

PLN BATAM INITIAL PUBLIC OFFERING VALUE CREATION FOR ELECTRICITY BUSINESS

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ABSTRACT

The growth of electricity sales in Batam Islands over the last ten years has reached an average of 6% per year. This growth is estimated to continue because the government has declared Batam Island as an industrial and business area. To reach high growth in demand for electricity, it is necessary to add in a large enough electricity supply facility with a large enough investment. This study aims to see the added value of a company is taking strategic corporate policies by listing on the stock exchange through an IPO which can provide added value and increase shareholders' wealth. The research starts from analyzing macroeconomic conditions, identification, and analysis of the company's internal and external environment to determine the company's development strategy. In determining valuation of the company, various approaches are carried out including Relative/Multiple Valuation, Discounted Cash Flow. From the calculation of Discounted Cash Flow using the projected cash basis 3 years, the intrinsic value of PT PLN Batam is Rp. 2,954/share. Using low to the high scenario, it is around Rp. 1,961 - Rp. 4,954 per share. When implements Multiple Valuations using an industrial average with PER of 15.2, the intrinsic value of PLN Batam is Rp. 6,353/share. While using the average industry PBVr, the intrinsic value of PLN Batam is Rp 4,308/share. From the results of the study it can be concluded, the valuation of PLN Batam is very interesting for investor with increasingly performance.

Keywords: Internal Analysis, External Analysis, Valuation, Discounted Cash Flow, Multiple/Relative Methods

1. INTRODUCTION

As an electricity Company that has its own business area in Batam Island and its surroundings, PT PLN Batam has many challenges either from External or Internal environment. Electricity sales grew 6% on average until 2019 for ten years. However, the pandemic struck the world and affected PT PLN Batam the growth becomes 0.68 % in 2020.

Since Covid 19 and the digital era all the business environment change rapidly, resulting in PLN Batam as electricity in Batam island and surroundings force to increase sales through aggressive marketing and efficiency to reduce operational variable cost.

To be a leader of electricity supply in Batam Islands, PT PLN Batam must make differentiation and cost leadership in the business sector. As a subsidiary of PT PLN Persero, PT PLN Batam has strong dependence, especially in the covenant. It will be a big constraint if PT PLN Batam raises funds without the covenant of the parent's company. Electricity business is intensive capital forcing the company the get fund tightly to increase the value of the firm and shareholder wealth enables PT PLN Batam to add the fixed asset to leverage the Revenue.

The best solution for PT PLN Batam is processing Initial Public Offering through the Indonesia Stock exchange. The IPO could be the best solution to raise funds to fulfill the high capital requirement to run the electricity business.

2. LITERATURE REVIEW

2.1 IPO

The most fundamental factor in the company IPO is to raise capital. They expect the market value higher than fair value. On average Initial Public Offering (IPO) is underpriced, the secondary market price of common stocks is traded is much higher than the IPO price. The transition from a private company into a public listing is an important moment for companies and investors, the process to execute IPO is a one-shot occurrence.

2.2 Projected Financial Report

The Projected Financial consists of the Income statement, Balance Sheet, and Cash Flow Statement.

2.3 Market Research

2.3.1 External Analysis

Megatrends, Macro Economics, Pestle Analysis, Porter's Five Forces

2.3.2 Internal Analysis

SWOT analysis, TOWS analysis, Financial Ratio, Du Pont Analysis

2.4 Valuation

2.4.1 Relative Valuation Method

The relative valuation method compares with the company value to its similar business company, competitors, and industrial peers to evaluate the company's financial ratio. This model is an alternative to determine value models that could obtain company's real value based on its multiple ratio or variable. The variables usually are used is PER (Price Earned Ratio) and PBV (Price Book Value). Not only these two variables but also other variables could be used in calculating, let's say Net profit, Equity of the firm and operational profit (EBIT).

2.4.2 Discounted Free Cash Flow Model

According to (Gregory A Gilbert) it necessitates that the expert utilizes extraordinary consideration in the assessment of incomes, rebate rates, and terminal qualities. Luckily, there are approaches to beat subjectivity and make the valuation cycle more normal and objective.

- DCF Formula

$$Value = 1 + \frac{CF_1}{(1+i)^1} + \frac{CF_2}{(1+i)^2} + \dots + \frac{CF_n}{(1+i)^n}$$

- Fair Market Value estimate

$$Value = \sum_{n=1}^t \frac{CF_n}{(1+i)^n} + \frac{TV_t}{(1+i)^t}$$

- Discounted Rate

The second step in the DCF process is the determination of the discount rate, Discount rate affected by Market, Vary with time, Depend on what is being discounted, Must be risk adjusted, Based on yields available on alternative investment, Inflation. To execute discount rate most of economist use WACC. According to Velez-Pareja, Ignacio; Tham, Joseph (August 7, 2005) WACC is weighted average Cost of Debt and Equity. To achieve WACC of the company, we have to recognize capital structure of the company in asset investment.

$$WACC = k_d \cdot 1 \cdot (1-t) \cdot \frac{D}{(D+E)} + k_e \cdot \frac{E}{(D+E)}$$

Where:

Kd = return of debt, Ke = Return of Equity, Wd = Weighted of Debt We = Weighted of Equity

2.4.3 Risk Analysis

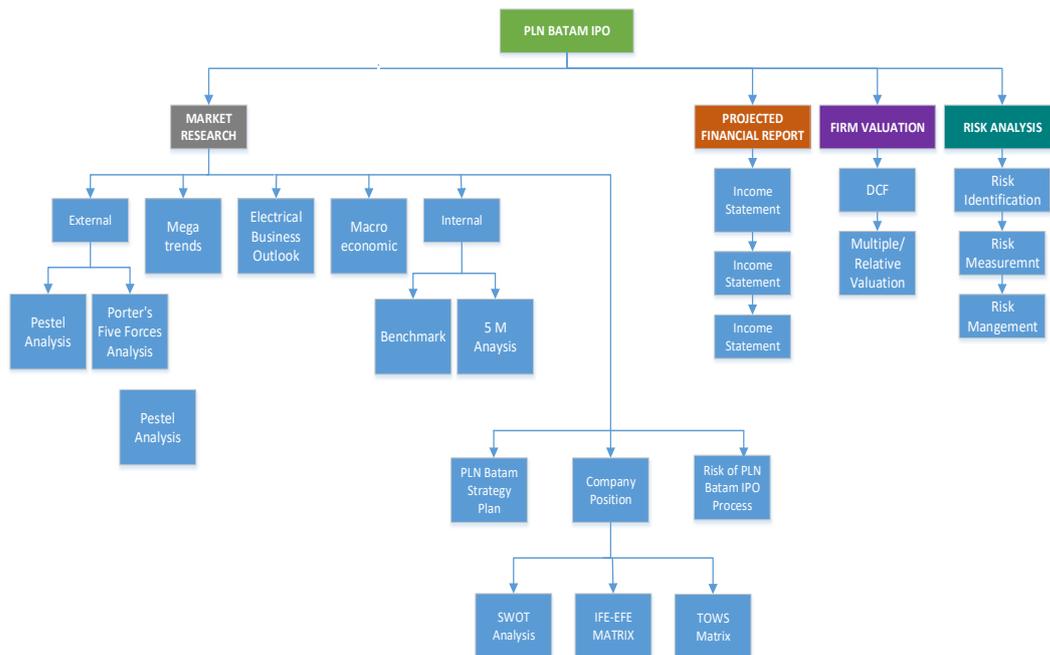
Cited from (Australia/New Zealand Standards, 1999) a logical and systematic process in identifying, analyzing, evaluating, controlling, monitoring, and communicating risks associated with all activities, functions, or processes with the aim of the company being able to minimize losses and maximize opportunities. The implementation of risk management helps companies identify risks from the start and help make decisions to address these risks.

3. METHODOLOGY

Conceptual Framework

This study is acknowledge the electricity company strategy to face more challenge in electricity business industry. The analysis begin from internal analysis to elaborate strength and weakness of firm and external analysis to identify opportunity and threat. Several economic analyzes show that the national economy will begin to grow as the government succeeds in dealing with the pandemic. PLN Batam is starting to plan to grow through market expansion and new services to consumers.

Table 1. Conceptual Framework



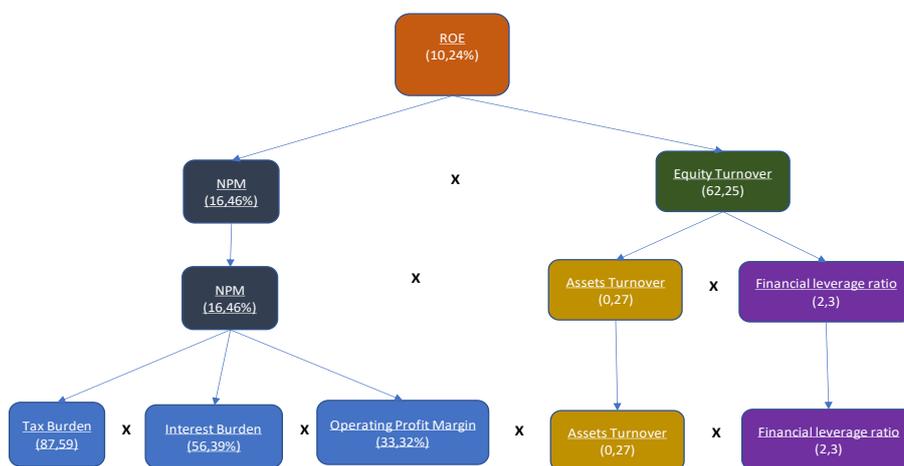
4. ANALYSIS

4.1 Financial Ratio Analysis

The purpose of doing ratio analysis is to see the extent to which the company's performance has been running from a financial perspective. It can be seen from the profitability, solvency, liquidity, and activity ratio.

To dig analysis, we need to use Du Pont Analysis that separate profitability with the asset utilization. This analysis to connect three kinds of ratio they are ROA, Net Profit Margin.

Table 2. PLN Batam ROE Du Pont Analysis Chart



The ROE in 2020 greater than 10%. To create the ROE as that amount, we could analyze from chart. Where to increase ROE, PLN Batam could look for solution by increasing net profit margin or equity turnover.

4.1 Prospective Financials Performance

4.1.1 Sales Projection

The variables of sales calculated using data analysis is run by regression approach. The sales obtained by calculating market share. The regression data analysis is the process to result in market share of PLN Batam. We assume the market share is increasing based

on economic growth through independent variables Selling price, GDP, and population. The Net Profit projection in 2023 is Rp 1.14 Trillion with net Sales increase 9% refer to several offer of big commercial customers load start from 2021 gradually increase until 2023. The EPS become Rp417.93/Share. The Price using 15.2 x average industrial PLN Batam price should be Rp 6,353/Share.

4.1.2 COGS Projection

The Cost of goods sold (COGS) in this chapter using average COGS proportion to sale, refer to historical data 56% COGS come from sales.

4.1.3 Projected Balance Sheet

The investment of fixed assets come from investment needed from sales growing. Every additional of sales will go to additional assets, it is adjusted in our projected cash flow simulation. It is very proportional to calculate of assets addition of CAPEX needed. The CAPEX needed not only to come from the loan but also from equity. The total asset increases significantly 7.8% in 2022 and 2.3% in 2023 the total assets Rp 22.18 Trillion. From the balance sheet Book Value per share is Rp 4,682/share. Using average industry PBVr 0.92 x PLN Batam value is Rp 4,308/Share.

4.1.4 Cash Flow Statement Projection

The final step to project a financial report is to project a cash flow statement. This cash flow is derived from the projection of the net income statement and balance sheet. Using this projection, we can determine how much and how long we will have a deficit and surplus for our business, and the result will be a positive ending cash balance. It is due to optimal working capital, aggressive marketing to increase sales, effective asset use through CAPEX, optimal financing capital structure to reach the low cost of capital.

4.3 Cost of Capital

Table 3. WACC PLN Batam

WACC Calculation		Weight	Cost	Weighted Cost
Cost of Debt (After Tax)	Calculated	50.68%	7.50%	3.80%
Cost of Common Stock	Calculated	49.32%	10.24%	5.05%
WACC				8.85%

To calculate the weighted average cost of capital, we use the debt and equity portion to reach WACC. The cost of debt after tax is 7.5% and the cost of common stock is 10.24%. The cost of capital of the firm is 8.85%. It could be used for obtaining free cash flow of the firm and free cash flow for the shareholder.

4.4 Valuation

Determining the intrinsic value of the company of PLN Batam, it is necessary to do a way to determine the valuation method. The valuation can be exercised using the Discounted Cash Flow method and Relative Valuation from the industry using the ratio (PE and PBV). From the data 2023 of our research, the sales projection result in the net profit per share Rp 417.93/Share multiplied by 15.2 x average Industry, PLN Batam price should be Rp6,353/Share. In the same year from the balance sheet Book Value per Share is Rp 4,682/share. Using average Industry PBVr 0.92 x PLN Batam value is Rp 4,308/Share. Lastly, using free cash flow projection using the cost of capital 8.85% the intrinsic value of PLN Batam Rp 2,954/share.

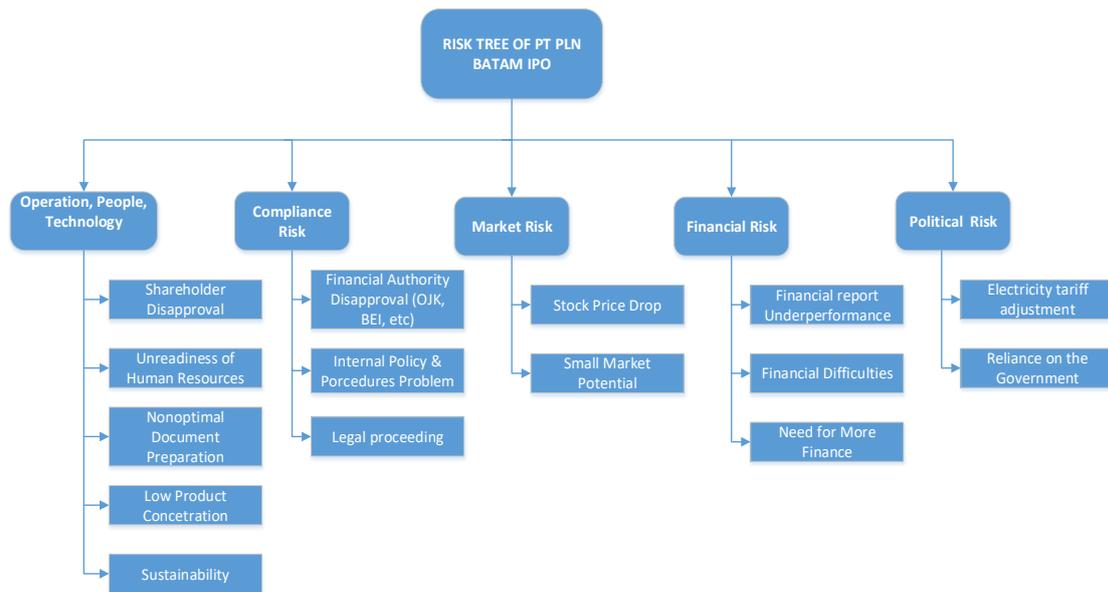
4.5 Risk Analysis

4.5.1 Risk Profile

To identify the risk that could undermine the objective of PT PLN Batam go public through the IPO program. The risk identified based on the constraints will occur in business processes and activities to collect all information related to business activities.

Then analyze it to find every possible risk exposure that can transform into a form of loss. The risk will be managed so that they become accepted risks, here is the risk identification of the PLN Batam IPO process.

Table 4. Risk Tree PLN Batam IPO Process



4.5.2 Risk Mitigation Matrix

According to Kizan (2011: 6), it is explained as follows "Risk treatments that deal with negative consequences are sometimes referred to as risk mitigation, risk elimination, risk prevention, and risk decline." It would be deciphered that risk treatment or recuperation is related to hostile results which are generally proposed as risk decrease, risk end, risk discouragement, and risk.

It will be contingency plan action to reduce the risk become accepted. Here is the mapping risk result in nutshell after mitigation action and the residual risk process, it could be viewed from the table below.

Table 4. Risk Profile

No	Event	Risk ID	Impact	Probability Rating	Risk Level	Risk Response	Mitigation	Residual Impact	Residual Probability	Residual Risk
Operation, People, Technology										
1	Shareholder Approval	R1	5	IV	20	Mitigate	- Propose a risk analysis of the continuity of the electricity business - Delivering pro cons to shareholders and directors of the benefits of PLN Batam IPO	4	II	8
2	Unreadiness Human Resource	R2	3	I	3	Mitigate	- Prepare human resources who are reliable and with integrity - Conduct competency mapping to ensure that individually they have core competencies and occupy positions that are relevant according to their competencies - Provide training to individuals in order to improve competence	1	I	1
3	Document Preparation Not Optimal	R3	4	II	8	Mitigate	- Carry out since beginning identification in advance of the requirements for IPO process such as administration document, legal document, prospectus, Financial Statement Projection, etc - Hire a consultant to get consulting services to prepare for the IPO process	2	II	4
4	Low Product Concentration	R4	4	III	12	Mitigate	- Doing business development does not depend on just one core product - Make aggressive marketing in order to generate more margin	3	2	6
5	Less Going Concern	R5	3	II	6	Mitigate	- Make competitive advantage of product with the lower price and higher quality - Concern to our customer in order to induce loyal customer - Give excellent service for our customer to produce customer awareness and resilient	2	I	2
Compliance										
1	Financial Authority Approval	R6	5	I	5	Mitigate	- Prepare a Financial Report that is audited by a Public Accountant registered with the OJK - Prepare Legal Audit from a Legal Consultant registered with the OJK - Submit articles of association and amendments prepared by a Notary and ratified by the competent authority	3	1	3
2	Internal Policy & Procedure	R7	2	I	2	Accept				
3	Legal Proceeding	R8	5	I	5	Mitigation	- Speed up accelerating the ongoing litigation process between PLN Batam and the contractor - Create truly credible contractuals involving highly competent people and pay attention to aspect laws	2	I	2
Market										
1	Stock Price Drop	R9	5	III	15	Mitigate	- Road show allows a company to generate interest from brokerage firms and institutions for the IPO - Increase Company performance reflect from Financial Statement to increase the investor interest to buy the company's stock - Make the interesting valuation of listing in Indonesia Stock Exchange - Create value by posting interesting information related to the company futures story of product	4	I	4
2	Small Market Potential	R10	3	III	9	Mitigate	- Conduct research and development to carry out market development - Expand business by penetrating the market - Create substitute products in the energy sector that have high competitive value	2	II	4
Financial										
1	Financial Report Under Performed	R11	3	II	6	Mitigate	- Evaluate the performance of companies that have underperformed performance - Optimize capital structure to create cost of capital - Perform financial analysis by doing dupont analysis to see productive policy policies to generate profits	2	I	2
2	Financial Difficulties	R12	4	II	8	Mitigate	- Reducing unproductive operating costs - Carry out an asset inventory with the aim of seeing non-productive assets so that they can be divested to create non operating income - Perform efficiency both in administration and operation without	3	I	3
3	Need More Finance	R13	3	III	9	Mitigate	- Right Issue of stock if PLN Batam go public - Result in excellent performance to create lender or investor trust whether give lenders or investors confidence in obtaining funds with low interest from lenders and low coupon fees when issuing debt securities because they are given the best rating	2	II	4
Political										
1	Electricity Tariff Adjustment	R14	3	III	9	Mitigate	- Prepare complete tariff adjustment documents to the competent authority - Evaluate tariff forming variables comprehensively - Make a comprehensive study for changes in electricity rates taking into account aspects of operations, finance, primary energy supply, market conditions, market share and others	3	II	6
2	Reliance on the Government	R15	2	V	10	Mitigate	- Make adjustments to regulations issued by the government by considering the least cost aspect - Submit formal proposals to the government regarding policies that have an impact on operational activities - Asking for leniency from the government, especially in regulating renewable energy prices and fuel costs (gas, coal, etc.) so that they get an economical price	2	II	4

From the table above some of risks accepted, it depends on company risk appetite. Some others are treated and mitigated to be residual risks that can be accepted. The risk map after being mitigated could be viewed on the table below.

Table 5. Residual Risk Matrix

ANALYSIS MATRIX FOR DETERMINING RISK LEVEL						
PROBABILITY	V (very big)		R15			
	IV (big)					R1
	III (medium)		R14'	R10 R13 R14	R4	
	II (small)		R10' R15'	R13' R3' R14' R5	R1' R3 R12	R9
	I (very small)		R2' R5'	R11' R2 R12' R8'	R7' R6'	R6 R8
		Not Important 1	Minor 2	Medium 3	Major 4	Catastrophe 5
		IMPACT				

From the table above the matrix profile resulted from treatment of existing control and mitigation. The accepted risk depends on the Company appetite in Risk Management.

Value creation if PLN Batam IPO

1. Prestige

IPO is major accomplishment. Because the public companies are generally perceived to more stable than private company. By providing periodic report create trust for investors, customers, and suppliers

2. Cash Infusion

IPO raise a lot of cash for the company. The money can be used to enhance market share, build new machine/facilities, and float the acquisition of new business and many others.

3. Lower Cost of Capital

In some part, the public market offers the lowest cost of capital. The reason is there is larger pool for investors. Meaning that it is easier to find those who are interested in the chance. When the stock bullish the cost of capital could be extremely low. Because the company could issue the stock in small amount with high valuation.

4. Easier to raise more fund

The company become listed in stock exchange usually easier to raise additional capital in term of stocks issued and debt financing. Let alone the company has trading record, it is very quickly for investor to make decision. The stock could be sale in any period of time specially when the market is bullish.

5. Stock as Currency

Stock in public is almost like a cash. Consequently, the company can use it as payment of acquisition. This could be more attractive when the stock in high value. In the meaning that it could be way out to buy a company on cheap based prices.

6. Liquidity for investor

A company that listed on stock exchange usually have institutional investors which may include private equity and venture capital firms. While they tend to hold their money for a long term. It means that IPO can generate high return.

CONCLUSION

As an electricity company that serves the people of Batam Island with reliable service guidance and as a subsidiary company which must provide benefits for shareholders. With the challenges and demands of a public service company, PLN Batam must become a reliable and reputable electricity company. Therefore, to create long-term value, a strategy is needed to increase the value of the company through reliable service, increase market share, increase the strength of superior competence for marketing to increase margin. For that reason, PLN Batam needs the capital required to develop.

As the intensive capital company in electricity PLN Batam need more flexible strategic in raising fund to invest in productive assets. The valuation of the company always increases in line with the cash flow generated from a financial performance which has increased gradually. In addition valuation could be calculated based on ratio average industry trough PE, PBV, and Ebitda Ratio.

IPO is the solution of PLN Batam to create that value, It is not only about fund raising but also other subjective variables benefit such as easiness to lend, brand image, liquidity for the investor, Cash infusion, Stock as currency, etc.

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