

## CHAPTER 1 INTRODUCTION

### 1.1. Background

Indonesia's natural gas industry has a long history and started before the independence of Republic Indonesia in 1945. Until the mid of-1970, natural gas was not treated as profitable commodity and only used in limited sector. Gas transmission and distribution infrastructures were also limited on that period.

Indonesia has substantial natural gas reserve, despite declining in oil reserves (7.3 billion barrels in 2015 compared to 7.38 billion barrels in 2014), Indonesia's natural gas reserves have increase (151.33 trillion cubic feet in 2015 compared to 149.3 trillion cubic feet in 2014).<sup>1</sup>

Natural gas will be Indonesia's fuel for the future due to green energy issue and also the availability of reserve. This also supported by the fact that natural gas market in Indonesia has grown tremendously during the past decade and is expected to keep rising in the coming years. The completion of Floating Storage Regasification Unit (FSRU) and many other natural gas infrastructures and as well as increasing demand of gas in power generation will result in Indonesia's gas consumption keep growing.

In the period of 2014-2050, gas utilization is projected to grow at an average 4.7% yearly. The use of natural gas will increase from 1,578 BCF in 2014 to 2,605 BCF in 2025 and 6,584 BCF in 2050 for base scenario.<sup>2</sup>

Based on the forecasted growth of gas utilization in the future, it will be a good opportunity for gas companies to capture the growth. Despite the opportunity that supports growth of natural gas business, there are several challenges faced by gas business players. One of the factors is the slowdown of economic growth and also weakening of global oil prices. The weakening of global oil prices result in shifting pattern of gas user to oil fuel. The other factor that influences gas business is the tightening regulation in Indonesia which the Government regulates gas allocation, gas price, economical gas infrastructure, and also gas distribution.

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<sup>1</sup> MEMR Statistic Migas 2015, p 18

<sup>2</sup> BPPT, Energy Outlook Indonesia 2016, p50

PT Pertamina (Persero), which is commonly called Pertamina, is a State Owned Enterprise (SOE) that engaged in oil and gas business covering oil and gas exploration, production, distribution, transportation, and processing activities. Pertamina has many subsidiaries to handle its businesses, PT Pertamina Gas (Pertagas) is one of its subsidiaries with 100% share ownership that handles gas business. PT Perusahaan Gas Negara Tbk, which commonly called PGN, is also a state owned company that engages in gas business, of which 56.97% of the shares are owned by the Government. Currently both gas companies, which are Pertagas and PGN, dominate the gas business in Indonesia.

The Ministry of SOE through its Strategic Planning 2015-2019 would like to synergize among the SOE that engaged in related business to increase the economic scale and reduce business redundancy. The synergy should be implemented to give financial or non-financial benefits to the SOE and also to accelerate the national development.

Refer to the Strategic Planning, the Ministry of SOE is willing to create an oil & gas holding company that consist of Pertamina and PGN. The Ministry of SOE would like to transfer PGN's shares that owned by the Government to Pertamina and as consequence, PGN will be a subsidiary of Pertamina with 56.97% shares ownership.

To follow up the direction of the Ministry of SOE, PGN shareholders conducted Extraordinary General Shareholders Meeting (Rapat Umum Pemegang Saham/RUPSLB) in January 25<sup>th</sup> 2018, and majority of the shareholders agreed to the Government planning to transfer the shares that owned by the Government to Pertamina.<sup>3</sup>

## **1.2. Business Overview**

### ***1.2.1. Gas Business Supply Chain***

Supply chain of gas business is divided into three parts of businesses, which consist of upstream business, midstream business and downstream business. Upstream business is a business in finding for gas reserves and then produces gas from the wellhead, which covers exploration until the production activity. Some of gas are produced from gas well, the other are produced from associated well that consist of oil and gas. It is often that the gas are contaminated with impurities such as CO<sub>2</sub> (Carbon Dioxide), H<sub>2</sub>S (Hydrogen Sulfide) and

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<sup>3</sup> Minutes of Meeting RUPSLB PGN January 25<sup>th</sup> 2018

other impurities that reduce the gas quality and as the consequence, it needs to build gas processing plant to purify the natural gas from debris, liquid and other impurities before transported to customers. Gas processing plant for associated gas well is more complicated than plant for gas well.

The upstream business process is owned by Exploration and Production (E&P) companies. In Indonesia there are many E&P Companies that produce gas, some of them are: PT Pertamina EP, Total Energy Indonesia, Chevron Indonesia, Kangean Energy Indonesia, Exxon Mobil, CNOOC, etc.

The natural gas will be transmitted to the customer side through gas pipeline network after processed in gas processing plant. If the gas pipelines infrastructures are not available, gas should be converted into Liquefied Natural Gas (LNG) by LNG liquefaction plant and then transported by LNG tanker to the customer's side. In the customer's side the LNG should be converted into natural gas through regasification plant before distributed to the end customers. This business section is commonly known as gas midstream business. In midstream business, there are a few companies that play in this business sector. Pertagas and PGN are companies that engaged in the midstream gas business.

In the receiving location, gas is delivered by distribution companies to the end customers that include of several sectors that are power generation, petrochemical, industries, commercials, households and also transportation. Gas companies deliver gas to the end gas customers by gas pipeline network and other distribution methods such as Compressed Natural Gas (CNG) and LNG. This business process is often called downstream gas business.

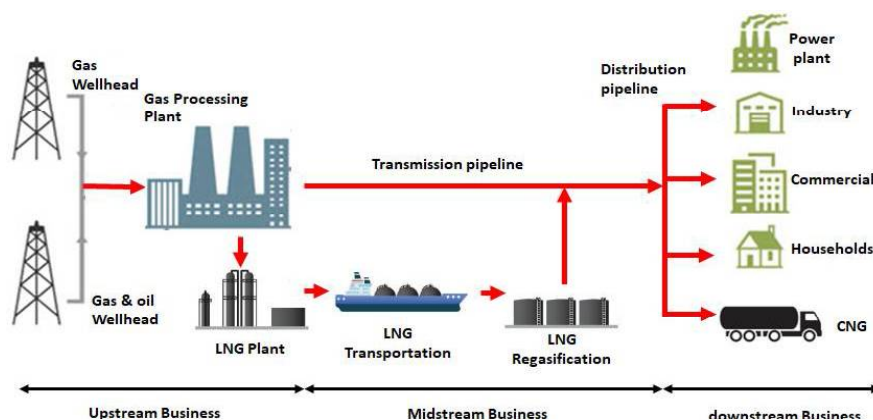


Figure 1.1. Gas business supply chain

### 1.2.2. Company Profile Pertamina Gas (Pertagas)

Pertagas is an Indonesian gas company and a subsidiary of Pertamina that was established in 2007. The establishment of the company is the implementation of Law no. 22 of 2001 regarding Oil and Gas. As the implementation of the law, in November 23<sup>rd</sup>, 2001, the status of Pertamina changed from the original as a business actor as well as regulator, into a State Owned Enterprises (SOE) that acts only as a business actor. Pertagas is authorized by Pertamina to manage, operate and maintain Pertamina's gas assets that include gas pipeline, LPG Plants, compressor station and also gas metering station. The share ownership of Pertagas is 99.99% Pertamina and 0.01% Pertamina Retail. (Annual report Pertagas, 2016)

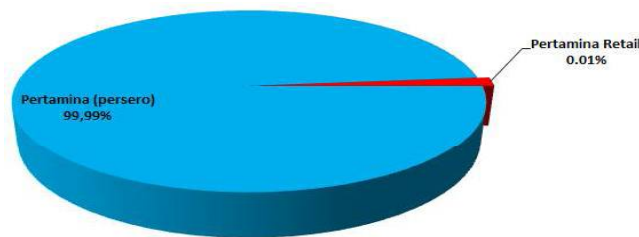


Figure 1.2. Shareholder ownership of Pertagas

Pertagas engages in midstream and downstream gas business that consist of several business lines as stated in Annual Report 2016 as follow.

#### 1. Gas Transportation

Pertagas operates many open access pipeline in several location in Indonesia. Open access pipeline is a gas pipeline that can be used together among gas owner to transport natural gas from well head to customers. As an owner of the pipeline infrastructure, Pertagas receives toll fee from the gas owner (shippers) as revenue of gas transportation. Open access pipeline of Pertagas is located in five areas that are covering Northern Sumatera Area, Southern Sumatera Area, Western Java Area, Eastern Java Area, and also Kalimantan Area. In 2016, Pertagas operate approximately 2158.76km of gas pipelines.

#### 2. Gas Trading

Other revenues for Pertagas are generated through gas sales. Gas sales of Pertagas are delivered by distribution pipeline network or also via CNG (Compressed Natural Gas). To handle gas sales business, Pertagas assign its subsidiary PT Pertagas Niaga which is currently it is obtained gas supply from the field of JOB Pertamina Golden Spike, JOB Pertamina Talisman Ogan-Komering (South Sumatera) and Terang Sirasun Batur (East Java).

### 3. Gas Processing

Beside of gas transportation and gas trading business, other business line of Pertamina is Gas Processing business. Liquefied Petroleum Gas (LPG) is the product of the gas processing business. Since 2012, Pertamina operated LPG plant that located in Pondok Tengah with 150 ton capacity per day, and Natural Gas to Liquid (NGL) processing plant with 710 ton capacity per day in South Sumatera.

### 4. Oil Transportation

Beside operate gas transportation pipeline, Pertamina also operate oil transportation pipelines in Tempino-Plaju, which cover Jambi, and South Sumatera Area with 267 km lengths.

### 5. Gas Regasification

Pertamina has a regasification gas power plant in Lhokseumawe Aceh, that to convert LNG into gas to deliver to customers in Belawan, North Sumatera through open access gas pipeline. The regasification business in Lhokseumawe is assigned to its subsidiary which is PT Perta Arun Gas.

### 6. Gas Compression

Since 2015, Pertamina has operated CNG Plant in Tambak Lorok Semarang Central Java to compress gas for PT Indonesia Power to supply peak load gas consumption. To handle the gas compression business in Tambak Lorok, Pertamina assign its subsidiary which is PT Perta Daya Gas that is Joint Venture Company among Pertamina and PT Indonesia Power, with 65% of shares ownership by Pertamina.

#### **1.2.3. Company Profile PT. Perusahaan Gas Negara Tbk (PGN)**

PGN is a SOE that was established in May 1965. The early years of the Company's history started in 1859 when it was the privately held Dutch Firma L.J.N Eindhoven, which later was taken over by the government of the Republic of Indonesia and, in 1965, turned into a state-owned enterprise named Perusahaan Gas Negara. PGN was then transformed into a Public State Owned Enterprise (Tbk) and, in December 5<sup>th</sup> 2003, it was listed on the Jakarta Stock Exchange with the ticker code "PGAS" thus allowing the public to own its shares. As of the end of 2014, PGN shares were owned 56.96% by the government of Indonesia and 43.04% by the public. Portion of PGN's shareholders is shown in Figure 1.3 as follow.

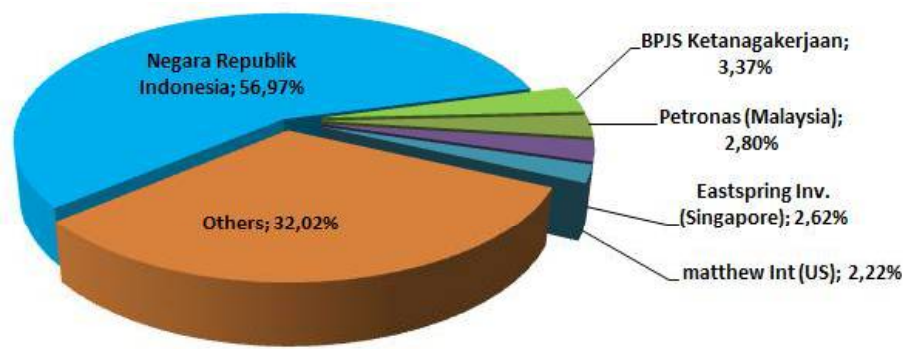


Figure 1.3. Shareholders composition of PGN

PGN is taking a role in all gas business supply chain which covers upstream sector, midstream sector and also downstream sector. PGN’s business lines as stated in Annual Report 2016 consist of several businesses as follows:

1. Gas Transmission Business

Gas transmission/transportation is the activity of transporting natural gas owned by shipper from receiving points in the form of a gas field or other source to the delivery point through a high-pressure transmission pipelines. In this business segment, PGN operates transmission pipelines to deliver gas which is owned by shipper and get benefits in the form of toll fees, in which the amount was stipulated by the Downstream Oil and Gas Regulatory Agency (BPH Migas). PGN Operates six sections gas transmission in Indonesia, with total length of transmission line is approximately 2208 km of pipelines. This business line is managed by PGN itself for transmission line SSWJ 1 and SSWJ 2, and also several subsidiaries i.e.: PT. Transportasi Gas Indonesia (TGI) for Grissik – Duri and Grissik – Singapore Pipelines, and PT Kalimantan Jawa Gas (KJG) that operates pipeline from Kepodang to Tambak Lorok Semarang.

2. Gas Trading & Distribution Business

Gas Trading & Distribution business segment is the activity to distribute and sale of natural gas to end users for industries, power plants, commercials, and households by using variety of modes, both pipeline and other method. This business segment is the main business lines of PGN which is managed by PGN and its subsidiary, PT Gagah Energi Indonesia (GEI). To support this business segment, PGN operates approximately 5.782km of distribution pipeline network which is spread in North Sumatera, Western Java, Central Java, and also Eastern Java which handled 803mmscfd volume of gas in 2016.

### 3. Gas & Oil Exploration & Production

Oil and gas business segment was the PGN's business activities and investments in oil and gas upstream sector including exploration and exploitation. This business activity was PGN's effort to expand its portfolio in the energy value chain through its subsidiaries namely PT Saka Energi Indonesia (SEI).

### 4. Other Business

Beside of the main business above, PGN have several subsidiaries that handle another business support as a strategy of diversification of the company. The other businesses that handled by PGN that are:

- Gas LNG Regasification, via its subsidiary PT PGN LNG Indonesia.
- Telecommunication Network, PGN has subsidiary that handle in this business that are PT PGAS Telekomunikasi Nusantara.
- Construction & Maintenance of Pipeline Network via its subsidiary PT PGAS Solution.

## 1.3. Business Issue

As stated earlier, the Government through Ministry of SOE set a plan to create oil & gas holding company that consist of Pertamina and PGN, with Pertamina as a parent of the holding company. With this holding, there will be two National Gas Company under Pertamina that are PGN and Pertagas, and Pertamina should synergize both companies to avoid redundancy of gas business.

Merger & Acquisition (M&A) is one of the options to synergize both companies after the creation of oil & gas holding company. Pertamina should analyze all aspects of potential synergy in M&A, and also calculate the potential synergy value to determine next strategy to synergize the companies.

The synergy should be taken to maximize benefits for stakeholders, increase efficiency, avoid redundancy, accelerate growth and strengthen position in the market. The synergy should be conducted and should ensure to give financial and non-financial benefits to both companies and also give impact to the national growth and development<sup>4</sup>

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<sup>4</sup> Strategic Planning of Ministry SOE 2015-2019, p 93.

#### **1.4. Problem Identification**

To breakdown the problem statement of this research, several research questions that hopefully could be answered in this research are:

1. What is the factors that influence gas business in Indonesia
2. What are the firm's specific capabilities in gas business
3. What is the Net Present Value PGN stand alone and Pertamina stand alone.
4. In what aspect of business Pertamina and PGN can make synergy
5. How much is the potential value of synergy that would arise in M&A PGN and Pertamina
6. What is the strategic action that should be taken by Pertamina to synergize both companies after the Government set the holding oil and gas

#### **1.5. Limitation**

In this research there are some limitations that include:

- a. Analysis of synergy only focuses on the possibility of M&A among Pertamina and PGN.
- b. The analysis is only focuses on financial aspect.
- c. The research is from the point of Pertamina as a parent of oil & gas holding company that will manage Pertamina and PGN as subsidiaries.
- d. Data that will be used in this research is based on financial data annual report from PGN and Pertamina from 2012-2016.
- e. This research will not discuss in details about how much cost that should be paid to create synergy.
- f. This research is based on external perspective and will therefore only include publicly available information.
- g. This research will not discuss details about government Public Service Obligation policy that involve both PGN and Pertamina
- h. This research will not discuss the details of obstacles, risks that might be faced by both companies to realize the synergy.
- i. This research will not discuss related legal aspect to create the synergy.
- j. This research only focuses synergy in gas business of both companies.