

# CHAPTER 1

## INTRODUCTION

### 1.1 Background

Initial Public Offering (IPO) or simply known as "public offering" is an event when a company issues common stock or shares to the public for the first time. They are often issued by smaller, younger companies seeking capital to expand, but can also be done by large privately-owned or even state-owned companies looking to become publicly traded.

I fortunate enough to be included in the IPO team for PT Tudung Putra Putri Jaya back in 2008, where I learned the IPO process. However, since the oil prices increase in mid 2008 impacting the company valuation, the IPO project was suspended. Therefore, I find it interesting to do my final thesis on company valuation, trying to finish it and understand how to value a company based on lectures I have received during my study in MM-MBA. When I first start to write this thesis back in September 2008, the hottest issue at that time is the IPO of PT Adaro Energy Tbk. Hence I choose this thesis based on PT Adaro Energy Tbk.

PT Adaro Energy Tbk as the second largest integrated coal-based energy company in Indonesia has announced its plan to go public on May 26, 2008 during public expose in Ritz Carlton Hotel, Jakarta. This decision was made in pursue of its company's vision to be the largest and most efficient integrated coal mining and energy company in South East Asia.

The decision to go public is a major milestone for every company. The road to Initial Public Offering can be a tedious and treacherous one and must be handled with care. The first step an Initial Public Offering aspirant should take is to evaluate whether the company is ready to withstand public scrutiny and whether it can meet the standards and performance expected of a public listed company. Pre-Initial Public Offering preparatory work must be done prior to embarking on the Initial Public Offering road. This includes assessing the company's growth prospects, beefing up the management team, strengthening its financial position, tightening its internal controls, improving operational efficiency, addressing problems and resolving issues that may adversely affect the

listing. In addition, the company should also evaluate whether it is able to commit adequate resources to meet the pressing deadlines in the Initial Public Offering process.

The decision to go public has several advantages where non public listed companies have less alternatives in raising the fund compared to public listed companies. Non public listed companies also required tighter control when they want to raise capital through banks or other financial institutions.

On the other hand, public listed companies have access to cheap fund from the public easily. The fresh fund comes from new investor is not going to disturb the operational, less tax and less paperwork too. Being on a major stock exchange also carries a considerable amount of prestige. In the past, only private companies with strong fundamentals could qualify for an IPO and it was not easy to get listed.

One of the most important processes in Initial Public Offering is setting the offering price. Based on Badan Pengawasan Pasar Modal dan Lembaga Keuangan (BAPEPAMLK) regulation No. KEP-01/PM/1988 dated February 2, 1988 article 11, stated that Initial Public Offering price is set between the company and the underwriter.

Underwriter is middlemen between companies and the investing public. The current biggest underwriters are JP Morgan Chase, Goldman Sachs, Merrill Lynch, Credit Suisse First Boston and Morgan Stanley. Successful Initial Public Offerings are typically supported by big underwriters that have better ability to promote the company while smaller underwriters are willing to underwrite any company.

As the effective date approaches, the underwriter and company sit down and decide on the price. This is not an easy decision as it depends on the company, the success of the road show and, most importantly, current market conditions. Of course, it is in both parties' interest to get as much as possible.

Therefore, there are a lot of works to do, both by the underwriter and the company, in calculating the right Initial Public Offering price before they are offered to the public.

## 1.2 Problem Identification

PT Adaro Energy Tbk is listed in the Indonesia Stock Exchange (IDX) as the 15th listed company in 2008. The stock code of PT Adaro Energy Tbk is ADRO, and it is listed in the Main Board.

PT Adaro Energy Tbk on July 16, 2008 has raised USD1.32 billion in the country's largest ever Initial Public Offering after pricing the shares near the top end of the indicated range. The company set the Initial Public Offering price at IDR1,100 per share, near the top end of its initial IDR1,050 to IDR1,125 range. This thesis would like to find out whether the price is overstated or understated.

## 1.3 Problem Limitation

The topic discussion is about analyzing the Initial Public Offering share price, is it undervalued or overvalued during the Initial Public Offering period based on Discounted Cash Flow (DCF) and Price Earnings (P/E) Multiple Model or better known as Price Earnings Ratio (PER).

Discounted Cash Flow (DCF) calculation method used in this thesis and some other key variables, such as Risk Premium, Risk-free interest rate and Beta, are based on guidance and data provided by Aswath Damodaran which can be found on his website (November 7, 2008. <http://pages.stern.nyu.edu/~adamodar/>). Free Cash Flows to the Firm (FCFF) stable growth model is used in Discounted Cash Flow (DCF) calculation to value PT Adaro Energy Tbk as a result from choosing the valuation model from Aswath Damodaran.

Price Earnings (P/E) Multiple Model calculation method used in this thesis is based on absolute Price Earnings Ratio although there is another analysis by relative Price Earnings Ratio which will not be discussed in this thesis. The theory of absolute Price Earnings Ratio will be discussed in subchapter 2.6 of this thesis.

This thesis also tries to analyze the current financial crisis situations that impacting the company's valuation of PT Adaro Energy Tbk based on recommendations by some bankers, securities analysts and data found on Indonesia Stock Exchange (IDX) website. The analysis will be limited to current price per share and Price Earnings ratios as the 2008 year end audited financial statement has not released yet.

## 1.4 Objectives

The objectives of this thesis are:

- a) To provide cash flow calculation based on time value of money and its effect to the valuation of the company.
- b) To provide price calculation based on Price Earnings Multiple Model using current Price Earnings ratios in mining industry, coal mining sector, comparable company and American coal mining sector.
- c) To provide pricing analysis for Initial Public Offering share.
- d) To provide analysis on company valuation based on current financial crisis.

## 1.5 Methodology

This thesis is written using theories from Corporate Finance and Investments which concentrated on the valuation of the company based on relevant data and information gathered. All gathered data and information are then analyzed and concluded.

Information and data of this thesis consist of secondary data. The secondary data will be obtained from several available sources of reference and literatures such as articles from magazine, newspapers, bulletin, internet website, and several books from library that relevant to this topic.

## 1.6 Framework

### CHAPTER I. INTRODUCTION

Describe the background, problem identification, problem limitation, objectives, methodology and framework.

### CHAPTER II. THEORY

Describe the financial markets, business valuation, cost of going public, discount rate theory, estimating growth, stock valuation methods and explanation on Damodaran's model.

### CHAPTER III. COMPANY BACKGROUND

Describe the company profile, vision and mission, organization structure, business activities, business industry, business

strategies, pricing calculation, business risks and notes on initial public offering.

CHAPTER IV. ANALYSIS

Describe the financial performance, discount rate calculation, Initial Public Offering share price calculation, analysis on Initial Public Offering share price and valuation based on current situation.

CHAPTER V. CONCLUSION AND RECOMMENDATION

Describe the conclusion and recommendation of this final paper.

