

CHAPTER I

INTRODUCTION

A. Background

The current growing economy will encourage companies to raise funds in financing all sorts of activities. This financing will result in changes in the capital structure of the business entity. There are two main alternatives financing. The first is acquisition of new debt or the capital increase and the other financing is by selling stocks or ownership of a business entity.

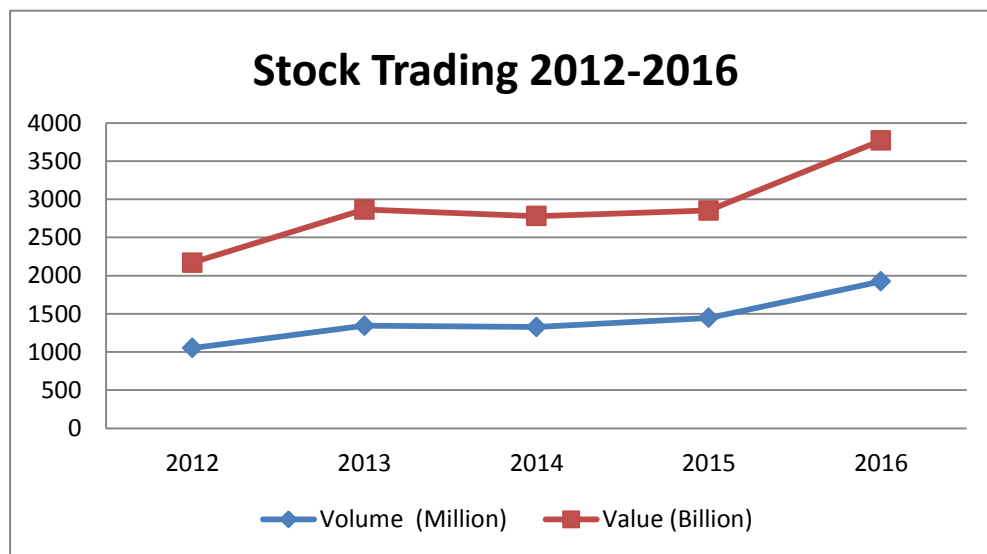
Financing by selling stocks or ownership of business entity can be done by companies that have been go public. Go public is an activity of offering stocks or other securities by issuers to the public. This activity is conducted based on the procedures governed by Capital Market Law and the Implementation Ordinance (Sunariyah, 2006:32). The companies have to be listed on the capital market to offer their securities, so investor can do investment activities related with their securities.

Capital market can be called as abstract market because of the traded is long term funds, this is the investment more than one year (Lubis, 2008:7). Capital market has an important roles, one of them is for companies to obtain funds. The capital market also provides an opportunity for investors as an alternative of investment by investing their capital in financial instruments in there. One of the most popular instruments in the capital market is stock.

In investing activity, investor has a variety option to choose financial instrument in capital market such as stock and bond. Investors who want to play

safe (risk averse) usually tend to invest their money to choose bond with certain return. It is different with investor who interest challenges (risk taker), they usually tend to choose invest in common stock. Investor's interest to do investing activity has increased especially in stock. This is supported by data in the

Graphic 1.1.



Graphic 1.1 Stock Trading period 2012-2016

Source: www.idx.co.id, 2017

Based on the graphic, trade volume tends to increase from 2012 to 2016, although there is a slight decrease in period 2014. The decreased of stock trading is from 1, 342 (billion) shares of stock with value Rp. 1,522 (trillion) in period 2013 to be 1, 327 (billion) share of stock and the value Rp. 1,453 (trillion) in 2014. However, the stock trading will be going upward after that period. In 2016, the stock trading can be reached trading volume at 1,925 (million) shares of stocks with the value at Rp. 1,844 (trillion).

Stock is one of the most popular instruments in the capital market. Investing in stock will get profit such as dividend and income from the difference between

the selling price of stocks and the purchase price (capital gain). However, investing in stock contains high risk and it is kind of challenge for investors. Investors believe that the higher risk will provide higher profit as well. It is called high risk – high return, high return will be followed by high risk too (Tandelilin, 2010:9).

One of the ways that can help Investor to reduces or minimize the risk of investment is by doing stock valuation. Beside reduces the risk, investor also can determine the position of stock. It is help in making decision of investment. So, investor can avoid loss and optimize return of investment.

The purpose of valuation is to know the intrinsic value of the stock. The intrinsic value is the true value, this value reflects the actual stock price of the traded stock (Jogiyanto, 2014:160). If investor knows the intrinsic value of the stock, it will help in taking the decision to buy or sell or save the stock.

There are two analysis that are widely used to determine the actual value of stock, that is fundamental analysis and technical analysis (Jogiyanto, 2014:160). fundamental analysis uses data from financial statements in determining stock prices such as sales data, company's profit, paid dividend, growth etc. While Technical analysis uses market data in determining stock prices such as market prices and volumes.

There are several approach in stock valuation. According to Husnan (2003:280) explain two models of stock valuation, those are Present Value Approach and Price Earning Ratio (PER) Approach. According to Damodaran (2002:11) there are three approaches to valuation. The first is Discounted Cash

Flow (DFC) valuation, it includes Free Cash Flow to Equity (FCFE) and Free Cash Flow to Firm (FCFF). The second, relative valuation and the third is contingent claim valuation.

This research will use fundamental analysis. Fundamental analysis is an analysis that uses the company's financial condition. This analysis is often used by long-term investors to get benefits by buying, selling or saving strategies. Focus of this research is using Free Cash Flow to Equity (FCFE) and Price Earning Ratio (PER) approaches in stock valuation methods. FCFE used is FCFE with constant growth model. FCFE approach is a measure of how much cash can be paid by company to the equity stockholders of a company after all expenses, reinvestment and debt are paid (investopedia.com), and constant growth model is used to value firms at the stable growth rate (Damodaran, 2001:359). This approach is chosen because it is an appropriate approach that captures the true capacity to generate cash flows for stockholder and it has accurate indicators in calculating cash flow received by stockholder. Besides that, the constant growth is chosen because the companies that will be valued are indicated to have stable growth. While, PER approach is the approach that tries to estimate stock value by multiplying earnings per share (EPS) by certain multiples (Husnan, 2003:280). This is chosen because PER is an indicator of market confidence in the company's growth prospects and it is one of the popular approaches used among stock analysts and practitioners.

The researches using Free Cash Flow to Equity (FCFE) or Price Earnings Ratio (PER) have been conducted by several previous researchers. Berkman, Bradbury

and Ferguson (2000) conduct research using Price-Earnings and Discounted Cash Flow Methods. In that research obtain that Discounted Cash Flow (DFC) method and the price earnings comparable have similar accuracy. The other researchers, those are Gardner, McGowan, and Moeller (2012) valuing stock using Free Cash Flow to Equity (FCFE). The researchers used Coca Cola Corporation (KO) as research object and super-normal growth model in their valuation. The result obtained is the value of the company stock using Free Cash Flow to Equity (FCFE) higher than the actual market value. The similar research is conducted by Ariyanto (2012). The researcher measure Free Cash Flow to Equity (FCFE) ability to assess stock price. The research object is Jakarta Islamic Index (JII) in Indonesia Stock Exchange. The growth model that used is constant growth model. The result of the research obtained that there are 18 stocks overvalued and 15 stocks undervalued. Ramdhan (2016) conduct research using Price Earning Ratio (PER) method. The samples of research consist of AKRA, ASII, UNTR and UNVR. The results indicates that UNTR in undervalued condition and all three other stocks that AKRA, ASII and UNVR in condition overvalued.

The researcher is motivated by some issues to take this research. One of the issues is about the government plans to rely on economic growth in 2018 from the investment sector (kompas.com). Bank Indonesia estimates Indonesia's economic growth of 5.1% to 5.5% and government estimates of 5.4% to 6.1%. In addition, investment growth in Indonesia will increase, because Indonesia succeeds in obtaining an investment grade rating from three rating agencies.

They are Fitch, Moody's and Standard and Poor's (S & P). So, that the flow of foreign investment into the country, either in the form of direct investment and portfolio investment projected will increase (cnnindonesia.com). Based on this information, the researcher is interested to conduct research investment in Indonesia capital market (Indonesia Stock Exchange).

This research will be conducted on companies' stocks list in the LQ-45 index because stocks in this index are 45 the most actively stocks traded. Stocks selected based on the trading liquidity and market capitalization (Jogiyanto, 2014:130) Liquidity of stock is determined by selling and buying transaction in capital market. The high liquidity of stocks, indicate how often the transactions occur on the stocks. Thus, it means that the stocks in this index have high demand from investor. Based on this situation, the company's stock LQ-45 index becomes the object of research related to stock valuation.

Based on the background above, this research entitled **“Stock Valuation using Free Cash Flow to Equity (FCFE) and Price Earning Ratio (PER) (Study at Companies Stocks listed on LQ-45 Index in Indonesia Stock Exchange period August 2017 – January 2018)”**.

B. Problem Formulation

Based on the previous background which has been explained, then the problem formulation for this undergraduate thesis are:

1. How is valuing stock price using Free Cash Flow to Equity (FCFE) and Price Earning Ratio (PER) approach?

2. How is recommending investment decision using the Free Cash Flow to Equity (FCFE) and the Price Earning Ratio (PER) approach?

C. Research Objective

1. To find out the intrinsic value of company stocks by using Free Cash Flow to Equity (FCFE) and Price Earning Ratio (PER) approach.
2. To determine the recommendation of investment decision based on the result of stock valuation using Free Cash Flow to Equity (FCFE) and Price Earning Ratio (PER) approach.

D. Research Contribution

This research expected to be able to contribute both in academic and in practical. Hence, significance of the study consist of :

1. Academic Contribution
 - a) This research is expected to enrich academic reference in the business administration, particularly in the scope of stock investment in Indonesia.
 - b) This research expected to be considered as the source of information for the next research in the future to develop the research related with stock valuation using Free Chas Flow to Equity (FCFE) or Price Earning Ratio (PER) approach.
2. Practical Contribution
 - a) This research is expected to provide information for the investor related with stock valuation which is important in doing stock investment.

- b) This research is expected can help investor in making decision of investment, especially stock investment.

E. Systematic of Discussion

The systematic of discussion this research were made according to guidance book from Brawijaya University and the systematic are as follows:

CHAPTER I INTRODUCTION

This chapter discuss about background of the research, research problem, research objective, research contribution and systematic discussion.

CHAPTER II LITERATURE REVIEW

This chapter illustrates the theories that correlate with the research problems encompassing the explanation of previous researches and theoretical basis. Theories discussed include capital market, investment, stock, stock valuation and investment decision.

CHAPTER III RESEARCH METHOD

This chapter explains research type, research location, research focus, research population and sample, data source, data collection, and analysis data technique.

CHAPTER IV RESEARCH RESULT AND DISCUSSION

This chapter explains the description of the samples data, research result related with investment decision.

CHAPTER V CONCLUSION AND SUGGESTION

The chapter is encompassing the summary to conclude the research and suggestion for further research in the future.