjunction with the privileges that are given (in the beginning) with the understanding that these privileges will gradually be taken back (in the future) once Pertamina can be in the position to be competent in equal footing with prominent international oil companies. This is true in the cases of Statoil, Petrobras, and Petronas, which all have enjoyed fully supports from its national stake holders – from the beginning in their early developments through the current prominence.

We would certainly argue that having a strong and successful national oil company will benefit the Indonesian petroleum industry. This is owing to not only through the operation of the company itself, but also through its facilitating investment in partnership with other companies investing in Indonesia.

It is only natural that being the national company of Indonesia, Pertamina aspires to be the largest hydrocarbon producer in the country in the near future. We understand that to increase the resource base, Pertamina needs to expand its operations towards the more difficult and risky off-shore and deep water blocks.

It is, however, acknowledged that Pertamina will need to cooperate with experienced international oil and gas companies to build its competence.

Towards this goal, we have actively been working together with international oil companies in securing new offshore blocks. Additionally, Pertamina will also exercise its privilege to get the government-granted equity partnerships (on business-to-business deal) in prospective new areas. Indeed, we strive to prove that Pertamina can and will be the trusted partner in the upstream ventures to revitalize the upstream business in Indonesia and consequently improving and maximizing the utilization of natural gas in this country.

That will be all of my speech today, and I thank you for your kind attention.

President and CEO, PT PERTAMINA (PERSERO)

Ari H. Soemarno