

VALUATION OF INDONESIAN CABLE COMPANY WITH FREE CASH FLOW TO FIRM AND RELATIVE VALUATION

Sucipto Harjono¹, Riko Hendrawan²

^{1,2}Universitas Telkom

* sucipto.harjono@gmail.com ** riko_hendrawan@yahoo.com

ABSTRACT

During 2014 - 2018, cable companies in Indonesia showed an 8.52% average annual revenue growth. Unfortunately, analysts are responding to this growth negatively. Hence, In this study, we will conduct a valuation of six cable companies in Indonesia that are listed on the Indonesia Stock Exchange (IDX). We evaluate using two methods, namely Free Cash Flow to Firm (FCFF) to get the Intrinsic Value of shares, Relative Valuation using Price to Book Value (PBV), and Price to Earnings Ratio (PER) to validate the intrinsic value. The valuation results consider three scenarios: optimistic, moderate, and pessimistic. In the optimistic scenario, the Intrinsic Value of JECC, KBLI, and VOKS shares are overvalued in all scenarios, while IKBI, KBLM, and SCCO are undervalued throughout the scenario. Validation using PBV for the optimistic scenario, all companies are considered overvalued. For the moderate scenario, the PBV of IKBI, KBLI, and VOKS are overvalued, while JECC, KBLM, and SCCO are undervalued. As for the pessimistic scenario, only the PBV of IKBI is overvalued. Validation using PER for the optimistic scenario, the PER of IKBI, JECC, KBLM, and SCCO are overvalued, while the PER of KBLI and VOKS are undervalued. For the moderate scenarios, the PER of IKBI and SCCO are overvalued, while the PER of JECC, KBLI, KBLM, and VOKS are undervalued. Whereas for the pessimistic scenario, only the PER of IKBI is overvalued, while JECC, KBLI, KBLM, SCCO, and VOKS are undervalued.

Keywords: valuation, shares, FCFF, PBV, PER

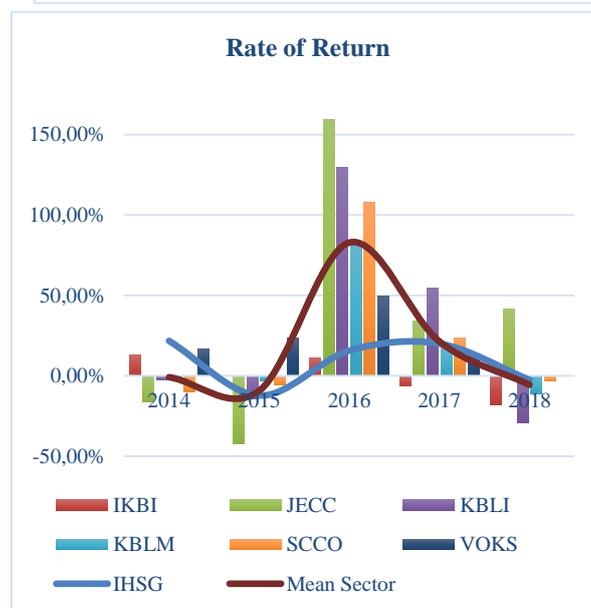
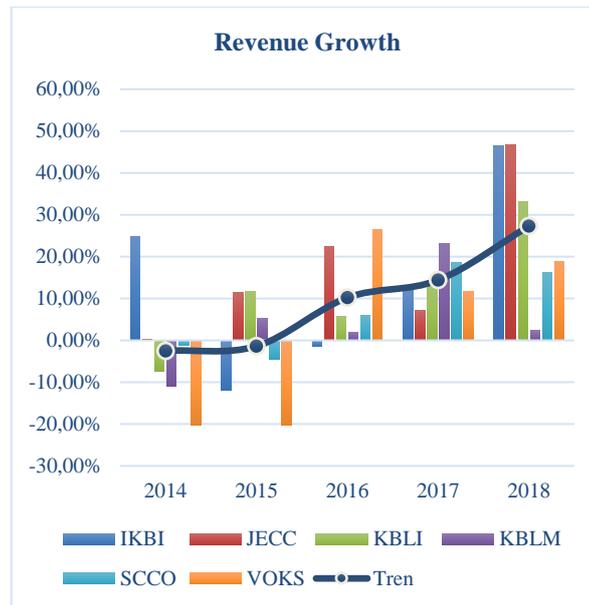
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INTRODUCTION

In line with the Government of the Republic of Indonesia's program to accelerate Minimum Service Standards for public services in disadvantaged areas, electricity and telecommunications are among the sectors of government concern (PPN/Bappenas, 2019). Correspondingly, the contribution of these two industrial sectors to the Gross Domestic Product (GDP) is also expected to increase, with a range of 5.39% for the information and communication industry and 1.03% for electricity and gas procurement (Perekonomian, 2019).

This increase directly helped boost the revenue growth of companies engaged in this sector and its supporting sector (Hutapea et al., 2015; Myers, 1984). Based on published financial reports, companies in the cable industry have shown an annual positive growth trend since 2014, with an average growth of 8.52% (YoY).

The increase in annual income growth is unfortunately not always accompanied by an increase in returns on the capital market (Murphy, 2022). Hence, the market analyst does not always positively respond to this growth. It is proven that the yield rate tends to decrease after rising in 2016 (Hutapea et al., 2013). Even since 2017, the average stock returns of companies in the cable industry tend to be lower than the market (IHSG), as illustrated in **Figures 1** and **2**.



Figures 1. Trend Revenue Growth in Cable Industry

Figures 2. Trend Rate of Return

Given this phenomenon, we are interested in further analyzing the valuation of cable companies. In this study, the writer will use the Free Cash Flow to Firm (FCFF) to determine the Intrinsic price of shares (Hendri & Eldiswandi, 2018; Paramitha et al., 2014). The relative valuation methods used in this study are Price-to-price-to-book value (PBV) and Price-to-price-to-earnings ratio (PER) (Indonesia Stock Exchange, 2021).

METHOD

This research uses a descriptive-quantitative approach by displaying data obtained from a population sample, in this case, cable companies listed on the Indonesia Stock Exchange (IDX). Data obtained from the sample will be used to carry out intrinsic valuations using FCFF, then validated with relative valuations using PBV and PER. By first projecting it into three growth scenarios: optimistic, moderate, and pessimistic.

The sample is taken by purposive sampling method, which chooses a particular sample that is intentional by the researcher because only the sample represents or can provide information to answer the research problem (Indrawati, 2015).

To apply the purposive sampling method, the writer applies two main criteria: (1) The companies sampled are cable companies listed on the IDX. (2) The company shares were traded during the observation period, in this case, from January 2014 - June 2019.

Based on these two criteria, the following six companies and their stock codes are sampled for the study: (1) PT. Sumi Indo Kabel, Tbk: IKBI, (2) PT. Jembo Cable Company, Tbk: JECC, (3) PT. KMI Wire and Cable, Tbk: KBLI (4) PT. Kabelindo Murni, Tbk: KBLM, (5) PT. Supreme Cable Manufacturing & Commerce, Tbk: SCCO (6) PT. Voksel Electric, Tbk: VOKS (Tandelilin, 2013).

The data used are secondary data which includes: (1) Stock trading data on the IDX during the observation period, (2) Annual financial statements that have been audited and published by the company, (3) IDX reports in the last observation period, as a comparison of research results (Indonesia Stock Exchange & Data Services Division, 2019).

RESULTS AND DISCUSSION

Macroeconomy Analysis

Bank Indonesia predicts economic growth in 2019 to be at the midpoint of the 5.0% - 5.4% range and will increase towards the midpoint of the 5.1% - 5.5% range by 2020. In terms of bank credit, Bank Indonesia estimates growth in bank credit in the range of 10% - 12% (YoY) during 2019 and 11% - 13% (YoY) in 2020 (Indonesia, 2019). In the monetary sector, throughout the First and Second Quarters of Bank Indonesia, the BI 7-day Reverse Repo Rate remained at 6.00%, with the Deposit Facility at 5.25% and the Lending Facility at 6.75%. (Indonesia, 2019)

Industrial Analysis

The Indonesian Electric Cable Factory Association (APKABEL) projects that domestic production capacity can increase by 10% - 15% from capacity at the end of 2018 (Arief, 2019). Given the revenue growth of the cable industry sub-sector in 2014 - 2018 and the average return on investment in the companies in the same period as in **Figures 1** and **2**, the projections submitted by APKABEL are acceptable. Therefore we will use the lower limit of this projection to calculate the projected growth in revenue of cable sub-sector companies for 2019-2024 (Radonovic, 2020).

Growth Projections

In making growth projections, we make three scenarios: optimistic, moderate, and pessimistic. As for estimating the magnitude of the projected growth in each scenario, we make a classification by considering the following parameters (Afriani & Asma, 2019): (1) the historical growth rate during the observation period, (2) the projected growth in the industrial sector, (3) the difference (spread) between the average growth and industrial sector projections.

Table 1. Projection Classification

Spread	Optimistic	Moderate	Pessimistic
Positive (+)	Projection = Industrial Projection + spread + ($\frac{1}{2}x$ spread)	Projection = Industrial Projection + spread	Projection = Industrial Projection
Negative (-)	Projection = Industrial Projection	Projection = Industrial Projection + spread	Projection = Historical Growth

By applying historical growth data from the sample to the projection classification, we can project the sample company's growth in the following three scenarios.

Table 2. Growth Projection

Companies	Average Historical	Industrial Average	Spread	Industrial Projection	Optimistic	Moderate	Pessimistic
IKBI	12.3%	8.52%	3.78%	10%	15.67%	13.78%	10%
JECC	16.57%		8.06%		22.08%	18.06%	10%
KBLI	10.51%		2.00%		12.99%	12.00%	10%
KBLM	3.78%		-4.73%		10%	5.27%	3.78%
SCCO	6.59%		-1.93%		10%	8.07%	6.59%
VOKS	1.35%		-7.17%		10%	2.83%	1.35%

Calculating Beta (β)

In valuations, β (Beta) is a coefficient that shows the risk that an asset has relative to the "market portfolio" (Damodaran, 2010). In calculating intrinsic value, β is one of the forms of the cost of equity (Re, see formula 4), which is used later in calculating WACC using formula 3. Calculating β is generally done by looking at how a stock has moved in the past, compared to market movements. Consequently, the estimated β obtained will be backward because it is influenced by past market data and noise (contains many errors). One solution proposed by Damodaran is not to compare it with the market but with the industrial sector (Damodaran, 2010). Following this suggestion, we calculate the value of β with the following approach.

$$\beta = \frac{\text{Covariance (Company, Industry)}}{\text{Variance (Industry)}} \tag{10}$$

Using a linear regression between the average value of the annual stock returns and the average cable industry yield, the β slope regression for the entire sample is as follows.

Table 3. β value

	IKBI	JECC	KBLI	KBLM	SCCO	VOKS
β (Beta)	0.15	1.87	1.67	0.98	1.28	0.40

Intrinsic and Relative Valuation in Optimistic Scenario

Table 4. Valuation in Optimistic Scenario

Optimistic	Market Price		Intrinsic Value	
	Jun'19	Jun'19	PBV Valuation	PER Valuation
IKBI	270	1,026	1.26	1,207
JECC	6,400	5,352	1.25	12.89
KBLI	555	554	1.00	8.28
KBLM	232	752	0.96	22.18
SCCO	9,375	18,073	1.19	19.29
VOKS	298	297.5	1.28	10.65

The intrinsic valuation in the optimistic scenario shows that JECC, KBLI, and VOKS are considered overvalued. However, for KBLI and VOKS, the difference between market price and intrinsic value is insignificant. Compared to the average PBV and PER ratio in June 2019 (PBV = 0.95, and PER = 11) (IDX, 2019), all companies' PBV is considered overvalued. However, the differences in average industrial PBV for KBLI and KBLM are insignificant. Meanwhile, only KBLI and VOKS are undervalued in the PER results.

Intrinsic and Relative Valuation in Moderate Scenario

Table 5. Valuation in Moderate Scenario

Moderate	Market Price		Intrinsic Value	
	Jun'19	Jun'19	PBV Valuation	PER Valuation
IKBI	270	954	1.17	1,122
JECC	6,400	3,739	0.87	8.45
KBLI	555	533	0.96	7.97
KBLM	232	260	0.33	7.67
SCCO	9,375	10,450	0.69	11.15
VOKS	298	13	0.05	0.47

In the moderate scenario, JECC, KBLI, and VOKS are overvalued, while IKBI, KBLM, and SCCO are undervalued. The PBV valuation shows that only IKBI and KBLI are considered overvalued, although, for KBLI, the difference with the average industrial PBV is insignificant. The PER valuation shows that only IKBI and SCCO are considered overvalued (Itemgenova & Sikveland, 2020).

Intrinsic Valuation and Relative Valuation in Pessimistic Scenario

Table 6. Valuation in Pessimistic Scenario

Pessimistic	Market Price		PBV Valuation	PER Valuation
	Jun'19	Jun'19		
IKBI	270	824	1.01	970.15
JECC	6,400	1,098	0.26	2.64

Pessimistic	Market Price		PBV Valuation	PER Valuation
	Jun'19	Jun'19		
KBLI	555	493	0.89	7.37
KBLM	232	245	0.31	7.24
SCCO	9,375	9,819	0.65	10.48
VOKS	298	5	0.02	0.18

In the pessimistic scenario, JECC, KBLI, and VOKS are overvalued, while IKBI, KBLM, and SCCO are undervalued. In the PBV and PER valuations, only IKBI is overvalued.

CONCLUSION

IKBI needs to be highlighted; Even though their intrinsic valuation is undervalued, the relative valuation results, especially PER, show overvalued in all scenarios. One cause of the high valuation of PER is the exclusion of depreciation and amortization as an expense in the income statement. Consequently, when included in the FCFE calculation, it gives lower Earnings before Interest and Tax (EBIT) and Earnings per Share (EPS) compared to what the company reported. The management of PT. As the issuer of IKBI shares, Sumi Indo Kabel can consider improving the performance, specifically to generate more earnings (net income). An increment in net income can lower the PER ratio, and a lower PER ratio is more likely to attract investors to purchase the shares.

JECC shares are considered overvalued in all scenarios. It interpreted that investors put more hope into the company. Therefore the management of PT. Jembo Cable Company, Tbk, should respond to this trust by improving performance, especially by maintaining operational profitability. Nevertheless, this is a sell signal for short-term investors for JECC shares.

Like JECC, KBLI shares are overvalued in all scenarios, even though the gap between valuation results and the market price is insignificant (close to its fair value). Therefore the shares can still be purchased for the short, medium, and long term.

KBLM and SCCO shares are undervalued in all scenarios, making their stock attractive to buy in all terms. A note for SCCO, the results of PER valuation show overvalued compared to industrial PER. It needs to be highlighted by the management of PT. Supreme Cable Manufacturing and Commerce, Tbk. as the issuer since the high PER is not attracting investors.

Specifically for VOKS, given the average annual growth from 2014 to 2018 is the lowest, it is reasonable when the valuation result is overvalued in all scenarios. However, reflecting on the performance that has tended to be positive since 2016, VOKS shares still can be purchased for the medium to long term by paying attention to their routine at the end of 2019.

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