Capital Structure Strategy to Enhance Value of PT. Astra International

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Abstract

Being the best company in their field is every company's goal. One of the success measurements of being the best company is how the company enhances its shareholders value through the prosperity increase of the owners or shareholders. Looking at the current performance of PT Astra International Tbk it is unfavourable for current investors and potential investors because of the declining in PT Astra International Tbk's value which lead to generate less earnings for its shareholders.

Consequently the purpose of this research is to propose financial strategy namely capital structure strategy to calculate the appropriate proportion of debt and equity through optimal capital structure calculation that able to enhance the value of PT Astra International Tbk. As for the methodology used in this research, it consists of financial ratio analysis, Discounted Cash Flow (DCF) Valuation and Weighted Average Cost of Capital (WACC) Approach for Optimal Capital Structure calculation. These methodologies will be used in determining the capital structure strategy for PT Astra International Tbk. The financial data in this research are collected from the companies' annual report from the last 6 years and the data from Indonesian Stock Exchange. According to the analysis in this result, the optimal capital structure for PT Astra International Tbk occurs when the company's debt proportion at 40% which generates the firm value of Rp295.786.553.748.130.

Keywords: PT Astra International; Financial Ratio Analysis; Discounted Cash Flow (DCF) Valuation; Weighted Average Cost of Capital (WACC) Approach; Optimal Capital Structure.

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1. Introduction

1.1. Research Background

PT Astra International Tbk is one of the largest diversified conglomerates or multinational company which can not Business in every country in the world are competing with each other and keep expanding their business continuously by giving their best performance to get more attention and trust from their partners, investors and customers. Therefore, every company implements different kind of policies and management systems in order to attract their partners, investors, and customers in hope to be the best company and become the market leader in their region or globally. As for the indicators for being the best company can be seen from the company's performances, which are high firm value and high firm profit (Bititci, 2010). The high firm value aspect represents the company had maximized the shareholder's value while high firm profit aspect represents the high amount of profit that is gained by shareholders and stakeholders. Those aspects could give benefit and great earnings for the company's shareholders and stakeholders as well as attracting potential shareholders.

PT Astra International Tbk is one of the largest diversified conglomerates or multinational company which can not be denied in possessing a high firm value and a high firm revenue in Indonesia. Morever PT Astra International considered as an investment holding company which is often regarded as the gauge of the Indonesian economy due to its presence in various sectors (automotive, agribusiness, heavy equipment, mining, energy, financial services, information technology, and infrastructure & logistics) which are present in almost every major sector of the Indonesian economy. In addition to this, these sector are not so much dependent on the volatility of one specific sector as most other Indonesian companies. Therefore, PT Astra International Tbk is likely to retain its position as a top Indonesian company in the foreseeable future.

From PT Astra International Tbk various sectors, the automotive sectors are the core business for Astra International due to their income contribution for more than 50% of Astra International total net income. Though this number considered high, it actually has drastically declined from contributing around 80% of Astra International total net income in the early of 2000s. The shift focus from automotive sector in PT Astra International Tbk was done because the future of car industry is gloomy due to the government policy in trying to raise taxes for owning of more than one car, curbed huge subsidies on fuel, has curbed enermous lending for vehicle purchases (by designing a higher downward payment for car purchases), and planned to make other policy which may reduce the number of car in Indonesia. Moreover, the latest trend in car is moving towards a smart and city car with inexpensive price which lead to the decrease in the profit margin of this type of car also the reduction in the demand of other types of car. All of these aspects may cause the profits from the automotive industry to become unprospect in the future.

In response to this matter, PT Astra International Tbk has started to reduce its dependecy on car sales and began to spread its source of incomes to other sectors. Strangely, the company new strategy in diversifying its source of income proved to be ineffective through its financial performance. The ineffective strategy of PT Astra International Tbk can be seen from the decrease in its net profit margin that has occured for 5 years straight compared to one year earlier even though its revenue and net income were recently declining since 2015. The slugish in Indonesian economy and other factors certainly take a role in the decreasing of the financial performance for PT Astra International Tbk, but it also indicates that the focus displacement from automotive sectors greatly affects the financial performance of PT Astra International Tbk.

Along with the decrease in its net profit margin, Astra’s stock price is showing a fluctuating movement in each year. Although its stock price is sometimes strengthened compared to one year earlier, the return contribution of Astra’s stock is actually inferior compared to the Indonesia market return (IHSG) ever since 2011. This means, the earnings of Astra’s investors are less than what they should get on Indonesian market.

Indirectly, the decrease in Astra’s stock price and net profit are affecting the company value of Astra. Referring to the mentioned indicators of being the best company, the current performance of Astra does not fit both indicators whether it is maximizing its value nor its profit. Looking at the current performance of Astra, the management of Astra needs to implement new strategy that able to increase the net income along with enhancing the firm value in order to give benefit for its investors along with regain the confidence of Astra’s investors towards Astra.

From the brief explanation above, this research came up to financial strategy to enhance the value of PT Astra International Tbk. In conducting this research, there will be three steps. First, conduct the external and internal analysis of PT Astra International Tbk in order to find the symptom within PT Astra International Tbk. Second, calculate value of the company in order to know current value of Astra International based on the Discounted Cash Flow Method (from calculating FCF, WACC, Terminal Value, and Firm Value). And lastly, propose a recommended financial strategy for PT Astra International Tbk that able to maximize the company’s value.

2. THEORETICAL FRAMEWORK

2.1. Company Valuation

The analysis of valuation of a company is designed to process to exposure the rest value of the company based on the concerned aspects (the company’s strength), the financial performance, the effect and the fair and accurate business value of a company. Valuing a company is essential to many parties. For internal management, it will give the information and estimation about the company’s condition and also helps the management on financing, making investment plan, deciding company's policy (ex: dividend). For external management (the stakeholders), it will give information about fair value of the company in the market.

2.1.1. Discounted Cash Flow Method

According to Damodaran, Discounted Cash Flow Models used to find out the value of a company by estimating the cash flows for a period (usually specified to be an extraordinary growth period) and a terminal value at the end of the period, moreover assuming cash flows will grow at a stable growth rate that can be sustained forever after terminal years" (Damodaran, 2006). Based on the explanation about the value of firm can be expected to maintain extraordinary growth for n years, in general terms will be: (Damodaran, 2006)

$$Value\ of\ Firm = \sum_{n=1}^{\infty}\left(\frac{Expected\ Cash\ Flow}{(1+r)^n} + \frac{Terminal\ Value}{(1+r)^n}\right) \quad \text{(Eq 1)}$$

As for the steps to conduct Discounted Cash Flow Valuation will be shown in the figure below.

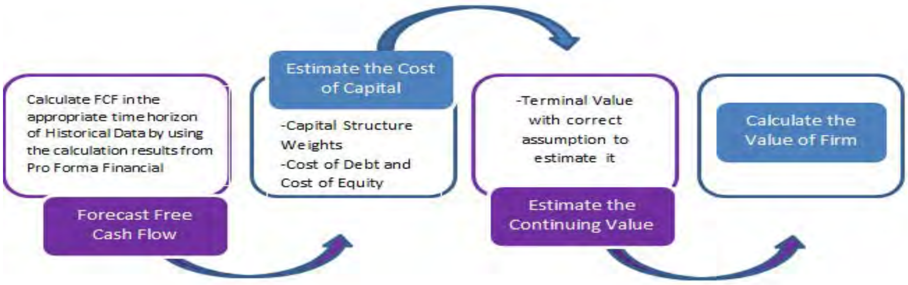

Figure 1 Discounted Cash Flow's Steps

2.3. Capital Structure

In finding the optimal capital structure from the company's capital (both equity and debt), it can be calculated through Weighted Average Cost of Capital (WACC) approach. WACC is an overall return that has to be gained from the company's business and activities, with the purpose of increasing or maintaining the market value of the company's work. To measure WACC, it requires the rate of return from every capital sources. Moreover, there will be different cost of capital and different class of securities each company has because it reflects the different risks each company poses.

3. RESEARCH METHOD

3.1. Problem Identification

The issues that raised in this research is concerning about the current performance of Astra is unfavorable for current investors and potential investors because of the declining in Astra's profitability and company value which lead to generate less profit for its shareholders. All of this were mainly caused by Astra's new strategy to reduce its dependency on its automotive sector and began to spread its source of incomes to other sectors due to government policies and other factors which cause the profits from the automotive sector to become unprospect in the future. To overcome the current condition of Astra, the management of Astra needs to quickly implement new strategy which able to give benefit to its investors by enhancing Astra's company value in accordance with Astra's current condition.

3.2. Research Objectives

In consequence with the problem identification, the objectives of this research were developed in order to compose the recommended financial strategy which able to enhance the value of PT Astra International Tbk. As a fundamental to determine the financial strategy for PT Astra International Tbk, a financial ratio analysis will be conducted in order to find Astra's current and historical financial performance. Then, a valuation will be conducted in order to find Astra's current value by using Discounted Cash Flow Method and Relative Valuation Method. After the valuation process, a financial strategy which able to enhance the value of PT Astra International Tbk will be proposed.

3.3. Literature Review

Based on the problem identification, this research is developed from various sources such as textbooks, journal, papers and internet sources which used as guidance in analyzing exposure and determining the research process in attempt to solve the problems. The theories that contained in this research are Financial Ratios, Company Valuation (FCF, Terminal Value, and Value of Firms), Capital Structure (WACC, Cost of Debt, and Cost of Equity).

3.4. Data Collection

All of the data within this research is secondary data from annual report of PT Astra International Tbk from the year 2010 – 2015, the capital market data of PT Astra International Tbk from the year 2010 – 2015, and other supporting data like the future plan that PT Astra International Tbk has planned and economy condition in Indonesia. These data will be analyzed later on.

3.5. Data Analysis

Through three steps, this research will generate the optimal capital structure to ehance the value of PT Astra International Tbk.

- First, conduct the financial ratio analysis to check the financial performance of PT Astra International Tbk.
- Second, calculate value of the company in order to know current value of Astra International based on the Discounted Cash Flow Method (from calculating FCF, WACC, Terminal Value, and Firm Value).
- Lastly, propose a recommended financial strategy for PT Astra International Tbk that able to maximize the company's value.

3.6. Conclusion & Recommendation

The conclusion of this research will be concluded from the data analysis stage. The conclusion may also act as a suggestion to review the financial performance of PT Astra International, Tbk. to find the best financial strategy which suitable with PT Astra International, Tbk.'s investment plans. This step will also include the summary of the findings which is highlighted in the research questions that will be presented including the recommendation and further research that has not been covered in this chapter.

4. Data Analysis

This section discloses the data analysis within this research

4.1. Company Valuation

The maximum value of the company can be achieved when the capital structure has been optimized and that condition may be achieved when the cost of capital at the minimum point. The value of the firm can be calculated by dividing the present value of free cash flow plus the present value of terminal value with the weighted average cost of capital (WACC). In calculating the value of the firm, there are three kinds of projection (pessimistic, most likely, and optimistic) and several key assumptions. The key assumptions in this research are:

- The sales growth rate in most likely is using PT Astra International Tbk's CAGR (13.33%), while the pessimistic is 7.53% and the optimistic is 15.99%;
- Tax rate is 25% based on Indonesia regulation on company tax rate
- Risk-free rate is 7.5% based on BI rate in December 2015
- Growth of the company is using inflation rate in 2015 (3.4%)

Here is the calculation result of PT Astra International Tbk's value with pessimistic, most-likely, and optimistic projection:

Summary	Pessimistic	Most Likely	Optimistic
Debt to Equity Ratio	17.56%		
Beta	1,2148		
After-tax Cost of Debt	6,19%		
Interest Rate	3,98%		
Cost of Equity	18,57%		
Cost of Capital	15,45%		
Total Free Cash Flow	Rp72,816,674,525,951	Rp110.918.894.351.356	Rp125,354,904,282,168
Terminal Value	Rp161,533,357,475,377	Rp335.463.067.683.513	Rp444,684,470,214,339
Value of Firm	Rp152,187,012,334,774	Rp286.105.793.749.593	Rp361,881,752,769,712

Table 2 Value of Firm PT Astra International Tbk in Year 2015

Based on the value of firm PT Astra International Tbk in the year 2015 in table 2, the value of pessimistic scenario is Rp152,187,012,334,774, the value of most-likely scenario is Rp286.105.793.749.593, and the value of optimistic scenario is Rp361,881,752,769,712. The value difference in each scenario was caused by the different sales growth that each scenario use. A 6.8% decrease in sales growth can lead to approximately 133 trillion rupiah difference in the value of firm between pessimistic and most likely scenario and a 2.66% increase in sales growth can lead to approximately 75 trillion rupiah difference in the value of firm between most likely and optimistic scenario. All of this scenario are using the same cost of capital that come from PT Astra International Tbk's annual report in the year 2015. This means the maximum value of the company has not been achieved due to the cost of capital has not been minimized.

4.2. Optimal Capital Structure

In capital structure, the cost of capital is the main components that need to be considered. This is because the optimal capital structure may be achieved when the cost of capital minimized and the value of the firm is maximized. The most likely scenario will be used as the reference in calculating the optimal capital structure in this research. Here is the calculation result of PT Astra International Tbk's optimal capital structure:

Debt Ratio	Rd	Equity Ratio	Re	WACC	Firm Value
0%	20,63%	100%	10,70%	10,70%	Rp273.777.001.224.475
10%	6,19%	90%	10,97%	10,49%	Rp281.908.764.506.176
20%	6,45%	80%	11,30%	10,33%	Rp288.344.281.312.224
30%	6,94%	70%	11,73%	10,29%	Rp289.959.069.026.952
40%	**6,94%**	**60%**	**12,30%**	**10,15%**	**Rp295.786.553.748.130**
50%	8,06%	50%	13,10%	10,58%	Rp278.284.416.751.276
60%	8,06%	40%	14,30%	10,56%	Rp279.203.755.935.921
70%	9,75%	30%	16,30%	11,71%	Rp240.435.876.690.348
80%	9,75%	20%	20,30%	11,86%	Rp236.323.299.395.080
90%	10,50%	10%	32,29%	12,68%	Rp215.476.688.211.629
100%	11,25%	0%	10,70%	11,25%	Rp254.610.095.310.506

Table 3 Optimal Capital Structure for PT Astra International

Based on the optimal capital structure for PT Astra International Tbk in table 3, the weighted average cost of capital hit the lowest point at 10.15% when the company's debt ratio at 40% and the company's equity ratio at 60% of the total capital. Along with a minimized weighted average cost of capital, the value of the firm is maximized at Rp295.786.553.748.130. Compared to the current value of the firm that PT Astra International Tbk has, there is Rp9.680.759.998.538 difference which can be optimized by increasing the debt to capital ratio of PT Astra International Tbk for 25,06% from 14,94% to 40%.

5. Conclusion & Recommendation

5.1. Conclusion

Currently, the performance of PT Astra International Tbk is showing a decreasing condition with its net income that decrease significantly in 2015 which caused a declining firm value. Based on various examination towards Astra, other than the plan in changing its focus from automotive sector, it shows that the global economic slowdown in 2015 take parts in the decrease of Astra's net income but Astra still proves its capability by scoring an above average financial ratio result compared to its industry, sector, and its time series from 2010 to 2014. Still, the decrease in Astra's performance make the company unattractive for investors. From the financial ratio analysis, it showed that the debt proportion that Astra possess is higher than its industry and sector which lead to further analysis of the capital within Astra. Afterwards, the capital within Astra is checked and the result of this research stated that the recommended optimal capital structure for PT Astra International Tbk occurs when the weighted average cost of capital reach the lowest point at 10,15% with the proportion of company's debt to capital ratio at 40% and the company's equity to capital ratio at 60% which able to enhance the value of the firm to Rp295.786.553.748.130. In applying the optimal capital structure, the value of the firm will increase for Rp9.680.759.998.538 from Rp286.105.793.749.592 to Rp295.786.553.748.130.

5.2. Recommendation

PT Astra International Tbk encourages to seek another source of debt in order to increase its level of debt for 25,06% from 14,94% to 40% to maximize the firm value of Astra. In increasing debt ratio at capital structure, Astra could issue another corporate bond or taking loans from bank or other kinds of facility agents. Looking at reputation and experience of Astra, it is simple for Astra to issue new debts because any creditors should feel confidence in issuing new bonds or loans for Astra. Afterwards, Astra just need to adjust its capital structure policy in accordance with the calculation result in this research.

As for the future research, in order to enhance the value of PT Astra International Tbk, it may use other kinds of methods in calculating optimal capital structure. Later on, all of the calculation results can be compared and generate more accurate result which may consider other factors that is not considered within WACC approach.

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