

Stock Price Valuation of PT. Erajaya Swasembada Tbk. (ERAA) Using Discounted Cash Flow Method

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OPENING PARAGRAPH

Indonesian GDP increased at a quite impressive rate during the 2014 – 2018 (World Bank, 2018). However, according to Economic Report on Indonesia 2017 by Bank Indonesia, the recovery of household consumption is relatively slow compared to the recovery of GDP which is caused more by the recovery of natural resources export (Bank Indonesia, 2017). Despite that, Indonesian consumer spending on mobile phone and accessories is always increasing year-on-year from 2013 to 2017 of (Survei Sosial Ekonomi Nasional, 2013, 2014, 2015, 2016, 2017). In 2013, Indonesian monthly Per Capita Consumer Spending for Mobile Phone and Accessories was only IDR 1749 and kept increasing, even almost tripled to IDR 5145 in 2017. If there is one publicly traded company that can reap a very big benefit from that, it will be PT. Erajaya Swasembada Tbk (ticker code: ERAA). Despite the digital disruption with online marketplace growing very fast, ERAA is still a leading importer, retailer and distributor of mobile devices in Indonesia with a market share of 33% in 2017. However, in 2018 the stock of Erajaya rose by 200% in 2018 in the midst of global uncertainty. By the end of 2018, the price of ERAA was IDR 2,200. At a glance, ERAA may seem overvalued. The investors may face hard time deciding whether ERAA is still investment worthy knowing that it has soared even in the midst of sideways market in 2018. However, the investors have to do a valuation to actually know whether an asset, in this case ERAA' stock, is actually overvalued or not. One of the methods to do valuation is using discounted cash flow valuation (DCF) which is done to know the intrinsic value of a company.

COMPANY BACKGROUND

PT. Erajaya Swasembada Tbk. ("Erajaya") established in 1996. With its head office located at Jalan Gedong Panjang No. 29 Jakarta, Erajaya conducts business activities of importing, distributing and retail trading of cellular telecommunication devices such as cellular and tablet phones, subscriber identity module cards (SIM Cards), mobile phone top-up vouchers, accessories, and other gadgets such as computers and other electronic peripherals. The vision of Erajaya is "Provide mobile devices and solutions to improve quality and lifestyle" (Erajaya Swasembada, 2017). Erajaya is a publicly listed company. Erajaya made an initial public offering of the 31.7% of its shares at December 14th 2011 with the initial offered price at 1000/share and since then has been publicly listed in the Indonesian Stock Exchange ("IDX") under the ticker code "ERAA". Erajaya is included in the trade, service and investment sector in the IDX. Erajaya has engaged in a strategic partnership with prominent global brands of telecommunications devices, for example, Alcatel, Apple, ASUS, Lenovo, LG, Motorola, Nokia, Oppo and Xiaomi, and Vivo. For mobile operator products and contents, Erajaya has partnership with Indosat Ooredoo, Telkomsel, XL Axiata and Smartfren. For lifestyle accessories and value-added services, Erajaya has partnership with Samsung, Xiaomi, DJI, Harman-Kardon, GoPro, Garmin and Apple. As of 2017, Erajaya has operated in almost every major Island of Indonesia except Papua. Abroad, it also has retail businesses in Malaysia and Singapore. As of December 31, 2018, the Company have successfully developed Omni-channel networks all over Indonesia , supported by 84 distribution points, 936 retail outlets, and more than 52,000 third-party resellers. Store openings has reached 212 stores in 2018 an increase of 59.39% compared to 133 stores in 2017 (Erajaya Swasembada, 2018).

Generally, the business line of Erajaya can be differentiated into three. The first line is distribution business. The second line is retail business. The third business line is online channels or e-Commerce, namely Erafone Dotcom and iBox.co.id. With approximately 32% - 33% market share as per December 31, 2017, the Company still holds position as the leading telecommunication retail and distribution company in Indonesia (Erajaya Swasembada, 2017).

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SPECIFIC AREA OF INTEREST

Erajaya has booked an impressive compounded annual growth rate (CAGR) in sales of 24.52% from 2014 to 2018 including 43% growth in 2018 alone. Although ERAA did a private placement to Xiaomi in May 2018, and issued 290.000.000 new shares, which diluted the EPS of ERAA, it still skyrocketed from 117 in 2017 to 293 in 2018 which means a 150% increase in a year. It is reflected in the market, which responds positively to the increase in EPS of Erajaya and the stock price rise significantly compared to other competitors. It is in line with a previous study which stated that EPS is proved to be a significant variable that influences stock price (Puspitaningtyas, 2017).

In 2018, Erajaya's stock recorded a quite impressive growth in Indonesian Stock Exchange in 2018 with 200% increase in a year while on the contrary, the index that included Erajaya's stock in the calculation, the KOMPAS100 index is down 6.3% and the ISSI index is down 3.1%. This shows that the general market is not actually bullish and thus only select few good stocks can perform well. The author wants to find out does the stock still have upward potential knowing the fact that the percentage of people who own or in possession of cellular phones is increasing during 2012-2016 in Indonesia increased from 47.99%, to 58.3% in 2016 (Badan Pusat Statistik Indonesia, 2016) and the stock price has gone up so far, so in the end the author hopes to give an investment recommendation to the investors of ERAA. This study is limited for the investors of ERAA.

The author gathered publicly available information from credible news source, official statement, and research company to create the assumptions for the financial projection. Financial report of the year 2014-2018 is used as the base year and creating a 5-year projection to calculate the stock's fair price. The fair price can be compared with the market price to see whether the stock still has some upward potential and thus may help the general public and investors to make their investment decision.

SPECIFIC PROBLEM

In 2018, ERAA rose by 200% while the Indonesian Stock Exchange (IDX) represented by the IHSG index closed down 2.5%. The weak condition if IDX may be due to the Dow Jones Industrial Average (DJI), one of the indexes of the US market which calculates the return of 30 large, public company from various US stock exchange, also suffered a loss in the year, and DJI is said to have a significant positive impact towards IHSG (Amin, 2012). In addition to that, Rupiah is also depreciated significantly towards USD in 2015 and 2018, 10% and 7% respectively. Rupiah to USD rate is also said to have a positive significant impact towards the IHSG, so depreciated Rupiah will impact the IHSG negatively (Amin, 2012; Kusuma & Badjra, 2016). ERAA at a glance may seem like it was already overvalued. However, one has to do valuation to know if an asset is actually overvalued or not. Valuation is a process of linking risk and return to determine a worth of an asset (Khan & Jain, 2007). The importance of valuation is that it can be used as a reference for investors in deciding to buy a stock or not. The decision can lead to a profit in the form of capital gains or dividends for the investor, or vice versa, experiencing a loss due to the falling stock price (Bodie, Kane, & Marcus, 2011). Stock price is considered overvalued if observed market values are higher than their predicted intrinsic values and stock price is considered undervalued if observed market values are lower than their predicted intrinsic values (Chung & Jeong-Bon, 2001).

According to Damodaran (2012), in general, there are three methods to do valuation (Damodaran, 2012). The first is discounted cash flow (DCF) valuation. The second is relative valuation. The third is contingent claim valuation. This paper is to calculate the fair stock price of ERAA by Discounted Cash Flow (DCF) method, specifically by calculating the Free Cash Flow to Firm (FCFF). The author decided that it is applicable to do a discounted cash flow valuation for Erajaya because Erajaya meet some requirements stated in Damodaran's book; cash flows are currently positive and can be estimated with some reliability for future periods, and where a proxy for risk that can be used to obtain discount rates is available (Damodaran, 2012). The current condition of Erajaya is good, showing no sign of bankruptcy, making it in line with the going concern principle of discounted cash flow valuation, cash flows are always positive, at least since the last 5 years and can be estimated with some reliability taking into account the growing base of smartphone user in Indonesia, the general condition of Indonesia's economic condition and other things, and risk can be proxied.

Looking further, despite the amazing yield in 2018, ERAA may still have a potential upside. ERAA's main sales is mobile phones and tablets which accounts for more than 80% of their sales. ERAA still has the room to grow driven by the growth of projected user of smartphone in Indonesia which will still grow by a CAGR of 6.36% until 2022 which is then projected using the same rate until 2023 which is the end of the explicit forecast period used by the author which is 5 years, 2019-2023 (Statista, 2019b). Other than that, Erajaya is also planning to open stores in second tier city in 2019 until 2021 which was previously untapped. Not forgetting that the IMEI regulation which is predicted to take place in mid 2019 and the introduction of the first-ever foldable phone by various brand principles in 2019 (Telset, 2019). By seeing the potential growth of Erajaya while still not forgetting the fact that the stock price has soared 200% in 2018, the author wants to calculate the fair price of Erajaya's stock. The author

wants to know the fair price and whether it will still be a good investment if an investor invests in Erajaya's stock because if the firm's value is higher than its market price, it means the market is undervaluing the firm and it will be a good investment because eventually the market will reflect the intrinsic fair price of the stock. This is done by calculating the fair price of Erajaya's stock through DCF valuation and FCFF method. The fair price then can be used as a guideline for investing in Erajaya's stock.

The author created several assumptions and it is used as the basis for the projection in explicit forecast period. The key driver is listed as follows:

| Driver | 2019F | 2020F | 2021F | 2022F | 2023F |
|--|----------------------|----------------------|----------------------|----------------------|----------------------|
| Sales (in million Rupiah) | IDR 33,417,413.32 | IDR 35,877,313.35 | IDR 37,918,607.07 | IDR 39,635,363.30 | IDR 42,321,028.54 |
| Analysis: The sales figure is derived using regression from historical data since 2014-2018 between sales and smartphone user and then created into a projection. The rest of the income is from accessories, spare part, IoT, and voucher and the CEO of Erajaya stated that the smartphone itself will be the enabler of the rest or in other word they are correlated with each other. The data of smartphone user in Indonesia is from Statista in 2018. | | | | | |
| Gross Profit Margin (GPM) | 9.33% | 9.54% | 9.76% | 9.76% | 9.76% |
| Analysis: ERAA is planning to expand and open new stores until 2021 and tapping into new cities which is previously untapped. It is expected to increase gross profit margin and the gross profit growth rate is taken from the historical GPM growth rate in 2014-2018 as ERAA also opened new stores during that period. Gross profit margin is expected to keep increasing as ERAA is opening their new stores so they can sell directly to end customer so they can reap a better profit margin. Added to that, the CEO of ERAA states that they are expecting to sell more of IOT and accessories which have better profit margin (CNBC Indonesia, 2019). | | | | | |
| Selling General & Administration Expense (exclude depreciation and amortization) to Sales | 5.07% | 5.07% | 5.07% | 5.07% | 5.07% |
| Analysis: ERAA is expected to maintain the last SG&A expense to sales ratio as there are no new driver to shift this particular number. In 2018 ERAA also open 220 new stores and the SG&A can be lowered, so considering ERAA's plan to expand, it is expected to be maintained. SG&A is correlated with sales, so the author used SG&A to sales ratio. | | | | | |
| Tax Rate | 25% | 25% | 25% | 25% | 25% |
| Article 17 of Indonesia's Corporate Tax Law | | | | | |
| Terminal Growth | 5.24% | | | | |
| Analysis: Terminal growth is taken from the average of projected Indonesian economic growth for the year 2019-2023 from Statista (Statista, 2019a). | | | | | |
| Inventory Days | 78 | 75 | 75 | 75 | 75 |
| Analysis: ERAA recently made a deal with Xiaomi, so Xiaomi imports the spare parts and manufacture it by itself locally and will be selling the phone as a finished goods to ERAA while previously it was ERAA who did the importing and manufacturing through a third-party and will lead to a decrease in DIO up to seven days compared to 2018 (RHB Securities, 2018). | | | | | |

Using the assumptions, the FCFF can be derived from the income statement and the result is as follows.

| Year | 2019F | 2020F | 2021F | 2022F | 2023F |
|------------------------|--------------|--------------|--------------|--------------|--------------|
| EBIT | Rp 1,443,833 | Rp 1,624,493 | Rp 1,795,849 | Rp 1,873,234 | Rp 1,999,861 |
| TAX | Rp 360,958 | Rp 406,123 | Rp 448,962 | Rp 468,309 | Rp 499,965 |
| After-tax EBIT (NOPAT) | Rp 1,082,875 | Rp 1,218,370 | Rp 1,346,887 | Rp 1,404,926 | Rp 1,499,896 |
| add back DD&A | Rp 83,658 | Rp 92,849 | Rp 102,354 | Rp 111,896 | Rp 121,282 |
| less Capex | Rp (160,531) | Rp (172,348) | Rp (182,154) | Rp (190,401) | Rp (203,302) |
| Working Capital | Rp 2,421,761 | Rp 2,574,489 | Rp 2,726,222 | Rp 2,863,347 | Rp 3,014,440 |
| less ΔNWC | Rp 108,660 | Rp 152,728 | Rp 151,734 | Rp 137,125 | Rp 151,093 |
| FCFF | Rp 897,343 | Rp 986,143 | Rp 1,115,354 | Rp 1,189,296 | Rp 1,266,783 |

After knowing the firm value of ERAA, we subtract the current debt value to arrive at the equity value. The current debt value is IDR 4,287,300,000,000 and the cash is at IDR 272,103,000,000 thus it will result in the equity value of IDR 11,432,873,000,000.

After that, since the share outstanding is known at 3,190,000,000 shares, equity value per share can be calculated by dividing the equity value by the number of shares outstanding. The equity value per share or intrinsic share price is IDR 3,584 per share. Compared to the market price, ERAA can be considered undervalued because the market price of IDR 2,200 is below the intrinsic price of IDR 3,584. Although in 2018 it rose by nearly 200%, ERAA still has the potential upside of 62.91%. This implies a potential upside of 62.91%. The author gives a buy recommendation for the investor of ERAA as it is still investment-worthy and has a lot of upside potential. However, as the author used some assumptions and projections in this study and may not be fully accurate, the author recommends investor to still adjust this recommendation with their investing style and the current development of market dynamics.

ALTERNATIVES

This study to look for the intrinsic value per share of ERAA is solved using DCF specifically FCFF, while another method to value ERAA is using market multiples or relative valuation, be it PE, PBV, EV/EBITDA and other market multiples, as long as the numerator and the denominator are consistently defined (Damodaran, 2012). By using market multiple of the industry, or comparable peers, it can also solve the question of the value of ERAA, whether it is actually overvalued or not. Valuation using multiples is also useful in the second stage of the valuation, after performing the valuation in another method, a calculation comparing with the multiples of comparable firms enable us to gauge the valuation performed and identify the deviation between the firm valued and the comparables (Fernandez, 2001).

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