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Stock Valuation and Dividend Policy Decision of PT ELSA INDONESIA, TBK

Muhammad Rizki Utomo[1], Sylviana Maya Damayanti[2], Ana Noveria[3]
[1,2,3] School of Business and Management, Bandung Institute of Technology

ABSTRACT: Oil shortages began in 2015 due to underinvestment caused by ESG policy. Oil firms need the funds to finance their new refinery, rig, and exploration since most western countries are switching from oil to alternative energy.
Geopolitical and economic instability, fear of a downturn, and rising inflation have harmed the worldwide Oil and Gas services market Since Russia invaded Ukraine in 2022, oil prices rose to USD122/barrel for WTI and USD128/barrel for Brent. WTI fell to USD80/barrel and Brent to USD86/barrel by 2022, despite mid-year volatility. PT Elnusa Tbk is an integrated oil services company through its subsidiaries, offers services that include geophysical data, drilling, and oilfield services. The objective of this research is proposes to evaluate the financial performance, valuation and making a recommendation for ELSA regarding its cash. Two methods of valuation are utilized to estimate ELSA's intrinsic value: absolute valuation and relative valuation. Discounted Cash Flow to the Firm (DCF) model is used for absolute valuation, meanwhile Price to Book Value (PBV) and Price to Earning Ratio (P/E Ratio) methods are used for relative valuation. Dividend policy and buyback share projection is conducted to find the best decision for ELSA. By referring to absolute valuation, ELSA's intrinsic value is estimated at IDR639/share. By referring to relative valuation using PBV and P/E methods, ELSA's intrinsic value is calculated at IDR 564/share . These numbers are significantly higher than ELSA's current price at IDR 378/share, thus providing relatively high margin of safety.in the following stage ELSA will keep on paying dividends to the shareholders. With ELSA DPR 33,25% in 10 years ELSA will have 4,756,289 million in 10 years and the cash could be for management risk if a big crisis or force majeure.

KEYWORDS: Absolute valuation, DPR, financial performance, margin of safety, Relative valuation.

INTRODUCTION

In 2015 Oil shortage is already happening due to under investment the reason it is underinvestment is due to the ESG policy. from time to time the demand of oil is increasing while the supply does not meet the demand since most country from the west is shifting from oil to clean energy as a result for oil companies, they don't have the capital to do financing their new refinery, rig and exploration.

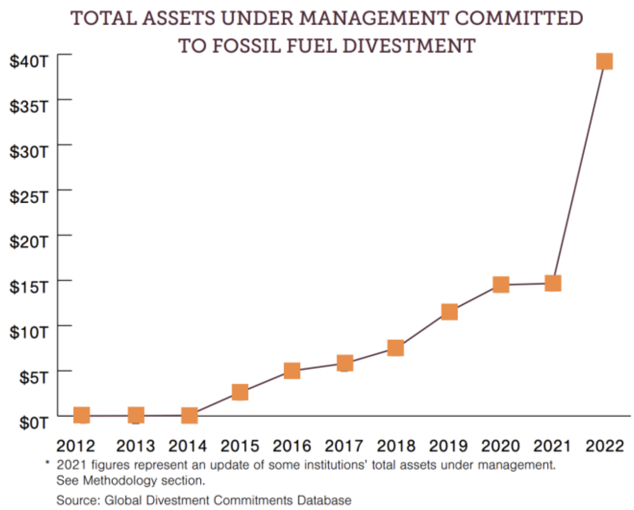

Figure 1. Total Asset under management commit to Fossil fuel Divestment

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The global Oil and Gas services industry has been affected by geopolitical and economic uncertainty, as well as the fear of a slowdown and high inflation. Because Russia attacked Ukraine at the beginning of 2022, oil prices keep on Increasing and hit highs of USD122/barrel for WTI and USD128/barrel for Brent. Even though the price is volatile in the middle of the year, WTI slowly went back down to USD80/barrel and Brent slowly went back up to USD86/barrel by the end of 2022.

Figure 2. WTI Crude oil price

Tensions between Russia and Ukraine have an effect not only on the countries that are near them, but also on countries like Indonesia in other parts of the world. The Jakarta Composite Index (JCI) of the Indonesia Stock Exchange in 2022 was able to handle the instability of the world market because Indonesia's economy is strong. The JCI had grown by 2.79% by the end of 2022, reaching 6,850. The stock index for all energy companies in the IDX Energy group went up by a huge 97.86%, to 2,280. Compared to the changes in the global market index, which were pretty big, and the world oil price, which went in the opposite direction and went down at the end of 2022, this index's rise is pretty steady.

BUSINESS ISSUE

The rise in Indonesia's energy stock index, which is also a type of energy stock index, affects the movement of Elnusa shares. Russia could no longer send oil and gas to countries that wanted to buy it. This is also because of the change in energy, and Europe's need for natural gas. As a result, Europe must substitute their usage of natural gas into oil which makes the supply chain more disorganized.

At the end of trade in 2022, Elnusa's shares went up by 13.87%, reaching Rp312. The company was worth Rp2.277 trillion, and 72,275,074 shares were traded. Elnusa Tbk PT have the capability as contractor for Oil upstream. The supply will be needed to be boosted (supply will increase by exploring/production) this line of business will bring many profits to the company and will have an impact to the financial statement of the company.

This objective of this research is to examine the fundamental financial performance and intrinsic value of ELSA is based on historical financial data from 2013 to 2022.After finding the valuation and the author make a recommendation for ELSA corporate action. Two methods of Valuation are used to estimate ELSA's intrinsic value: is an absolute and relative appraisal. Discounted Cash Flow to the Firm (DCF) model is used for absolute valuation, meanwhile Price to Book Value (PBV) and Price to Earnings Ratio

(P/E Ratio) methods are used for relative valuation. From topline perspective, the Company's revenue is expected to increase by 28% YoY from IDR12.3 trillion in 2022 to IDR 15.3 trillion in 2023. The growth is expected to be contributed mainly from energy.

CONCEPTUAL FRAMEWORK

The Business issues of ELSA is the rising of Oil price as a result the company will have a big profit. After getting the profit of the year comes a problem which is how do the company make use of it's resources effectively. On of the best solution for is either by buying back their own share or giving dividends to the shareholders before making this decision ELSA must do a valuation of their share.

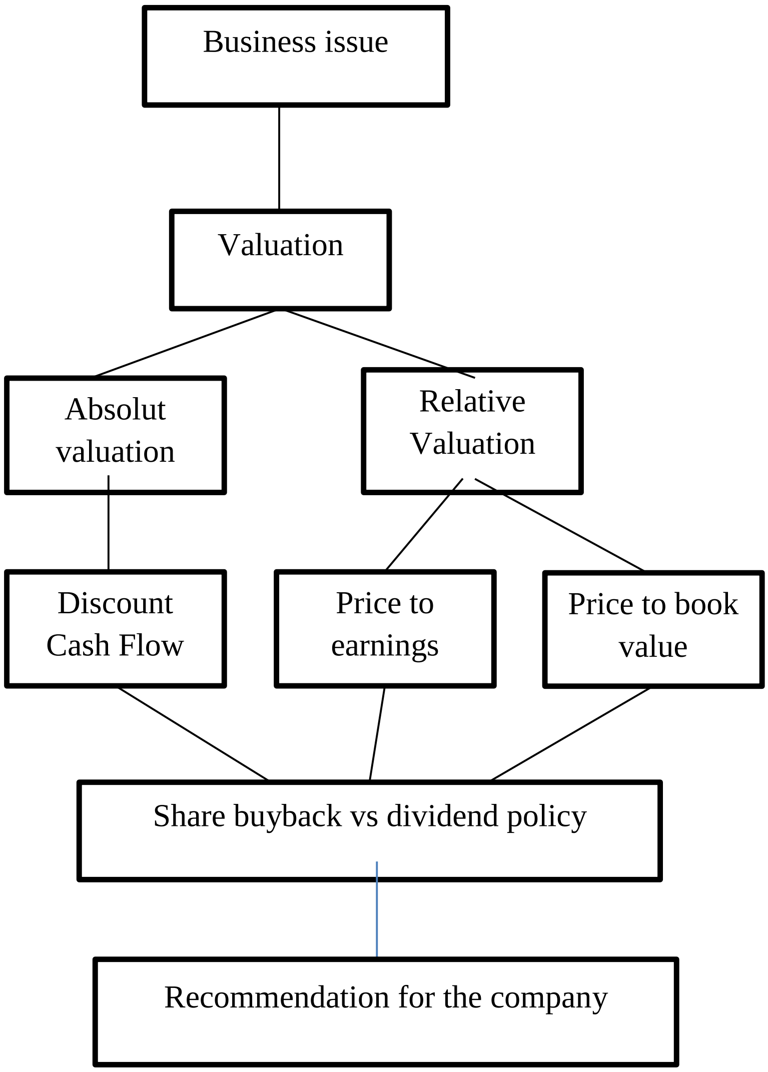

Figure 3. Conceptual Framework

There are 2 method which are used in this study which is Absolut valuation and Relative valuation. For Absolut valuation the method will be Discounted Cash flow and from Relative Valuation will be using multiply approach from Price to book value (PBV) and Price to Earnings ratio (PER). After the valuation we will make the best decision for ELSA share buyback vs dividend policy it would be by projection which one is more beneficial for ELSA in the long run. After making the decision based on the calculation the author will make a recommendation for the company.

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RESEARCH METHODOLOGY

This study used the PT Elnusa Tbk as the object of research. PT Elnusa Tbk Company was selected based on the phenomenon and research objectives. The author begins by summarize the macro economy overview regarding the oil prices after that the author begin to identify business issues and set the research question research objectives, once the research objective and issues are in place, the literature review is conducted.

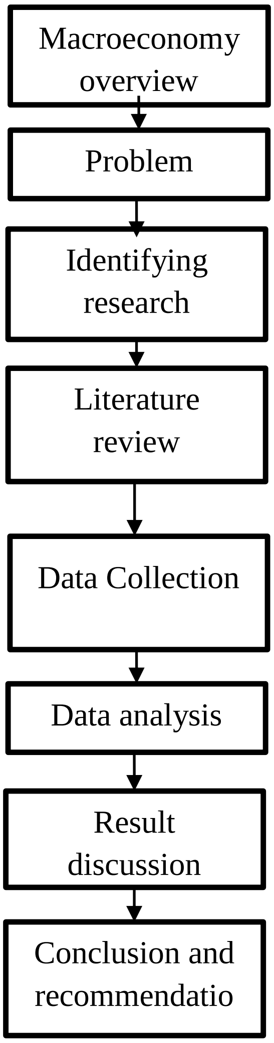

Figure 4. Research Design

RESULT AND DISCUSSION

A. PESTLE Analysis

1) Political

In 2022 a lot of turmoil and challenges in the world economy and geopolitics. The Covid-19 pandemic, which has been brought under control, apparently does not guarantee that global economic conditions in 2022 will be on a better track. Global society now faces an escalating Russia-Ukraine geopolitical tension that has led to disruptions in the supply chain, resulting in energy and food crises in many parts of the world. The war between the two European countries led many nations to curtail their relations with Russia and even impose sanctions and embargoes on that country. A lot of country is affected by this war especially Indonesia since Indonesia face a dilemma regarding to support which country in the war of those countries.

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2) *Economic*

In 2022, the global economy slowed and faced uncertainties. High inflation, tighter monetary policy, Covid-19 control policies, and geopolitical tensions between Russia and Ukraine contributed to the economic tension. Recent IMF revisions have lowered the global economic growth projection. In its October 2022 World Economic Outlook (WEO), the IMF predicted 3.2% global economic growth, down from 4.4% in January2022.

As for the domestic oil and gas industry, the Directorate General of Oil and Gas (the Ministry of Energy and Mineral Resources, 2023) reported that considering the movement in global crude oil prices, the Indonesian Crude Price (ICP) is seen within the range of US$95–US$105 per barrel in 2022, higher than the average ICP in 2021, which stood at US$68.5 per barrel. The increase in the average ICP in 2022 has affected the realized revenue in oil and natural gas resources, which is estimated at Rp129,185.9 billion, an increase of 33.7% from the realization in 2021.

According to the Ministry's report, oil and gas lifting has dropped since 2021, despite greater ICP and realized income in 2022. Crude oil lifting in 2022 is projected to reach 625,000-630,000 barrels per day (bpd), down from 660,000 in 2021. Gas production is projected to reach 956,000-964,000 barrels of oil equivalent per day (boepd) in 2022. The volume of gas lifted is steady compared to 2021.

3) *Social*

The oil sector has faced social and legal issues that have required more scrutiny and appropriate corporate practices. The sector has been plagued by human rights abuses such labour exploitation and indigenous relocation. Such violations have raised public awareness and outrage, forcing oil firms to implement thorough and open rules.

Corruption has also been a persistent challenge within the oil sector, with instances of bribery, and other illegal practices that undermine the fairness competition and social Oil corporations have adopted stronger compliance programs and ethical standards to address these challenges after regulatory agencies and international organizations called for more anti-corruption supervision and enforcement.

Communities disproportionately suffer the ecological consequences of oil exploration and extraction, making environmental justice a key concern. Environmental deterioration, and health risks. Oil firms are embracing their environmental obligations and developing sustainable measures to reduce ecological impact in response to demand.

These several issues make good business practices more important for oil corporations. This includes tackling social and environmental issues, communicating openly, building community collaborations, and developing sustainable energy options. Oil businesses must embrace CSR to overcome changing public expectations and regulatory restrictions.

4) *Technology*

The Industry has adopted new technologies to improve efficiency, reduce costs, and minimize environmental impacts. For example, the use of fracking and horizontal drilling has increased oil production from shale formations, changing the landscape of the industry

Additionally, technological advancements have a negative impact on oil companies, particularly digitalization, which in turn causes the operations of the firm to become increasingly dependent on technology and further increases the danger of data breaches security.

5) *Legal*

The oil industry has faced various social and legal challenges, such as human rights abuses, corruption, and environmental justice issues. These challenges have led to increased scrutiny and the need for companies to adopt responsible business practices

6) *Environment*

The oil industry has faced increasing of strictly supervision and regulation due to environmental issues, such as climate change and pollution. This has led to the development of new technologies and practices to reduce the industry's environmental footprint.

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B. *Financial Performance Analysis*

1) *Liquidity Ratio*

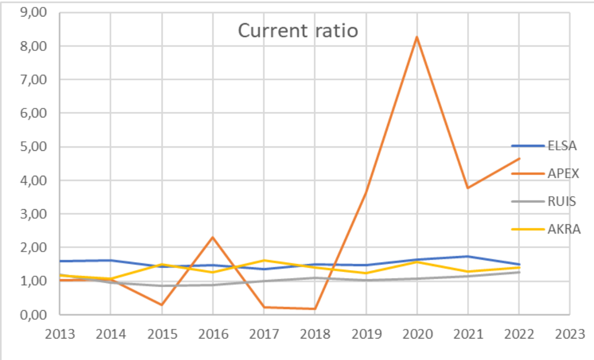

Figure 5. Current Ratio

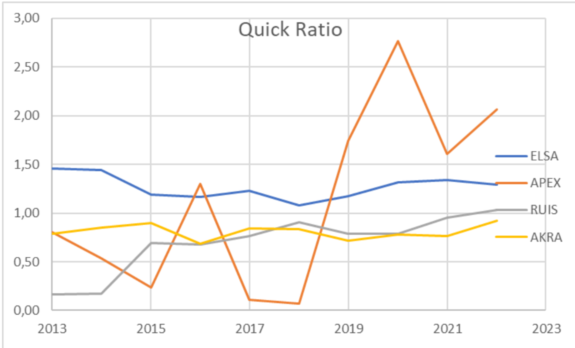

Figure 6. Current Ratio

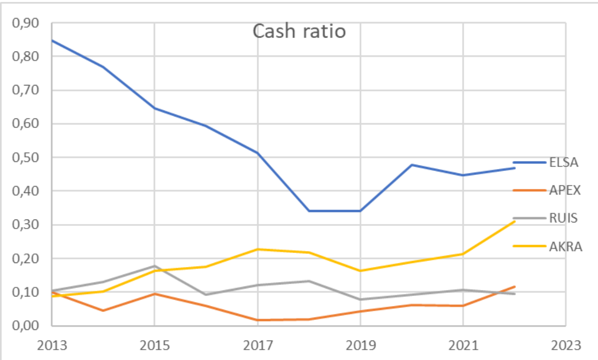

Figure 7. Cash ratio

Current Ratio is a Liquidity Ratios to measures the company's ability to meet its short-term liabilities with its current assets. The table shows ELSA's current ratio from 2013-2022 is always above 1. This ratio is considered good as the value is above 1 which indicate that ELSA can pay its current liabilities. Apex has the most significant fluctuation within 10 years with the first peak in 2016 at more than 2 and the second peak in 2020 at roughly 8 however the last 2 years apex experience significant drop to 4 at 2021 and maintain 4,5 in 2022 however the company remain as the most liquid among its peers.

The quick ratios is a liquidity ratio that measures the ability of a company's to pay its short term liabilities by having assets that are readily convertible into cash. Quick assets are current assets that can be converted into cash in 90 days or less. The table shows ELSA quick ratio is above 1 which indicate that ELSA can pay its current liabilities in 90 days with its quick assets and after the payment, ELSA still have excess of quick asset with ratio of 0.30 in 2022. Akra experience fluctuations between 1,5 to 1 over the past 10 years meanwhile RUIS experiences increase from 0,1 to 1 at the end of the period more over APEX has the most noticeable ups and downs beginning below 1 in 2013 and increase 2016 and drop to 0 in 2017 however at 2019 to 2020 it's performed more than double reaching almost 3 it 2020

If a company's cash ratio is greater than 1, the company has more cash and cash equivalents than current liabilities. In this situation, ELSA don't have the ability to cover all short-term debt. but among its competitor ELSA have the highest cash ratio in 2022. Even though ELSA has cash ratio is generally better, but it may also indicate that the firm is inefficiently using cash or not optimizing low-cost borrowing, a high cash ratio may also suggest that a company is worried about future profitability and is accumulating a protective capital cushion. It can be seen from figure 4.3 that the competitor only performs below 0.3 throughout the whole 10 years with APEX has the least cash ratio performance.

2) *Profitability Ratio*

Profitability ratios is a company's ability to earn profits from its sales or operations, balance sheet assets, or shareholders' equity.

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Table 1. Profitability ratio

Ratio	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Profitability										
Gross profit margin	15,73%	18,00%	24,02%	16,97%	11,62%	9,84%	10,39%	9,61%	7,93%	7,41%
Operating profit margin	8,20%	13,68%	18,91%	11,75%	6,76%	5,69%	5,90%	4,93%	2,84%	3,96%
Net profit margin	5,90%	10,22%	15,60%	8,73%	5,04%	4,17%	4,25%	3,22%	1,34%	3,07%
EPS	33,24	59,12	85,96	43,31	34,36	37,86	48,84	34,13	14,91	51,80

The profitability ratio table show ELSA has very low profitability index. All of the parameter which are Gross profit margin (GPM), operating profit margin (OPM) and net profit margin (NPM) keep on decreasing from 2016-2021 due to oil prices. In 2022 ELSA's GPM is 7,41% OPM 3,96% and NPM 3,07% the ratio needs to be improved

C. Absolute Valuation

1) Weight Average Cost of Capital (WACC)

From the table of WACC calculation Cost of Debt is: 9,11%, Cost of Equity:19,13%, Equity capital is 82,32%, and calculated the WACC value which is 17,01%.

Table 2. WACC Calculation

WACC Calculation	
Risk-free rate(rf)	6,94%
Beta	1,546
Risk Premium	7,89%
Tax Rate (T)	22,00%
Equity Capital %	82,32%
Debt Capital %	17,68%
Cost of equity (ke)**(CAPM)**	19,13%
Cost of debt	9,11%
WACC	**17,01%**

A positive terminal growth rate implies that the company will grow in perpetuity The terminal growth rates typically range between the historical inflation rate (2%-3%). The author is assigning 2% terminal growth rate by conservative approach which is considered worst case scenario. The Tax rate is 22% the value is from Indonesia Income tax rate.

Table 3. FCF Assumption

Assumptions:	
Tax rate(T)	22,0%
Discount rate (WACC)	17,01%
Terminal value growth rate	2%
Current price (des 22)	312
Growth rate year 1-5	6,37%
Growth rate year 6-10	21,66%
Base FCF	313.527
Net Debt Level	772.596
Shares outstanding (bn)	7.299

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Table 4. FCF Calculation

Year	*2022*	*2023F*	*2024F*	*2025F*	*2026F*	*2027F*	*2028F*	*2029F*	*2030F*	*2031F*	*2032F*	*Terminal value*
FCF Projection	*313.527*	*333.496*	*354.738*	*377.332*	*401.365*	*426.929*	*519.417*	*631.942*	*768.844*	*935.403*	*1.18.045*	*7.734.826*
		6,37%	*6,37%*	*6,37%*	*6,37%*	*6,37%*	*21,66%*	*21,66%*	*21,66%*	*21,66%*	*21,66%*	
		17%	*17%*	*17%*	*17%*	*17%*	*17%*	*17%*	*17%*	*17%*	*17%*	
PV		*285.021*	*259.107*	*235.549*	*214.133*	*194.665*	*202.411*	*210.465*	*218.840*	*227.549*	*236.604*	*1.608.098*
SUM of pv												*3.892.443*
Fair Value												***639***
Margin of Safety												***104.9%***

The Growth from year 1-5 is 6,37% it is the average growth of Revenue from 2013 to 2017 and the growth from 6-10 years is 21,66% the assumption is the average growth of revenue from 2018 to 2022 the growth is very significant due to oil price is rising. The Net Debt level is from net debt from 2022 deducted by total debt in 2022 from appendix D. the Base FCF is the average FCF from 2013 to 2022

Absolute valuation is calculated by the equation of chapter 3.6 the total PV would be 3,892,443 it would be deducted by the net debt level which is 772,596 and divided by the outstanding share of ELSA which is 7299 as a result the fair value will be 639 which is 104,9% with margin of safety from the current price of December 2022

D. Relative Valuation

Market ratios relate the firm's market value, as measured by its current share price, to certain accounting values. The price to earnings (PER) of ELSA is 6 it could be considered low in 2022 the PER indicates that the current price is low relative to earnings. The price to book value (PBV) of ELSA is 0.55 in 2022 it indicates that the company is undervalue since it is lower than 1.

Table 5. Relative valuation

ELSA	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**
Price	330	685	248	420	372	344	306	352	276	312
PER	10	12	3	10	11	9	6	10	19	6
PBV	1,07	1,96	0,69	1,07	0,89	0,76	0,62	0,69	0,53	0,55
book value	310	349	361	394	418	452	490	513	518	564

E. Dividend Policy vs Share buyback

company pays out a dividend, shareholders retain their shares and receive cash. If a company repurchases shares, the selling shareholders receive cash, and the remaining shareholders have shares with higher value (but they don't receive any cash). Overall, there is no change in underlying value, just a change in the mix of shareholders.

Explanation: The assumption is based on the average prices of ELSA for 10 years which is 365 and divided by the average earning of ELSA for 10 years which is 44 after it is divided it would get 8. The assumption of the share repurchase is 730 share is from 10% of the total share outstanding of ELSA. This limit ensures that the company does not exhaust its resources on

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buyback and has sufficient funds for its operations The assumption of dividend yields 12,17% is from the historical data average of ELSA from 2013-2022

F. *Share buyback projection*

Table 6. Share buyback projection

ELSA	(in Rp mn)	2022	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F
Dividend/share	7298,5	26	9	10	11	13	14	16	18	20	21	23
Earning/share		52	54	65	80	98	119	143	169	200	234	272
Dividen yield	eps/price	16,60%	12,17%	12,17%	12,17%	12,17%	12,17%	12,17%	12,17%	12,17%	12,17%	12,17%
Relative valuation												
Price	PE*EPS	312	442	532	657	805	976	1.171	1.392	1.641	1.920	2.231
PER	price/earning	6	8	8	8	8	8	8	8	8	8	8
PBV		0,55	0,73	0,83	0,95	1,09	1,24	1,39	1,54	1,70	1,86	2,02
book value	equity/share	564	603	645	690	738	789	844	903	965	1.032	1.104
			ASSUMPTION	average price			365	average earning	44			
Dividend					P/E average		8					
buyback												
EPS before buyback		52	54	65	80	98	119	143	169	200	234	272
Current price		312	442	532	657	805	976	1.171	1.392	1.641	1.920	2.231
Number of share repurchased		730	730	730	730	730	730	730	730	730	730	730
number of share outstanding		7.299	7.299	7.299	7.299	7.299	7.299	7.299	7.299	7.299	7.299	7.299
after-tax cost of debt	9,11%	9,11%	9,11%	9,11%	9,11%	9,11%	9,11%	9,11%	9,11%	9,11%	9,11%	9,11%
EPS after buyback		54	55	67	82	101	122	147	174	205	240	279

From the calculation if the company make a decision on buying 10% of their total outstanding shares (730) from 2023 based on the relative valuation with the assumption above the c This limit ensures that the company does not exhaust its resources on buyback and has sufficient funds for its operations company could only buy it until 2025.After that year the Valuation of Elsa is already over value since the price of book value is 1.

G. *Dividend payment calculation*

Table 7. Dividend policy projection

ELSA (in Rp mn)	2022	2023F	2024F	2025F	2026F	2027F	2028F	2029F	2030F	2031F	2032F	2023-2032
Assumptions:												
Sales growth rate	14,87%	14,87%	14,87%	14,87%	14,87%	14,87%	14,87%	14,87%	14,87%	14,87%	14,87%	
Dividend-payout ratio	50%	33,25%	33,25%	33,25%	33,25%	33,25%	33,25%	33,25%	33,25%	33,25%	33,25%	
Projections												
	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	
Sales	12.305.690	14.135.070	16.236.408	18.650.134	21.422.688	24.607.413	28.265.583	32.467.582	37.294.255	42.838.469	49.206.892	
Sources:												
Net income	378.058	392.638	472.773	583.196	715.015	867.026	1.040.289	1.236.536	1.457.657	1.705.486	1.981.644	
Depreciation	645.948	719.695	801.861	893.409	995.408	1.109.052	1.235.671	1.376.746	1.533.927	1.709.054	1.904.174	
Total	1.024.006	1.112.333	1.274.635	1.476.605	1.710.423	1.976.078	2.275.960	2.613.282	2.991.584	3.414.539	3.885.818	
Uses:												
Capital expenditures	372.480	476.868	610.510	781.605	1.000.650	1.281.083	1.640.106	2.099.746	2.688.201	3.441.569	4.406.070	
Change in working capital	130.295	432.236	203.331	246.268	297.933	359.978	434.353	523.357	629.700	756.569	907.719	
Total	502.775	909.103	407.178	535.337	702.717	921.105	1.205.753	1.576.389	2.058.501	2.685.000	3.498.351	
Excess cash / (borrowing needs)	521.231	203.230	867.457	941.268	1.007.706	1.054.973	1.070.207	1.036.893	933.083	729.539	387.467	8.231.822
Dividend	**189.031**	**130.558**	**157.204**	**193.921**	**237.753**	**288.299**	**345.912**	**411.167**	**484.693**	**567.100**	**658.926**	**3.475.534**
After dividend												
Excess cash / (borrowing needs)	332.200	72.671	710.252	747.346	769.952	766.674	724.295	625.726	448.390	162.440	271.460	4.756.289

The projection of dividend payout ratio from 2023 is 33,25% this value is from the average dividend pay-out ratio growth from 2013 to 2022.The projection of assumptions sales growth rate for 2023 is 14,87% this value is from the average of Revenue in 2013 to 2022.The projection of Net income from 2023 to 2032 is the Revenue is deducted by COGS. from 2022 to 2023 the COGS growth is constant which is 92.59% of the total revenues. After that the gross profit will be deducted by other operating expenses the growth rate is from the average of total operating expenses average in the last 10 years. After that the operating income will be deducted by interest income with the growth rate average in the last 10 years after that the Earning Before tax is deducted by final tax expenses and income tax expense with the growth rate of 10 years. from appendix 1 the growth rate of the depreciation is 11,42% the value is from the average growth rate of 10 years from 2013 to 2022.The growth rate of capital expenditures is 28,03% the value is from the average growth rate of 10 years from 2013 to 2022 .The value of the change in working capital is from the appendix 2 is the calculation of current year minus previous year. The value of Excess cash is the total of is needed to borrow for 10 years is 8,231,822 and the total dividend for 10 years if 3,475,534 after the dividend ELSA cash would be 4,756,289 million cash and the cash could be used for Management risk if a big crisis or force majeure is happening again like COVID or financial crisis.

H. Summary of Analysis

1) ELSA's current ratio from 2013-2022 is always above 1. This ratio is considered good as the value is above 1 which indicate that ELSA can pay its current liabilities.
2) ELSA quick ratio is above 1 which indicate that ELSA can pay its current liabilities in 90 days with its quick assets and after the payment, ELSA still have excess of quick asset with ratio of 0.30 in 2022
3) cash ratio from 10 years cannot be said the best among its competitors. it is clear that the cash ratio is very significant highest among the competitors.
4) From the absolute valuation (DCF), the intrinsic value of ELSA is 639 while the. On this day 19 December ELSA price is 378 after getting the valuation it's clear that ELSA is undervalue with the margin of safety of 69,1% with absolute valuation
5) Relative valuation if the PBV is 1 ELSA would be 564 based on ratio of year of 2022 and PER is 6. on this day the margin of safety is 49,74% for relative valuation. this is considered undervalue
6) Buyback share: The scenario if ELSA is buying back it share with the assumption of 10% of their outstanding share each year with the assumption of PER average which is 8. Elsa could buy back it share until 2025 since at 2026 ELSA valuation based on relative valuation method is overvalued since the PBV is above 1.
7) Dividend payout ratio: The scenario if ELSA is keep on giving a dividend to it's shareholders by 33,25% (the assumption is from total average of 10 years of ELSA dividend pay out ratio) ELSA will have 4,756,289 Million cash and could use this cash for future use such as transitioning into green energy or renewable energy since the world is slowly leaving the oil industry.

RECOMMENDATION

Recommendation to the company: keep on Dividend policy

Benefit for ELSA for paying Dividend:

1) Positive signal to the Market

Paying dividend has a potential to improve the image of ELSA because it will indicate that ELSA have a financial stability and trust in the future prospect. This sign will attract a new long term investor that is interested to buy and hold ELSA as long as possible for receiving dividend every year.

2) Reduce Stock Price Volatility

Since ELSA will be having a lot of long term Investor that wanted to receive dividends every year the Stock price wont be volatile because most of the shareholders will be holding the shares instead of buying and selling it for capital gain.

3) Avoiding overinvestment

Since Green energy and renewable energy is getting more popular every day a company that still generate profit from fossil energy will be criticized and very risky to expand their business since the world is slowly leaving oil Energy by paying dividend ELSA would mitigate it's risk if the commodity Supercycle will ever exist again in the near future

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