Optimal Capital Structure Analysis of Pt Centratama Telekomunikasi Indonesia Tbk

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Abstract. PT Centratama Telekomunikasi Indonesia Tbk has grown its telecommunication tower portfolio significantly since 2017, primarily through acquisition. In 2022, the company acquired approximately 4,000 telecommunication towers, propelling it to become Indonesia's third-largest telecommunication tower provider. However, this debt-funded acquisition resulted in the interest expense being higher than the EBIT, which caused the net income to be negative. Recently, PT Centratama Telekomunikasi Indonesia Tbk plans to obtain an additional 397 telecommunication towers that cost IDR 1.17 trillion. PT Centratama Telekomunikasi Indonesia, Tbk intends to finance this acquisition through debt and internal financing. The most favourable financing strategy can be assessed by calculating the company's optimal capital structure to determine the lowest cost from the financing. This research will utilise the Weighted Average Cost of Capital method to determine the optimal capital structure. Based on the 2021 restated financial report of PT Centratama Telekomunikasi Indonesia, Tbk, the capital structure of the company is currently at 38.14% equity and 61.86% debt, which incurs a cost of capital of 10.75%. Meanwhile, the optimal capital structure calculation suggested that PT Centratama Telekomunikasi Indonesia Tbk can achieve the lowest cost of capital at 9.08%, with the proportion of equity and debt at 86% and 14%, respectively. Therefore, the most favourable financing strategy for the recent acquisition plan is using equity to achieve the optimal capital structure.

Keywords: PT Centratama Telekomunikasi Indonesia Tbk, Optimal Capital Structure, Cost of Capital, Financing Strategy

1 Introduction

The Indonesian government is accelerating internet service distribution to all regions in Indonesia[1]. The telecommunication industry is expanding to meet the demand for internet services, with companies such as PT Centratama Telekomunikasi Indonesia Tbk acquiring and building more towers.

PT Centratama Telekomunikasi Indonesia Tbk was established under the name of PT Centrindo Utama in 1987 and subsequently went public on the Indonesia Stock Exchange in 2001, trading under the ticker code CENT. The company primarily operates

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in telecommunication infrastructure, specialising in leasing telecommunication towers, constructing telecommunication facilities, and wholesaling telecommunication equipment. Remarkably, PT Centratama Telekomunikasi Indonesia Tbk has become the third-largest provider of telecommunication towers after substantially growing its tower portfolio annually since 2017.

PT Centratama Telekomunikasi Indonesia, Tbk has set its sights on acquiring 397 telecommunication towers. The company has already entered into a transaction agreement stipulating that the acquisition plan must be executed within 12 months from the approval of the plan at the company's general meeting of shareholders, scheduled for October 2023. The projected cost for this acquisition is IDR 1.17 trillion, and the company intends to fund it through internal cash and debt. It is imperative to thoroughly evaluate this financing decision to ensure that the company secures the necessary funds at the lowest possible cost. By identifying the right mix of financing sources, the company can achieve an optimal capital structure[2].

According to Gohar and Rehman, capital structure refers to the allocation of debt and equity sources for the benefit of the firm[3]. The cost of equity represents the return required by investors[4]. Meanwhile, the cost of debt is the interest rate paid on borrowed funds[5]. The combination of these costs is known as the cost of capital, which is the minimum rate of return needed to attract investment from both debtors and investors. Optimising the combination of debt and equity leads to the maximisation of a company's value[6].

In 1963, Modigliani and Miller examined the impact of corporate taxes on a company's capital structure and argued that having higher levels of debt can be advantageous due to the tax benefits[7]. This implies that as a company's debt increases, its overall value will likely rise owing to these tax advantages[8]. However, it is essential to note that it cannot be definitively stated that the ideal capital structure for a company is one hundred per cent debt[9]. It is due to the risk associated with debt that could lead to bankruptcy[10].

PT Centratama Telekomunikasi Indonesia Tbk has been expanding its telecommunication tower portfolio through debt-funded acquisitions to become Indonesia's third-largest telecommunication tower provider. However, the company's capital structure differs significantly from the industry average in 2022 and 2021. The company’s debt to equity ratio (DER) in 2022 is in the negative due to negative profit that exhausts the equity value. The negative profit was caused by the higher expenses from utilising loans for the 2022 acquisition, leading to negative earnings before interest tax (EBIT). Meanwhile, the company’s 2021 DER of 5.70 is significantly higher than the industry average, which stands at 2.82. The company's DER will increase further if it still relies on debt to acquire 397 towers worth IDR 1.17 trillion. With the transaction agreement already signed, the company must secure funds before the October 2023 deadline. Consequently, scrutinising whether the company's debt-focused financing strategy aligns with its optimal capital structure is of utmost importance. This research will focus on ascertaining the most optimal capital structure for PT Centratama Telekomunikasi Indonesia, Tbk and pinpointing the suitable financing approach for the acquisition plan.

2 Methods

The author will use the 2021 restated financial report from the 2022 annual report to calculate PT Centratama Telekomunikasi Indonesia, Tbk's capital structure because it depicts the company's condition in a typical environment with positive EBIT. This study also requires secondary data obtained from online sources such as BI7DRR, Indonesia Market Risk Premia, Yahoo Finance, PHEI, and the company's 2021 restated financial report.

The author will calculate the company's current and optimal capital structure to identify the gap between the company's capital structure performance. The gap between the current and optimal capital structure will also be used to identify the appropriate financing strategy for the acquisition plan.

The company's current and optimal capital structure can be calculated with a weighted average cost of capital (WACC) method[11]. To calculate the WACC, the company's cost of debt, cost of equity, and weight of debt and equity are needed. The lowest cost of capital will be the company's optimal capital structure[12]. The weighted average cost of capital formula is as follows:

$$WACC = (Wd \times [rd \times (1 - T)] + (We \times re) \tag{1}$$

Where:

Wd = Weight of Debt

rd = Cost of Debt

T = Effective Tax Rate

We = Weight of Equity

re = Cost of Equity

Furthermore, the Damodaran Synthetic Rating Table Spread will be used to reflect the company's cost of debt at different debt levels[13]. Since PT Centratama Telekomunikasi Indonesia, Tbk's market capitalisation is under <5 billion USD, the following Damodaran Synthetic Rating Spread Table, which is shown in Table 1, will be used:

Table 1. Damodaran Synthetic Rating Table Spread (January 2022)

Damodaran Synthetic Rating Spread (January 2022)			
If the interest coverage ratio is.			
>	≤ to	Rating is	Spread is
12.5	100000	Aaa/AAA	0.67%
9.5	12.499999	Aa2/AA	0.82%
7.5	9.499999	A1/A+	1.03%
6	7.499999	A2/A	1.14%
4.5	5.999999	A3/A-	1.29%
4	4.499999	Baa2/BBB	1.59%
3.5	3.9999999	Ba1/BB+	1.93%
3	3.499999	Ba2/BB	2.15%
2.5	2.999999	B1/B+	3.15%
2	2.499999	B2/B	3.78%
1.5	1.999999	B3/B-	4.62%
1.25	1.499999	Caa/CCC	7.78%
0.8	1.249999	Ca2/CC	8.80%
0.5	0.799999	C2/C	10.76%
-100000	0.499999	D2/D	14.34%

After the company's current capital structure and optimal capital structure have been identified, the author will compare both capital structures and then determine the suitable financing strategy for the upcoming acquisition plan. The financing strategy can be determined by identifying the company's current and optimal capital structure value difference in equity and debt composition.

3 Results and Discussion

To attain PT Centratama Telekomunikasi Indonesia Tbk's optimal capital structure, a shift is required where the debt proportion becomes 14%, and the equity proportion increases to 86%. This adjustment would result in a reduced cost of capital, to be at 9.08%. Currently, the company's capital structure comprises 61.86% debt and 38.14% equity, leading to a higher cost of capital at 10.75%. Given this disparity in composition between the current and optimal capital structures, it is evident that some adjustments are necessary for the company to achieve the lowest possible cost of capital.

Furthermore, the company needs additional funding amounting to IDR 1,170,000,000,000 to execute its acquisition plan in 2023 successfully. Therefore, it is imperative to carefully determine the appropriate financing strategy to prevent any deviation from the optimal capital structure.

Table 2. Financing Strategy

Capital Structure	Value
Total Capital Before Expansion (A)	18,970,293,856,800
Total Capital After Expansion (B)	20,140,293,856,800
Expected Debt Value (C = B x Optimum Debt Level)	2,819,641,139,952
Expected Equity Value (D = B x Optimum Equity Level)	17,320,652,716,848
Current Long-term Debt Value (E)	11,735,730,000,000.00
Current Equity Value (F)	7,234,563,856,800
Adjustment on Debt (G = C – E)	-8,916,088,860,048
Adjustment on Equity (H = D – F)	10,086,088,860,048

Based on the adjustment calculations outlined above (refer to Table 2), the most effective way to reconfigure the company's capital structure to achieve the lowest cost of capital after the expansion involves reducing the total debt by IDR 8,916,088,860,048 and simultaneously increasing the total equity by IDR 10,086,088,860,048. This strategic adjustment is necessary to bring the company closer to its optimal capital structure.

Given that the adjustment for equity demonstrates a positive value (as shown in Table 2), utilising equity for the additional funding is advisable, as it will move the company's capital structure closer to the optimal capital structure. The additional funding of IDR 1,170,000,000,000 will elevate the company's total equity to IDR 8,404,563,856,800. Consequently, the overall capital structure will increase to IDR 20,140,293,856,800. This injection of funds will also change the debt-to-equity ratio, with debt accounting for 58.27% and equity comprising 41.73% of the total capital structure.

This adjustment by arranging the company’s capital structure to be near its optimal capital structure can impact its value. Previous studies conducted in the same industry also support this statement. The composition of debt and equity, which is shown in the debt-to-equity ratio and long-term debt-equity ratio, has a significant influence on profitability for telecommunication companies listed in IDX[14]. Furthermore, a study of capital structure on telecommunication companies in Europe also suggested that a company’s value will increase the higher the debt, until a certain point where the debt outweighs the benefit it provides[15]. Since the optimal capital structure calculation suggested that the debt must be decreased, it can be concluded that PT Centratama Telekomunikasi Indonesia Tbk’s usage of debt has outweighed the benefit it can give.

4 Conclusions

PT Centratama Telekomunikasi Indonesia Tbk's current capital structure comprises 61.86% debt and 38.14% equity. Utilising the Weighted Average Cost of Capital (WACC) method, the company's current cost of capital stands at 10.75%. However, this capital structure is not optimal for the company, as a more optimal one exists. The optimal capital structure can be attained by adjusting the company's capital mix to 14% debt and 86% equity, leading to a cost of capital of 9.08%. This optimised capital structure will reduce the company's cost of capital by 1.67%. Since achieving the optimal capital structure involves increasing equity and decreasing debt, the recommended financing approach for the October 2023 acquisition project is to utilise equity.

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