
FUNDAMENTAL ANALYSIS IN INDONESIAN TOBACCO AND CIGARETTE INDUSTRY AND ITS POTENTIAL INVESTMENT OPPORTUNITIES

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ABSTRAK:

Produsen tembakau dan rokok di Indonesia sebagian besar dikategorikan sebagai industri padat karya. Namun, jumlah perusahaan yang terdaftar di Bursa Efek Indonesia (BEI) masih dipandang cukup rendah dibandingkan dengan perusahaan-perusahaan yang tidak tercatat. Mengingat fakta bahwa di antara sepuluh perusahaan terbesar dalam hal kapitalisasi pasar adalah terdiri dari dua perusahaan rokok (PT. HM Sampoerna, Tbk. dan PT. Gudang Garam, Tbk.), oleh sebab itu, dapat disimpulkan bagaimana besarnya peluang investasi pada industri tersebut. Penelitian ini bertujuan untuk melakukan analisis fundamental terhadap industri tembakau dan rokok di Indonesia dengan ukuran sampel sebanyak empat perusahaan yang terdaftar selama lima tahun periode penelitian 2011-2015 serta untuk melakukan analisis industri sebagai alternatif dalam pertimbangan investasi. Analisis fundamental merupakan bagian dari teknik analisis laporan keuangan dengan menggunakan metode *time series analysis* dan *ratio analysis*. Analisis industri mengeksplorasi lebih lanjut mengenai dinamika pasar saat ini beserta beberapa peraturan pemerintah yang terkait. Penelitian ini mengungkapkan bahwa saham PT. HM Sampoerna, Tbk. dianggap sebagai pilihan investasi yang cukup baik. Hal tersebut juga menunjukkan bahwa investasi di industri tembakau dan rokok saat ini masih memiliki prospek bisnis yang baik, disebabkan karena popularitas dari kebiasaan merokok oleh masyarakat, biaya tenaga kerja yang rendah maupun kemudahan memperoleh bahan baku.

Kata Kunci: analisa fundamental, peluang investasi, industri tembakau dan rokok.

ABSTRACT:

Tobacco and cigarette manufacturers in Indonesia are mostly classified as a labor-intensive industry. However, the numbers of companies that are listed in Indonesian Stock Exchange (IDX) are considered low compared to the non-listed one. Given a fact that among the top ten largest companies in terms of market capitalization is comprised of two cigarette companies (PT. HM Sampoerna, Tbk and PT. Gudang Garam, Tbk.), therefore, it could be inferred how substantial is the investment opportunity in this industry. This study aims to analyze the fundamental analysis of tobacco and cigarette industry in Indonesia with a sample size of four listed companies during five years research period 2011-2015 and to perform its industry analysis as an alternative for investment consideration. Fundamental analysis represents parts of financial statements analysis using time series and ratio analysis methods. Industry analysis explores more about current market dynamics and regulatory frameworks. This study reveals that PT. HM Sampoerna, Tbk.'s stock is considered as a good investment choice. It also showed that investment in tobacco and cigarette industry is currently having a good business prospect as well, because of the popularity of cigarette consumption habits by people, lower labor cost and the ease of obtaining raw materials.

Keywords: fundamental analysis, investment opportunity, tobacco and cigarette industry.

INTRODUCTION

Smoking has become a lifestyle in Indonesia for many years. The Tobacco Atlas (2014) state that adult smoking pattern is consisted of 57.1% men and 3.6% female in this country. In 2014, it is estimated that number of cigarettes smoked per person per annum over the age of 15 are around 1,322 cigarettes in Indonesia and there were about 5.8 trillion cigarette were smoked in the world. Based on Table 1, Indonesia is categorized as the third largest cigarette consumers after China and Russia. It indicates that business opportunities in this sector is highly potential nowadays.

Table 1. Top 10 Cigarette Smoking Countries FY14

Nations	Number of Cigarettes Consumption (in '000)	#Rank
China	2,568,139,400	1
Russia	321,427,000	2
USA	281,292,000	3
Indonesia	239,154,500	4
Japan	189,340,000	5
Germany	106,410,800	6
India	100,181,600	7
Turkey	89,561,500	8
South Korea	87,737,600	9
Vietnam	87,079,400	10

Source: World Economic Forum, Tobaccoatlas.org (2014)

Disclosure of information, the availability of human resources and abundant raw materials, adequate infrastructures, wide distribution channel and several attractive incentives provided by the Indonesian government offer ease of investing as to attract investors to invest their funds in this country. There are various investment alternatives including investment in the form of shares that can be done by various parties, both individuals and corporates with different objectives such as to earn a profit, to get a higher investment return, to create value for investors, to increase the company value, and to meet other long-term financial goals. According to Brigham and Houston (2015), investment in stocks and bonds consist of three activities: (1) *Security Analysis* to find the appropriate value of single securities, (2) *Portfolio Theory* to find the optimal method in portfolio structures and (3) *Market Analysis* to identify a condition whether the markets are 'too high', 'too low' or 'about right' during certain period of time.

This study examines four tobacco and cigarette manufacturers listed in Indonesian Stock Exchange (IDX) as of 31 December 2015. PT. HM Sampoerna, Tbk becomes the largest market player in this industry with market capitalization of Rp437.4 trillion or 8.98% from total Rp4,872.7 trillion among the other listed companies, as summarized on Table 2. Fundamental analysis on the research sample covers basic company's financial information of stock price, sales revenue, net profit, earnings per share (EPS), P/E ratio (PER), return on equity (ROE) and price to book value ratio (PBV). This analysis will assist the investors to make a better investment decision, to minimize risk of investment, and to understand about the past financial performance of the firm. The

objective of fundamental analysis is to calculate intrinsic value of a share by considering main financial variables and economic conditions (Amsaveni and Gomathi, 2013).

Table 2. List of Tobacco Manufacturers as of 31 December 2015

Eminent	Stock Code	IPO Date	Closing Price (Rp)	Number of Listed Shares	Market Capitalization		# Rank
					Rp million	%	
PT. Bentoel Internasional Investama, Tbk.	RMBA	5-Mar-90	510	7,240,005,000	3,692,403	0.08	155
PT. Gudang Garam, Tbk.	GGRM	27-Aug-90	55,000	1,924,088,000	105,824,840	2.17	8
PT. HM Sampoerna, Tbk.	HMSP	15-Aug-90	94,000	4,652,723,076	437,355,969	8.98	1
PT. Wismilak Inti Makmur, Tbk.	WIIM	18-Dec-12	430	2,099,873,760	902,946	0.02	289

Source: IDX, Reprocessed by Writer

Problems Formulation

There are several problems that can be identified:

1. How is the performance evaluation of tobacco and cigarette companies based on the fundamental analysis?
2. How is the investment opportunity in Indonesian tobacco and cigarette industry?

Research Objectives

Purpose of this study are as follows:

1. To understand the performance of tobacco and cigarette companies based on the fundamental analysis.
2. To explore the investment opportunity in Indonesian tobacco and cigarette industry.

LITERATURE REVIEW

Previous Research

In general, analysts point out two primary investment approaches in conducting fundamental analysis: traditional 'Top-Down' and another 'Bottom-Up' (Galyadkina and Gerasimova, 2011). Traditional approach begins with review on the macroeconomic and ends with the company performance evaluation. Another analysis, in the opposite, starts from the microeconomic and finishes with the review on economic condition of a country. Further, Galyadkina and Gerasimova (2011) also specifies that traditionally, the fundamental analysis consists of five sequential steps: (a) evaluation of macroeconomic indicators, (b) exploration of the company liquidity, (c) comparison of investment attribute towards diverse shares, (d) review of investment attractiveness and (e) calculation of how much money needed to be invested. Some indicators are used to calculate return on investment, such as: EPS, dividends per share (DPS), share price to profit ratio (P/EPS), and payment coefficient.

Putrayasa and Darmayasa (2015) identify the stocks performance to support investment decision at mining companies stocks recorded in IDX LQ45 Index during 2009-2013. They perform the fundamental analysis using indicators: EPS, PER, ROI, ROE and PBV. This study concludes that PT. Tambang Batu Bara Bukit Asam (Persero), Tbk. is considered as the first investment choice among the other mining companies.

A similar study to find the impact of fundamental analysis, technical analysis and macroeconomic factors on stock price of agriculture industry (Artha *et al.*, 2014). Panel regression method is applied during the research period in February 2013 - April 2013. This study reveals that book value per share (BVS), PBV, debt to equity ratio (DER), trend of stock price, BI rate, world oil price and Rupiah exchange rate provide a significant effect on the stock price of agriculture industry at 1% level.

Theoretical Background

Fundamental analysis is a process of reviewing the business using the key financial information. This type of review focuses on time-series and ratio analysis to determine the financial health of a firm. Fundamental analysis is commonly used to support investment decision making process and share valuation.

There are three objectives of fundamental analysis (A.S., 2013): (1) to predict the national economy growth, (2) to estimate fluctuation of the stock price, and (3) to select the appropriate period and the right securities for investment.

Research by Penman (2013) illustrates that the investment cost represents current stock market price. If share valuation is higher than market price, he suggests the investors to buy this stock. The steps of fundamental analysis to estimate a company value is described on Figure 1. Discussion on this study is emphasis more on the first two steps: understand the tobacco business (industry analysis) and analyzing the financial information (company analysis).

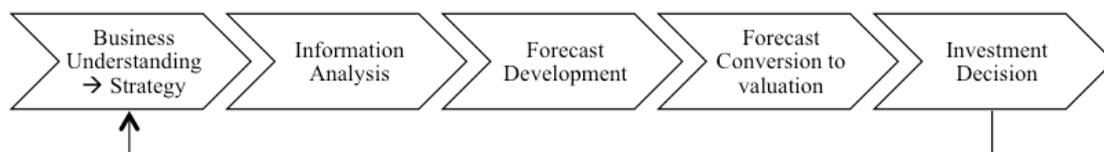


Figure 1. Process of Fundamental Analysis

Source: Penman (2013)

RESEARCH METHOD

Data Source and Collection Method

This study is based on secondary data source of all listed tobacco and cigarette companies in IDX during period 2011-2015. Information on the data source consist of audited financial statements, stocks annual closing price, and market capitalization. Literature study is used in data collection method to obtain some information from text books, business news, government regulations, accounting and management journals,

industry information from the tobacco association and other related sources. List of four tobacco manufacturers selected as sample for this research is shown in Table 2.

Data Analysis Method

This qualitative research is conducted in the form of descriptive analysis, using a case study as research design to perform fundamental analysis of five years financial performance and to review potential investment opportunity in tobacco and cigarette sectors. Gunawan (2015) explains that case study is one of the qualitative research strategy, and the purpose for conducting a case study is to reveal a detailed and comprehensive review of the research object. After the financial information collected from data source, then some financials data are compared using time-series analysis and some financial ratios are calculated in Table 3. Industry analysis in tobacco sector is carried out by understanding the current market structure, future business prospects and government regulations to find its investment opportunity.

Table 3. Financial Ratios in Fundamental Analysis

Indicator	Unit	Formula
Earnings Per Share (EPS): Portion of a net income distributed to common stockholders after deducting with preferred stock	Currency (Rp)	$(\text{Net income} - \text{Preferred dividend}) / \text{Weighted average number of common shares outstanding}$
Price/Earnings Ratio (P/E ratio or PER): Ratio to value a firm that measures its current share price relative to its earnings per share	Times (X)	$\text{Price per share} / \text{Earnings per share}$
Return on Equity (ROE): Profitability of a business in relation to the book value of equity	Percentage (%)	$\text{Net income} / \text{Common equity}$
Price to Book Value Ratio (PBV): Ratio to compare current stock price to its book value	Times (X)	$\text{Market price per share} / \text{Book value per share}$

Source: Brigham and Houston (2015)

FINDINGS AND DISCUSSIONS

Fundamental Analysis

Time-series Analysis

The purpose of time-series analysis is to identify the accounts' movement in company financial statements compared to its prior financial periods. Investors and the other financial statements users need to pay more attention over any significant changes. This study compares financial performance of tobacco and cigarette companies on their stock price, sales revenue and net profit for period 2011-2015.

As shown in Table 4, PT. HM Sampoerna, Tbk. (HMSP) experienced the highest increase in its stock prices over the past five years of 19.2%, compared to the other three

companies who had negative stock growth. Other than stock price, HMSP also had a positive increase on its sales revenue of 11.0%. HMSP had the biggest revenue and profit with sales contribution covered up to 50.0% or amounting to Rp89.1 trillion, from total tobacco manufacturers revenue of Rp178.1 trillion in 2015. Meanwhile, PT. Wismilak Inti Makmur, Tbk. (WIIM) was in the first rank in terms of revenue and profit growth for 13.2% and 14.1%, respectively. WIIM is a newly listed cigarette company on 18 December 2012.

Table 4. Time Series Analysis on Tobacco Manufacturers FY11-FY15

Code	Indicator	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12	31-Dec-11
RMBA	Stock price (Rp)	510	520	570	580	790
	Sales revenue (Rp billion)	16,814	14,091	12,274	9,850	10,070
	Net profit/(loss) (Rp billion)	-1,639	-2,279	-1,042	-323	306
GGRM	Stock price (Rp)	55,000	60,700	42,000	56,300	62,050
	Sales revenue (Rp billion)	70,366	65,186	55,437	49,029	41,884
	Net profit (Rp billion)	6,453	5,395	4,384	4,069	4,958
HMSP	Stock price (Rp)	94,000	68,650	62,400	59,900	39,000
	Sales revenue (Rp billion)	89,069	80,690	75,025	66,626	52,857
	Net profit (Rp billion)	10,363	10,181	10,818	9,945	8,064
WIIM	Stock price (Rp)	430	625	670	760	n/a.
	Sales revenue (Rp billion)	1,839	1,662	1,588	1,119	n/a.
	Net profit (Rp billion)	131	112	132	77	n/a.

Source: Audited Financial Statements, Yahoo Finance

Ratio Analysis

There are several finance indicators used as a tool in fundamental analysis. EPS, PER and PBV relates to market value analysis; and ROE is a ratio to measure profitability. Set out below is the results of financial ratio analysis of tobacco and cigarette companies during the last five years.

Table 5. Ratio Analysis on Tobacco Manufacturers FY11-FY15

Code	Indicator	31-Dec-15	31-Dec-14	31-Dec-13	31-Dec-12	31-Dec-11
RMBA	EPS (Rp)	-215	-315	-144	-45	42
	PER (X)	-2.4	-1.7	-4.0	-13.0	18.7
	ROE (%)	43.7	163.1	-118.2	-16.8	13.6
	PBV (X)	-1.4	-2.7	4.7	2.2	2.6
GGRM	EPS (Rp)	3,345	2,790	2,250	2,115	2,577
	PER (X)	16.4	21.8	18.7	26.6	24.1
	ROE (%)	17.0	16.2	14.9	15.3	20.2
	PBV (X)	2.8	3.5	2.8	4.1	4.9
HMSP	EPS (Rp)	2,227	2,323	2,468	2,237	3,674
	PER (X)	43.2	29.6	25.3	26.8	10.6
	ROE (%)	32.4	75.4	76.4	74.7	79.1
	PBV (X)	50.3	22.3	19.3	19.7	167.6

WIIM	EPS (Rp)	58	53	63	37	n/a.
	PER (X)	6.9	11.7	10.7	20.7	n/a.
	ROE (%)	9.9	13.1	16.9	11.8	n/a.
	PBV (X)	1.0	1.5	1.8	2.4	n/a.

Source: IDX, Reprocessed by Writer

Investors are commonly chose a company with a higher ROE, as it is believed this condition correlates to a higher stock price and low debt. Companies with less performance usually have ROE below 15%. In this case, HMSP has the highest ROE above 75% in 2011-2014. In 2015, HMSP had an additional paid-in capital from limited public offering of Rp20.7 trillion resulted in equity increased from Rp13.5 trillion (FY14) to Rp 32.0 trillion (FY15), which decreased its ROE to 32.4x.

Both of PT. Gudang Garam, Tbk. (GGRM) and HMSP have a good company performance as reflected in their EPS amount with average of Rp2,615 (GGRM) and Rp2,586 (HMSP). It means those companies are able to generate high profits or dividends for investors. This condition is line with their outstanding profits achievement. Net income for the years ended 31 December 2015 received by HMSP and GGRM was amounting to Rp10.4 trillion and Rp6.5 trillion, respectively.

HMSP also got the highest PER and PBV compared to the other companies (2015: 43.2x and 50.3x). This ratios tends to be higher in companies with good growth prospects and in companies who has a low business risk.

Industry Analysis

Large number of smokers frequently use kreteks, or cigarettes made of tobacco and cloves which is known as a hand-made product. Consumption of cigarette is commonly connected to lower economic status, in low and middle income countries. But in Indonesia, the cigarette price is affordable among people with different economic background. There are several problems faced by the industry players in tobacco sector nowadays (Kementrian Perindustrian, 2016): (1) decreasing number of tobacco plantation area and tobacco price which result in a lower production volume, (2) decreasing number of manufacturers, and (3) increasing number of demands. This conditions expose a wide opportunity to engaged in tobacco and cigarette business.

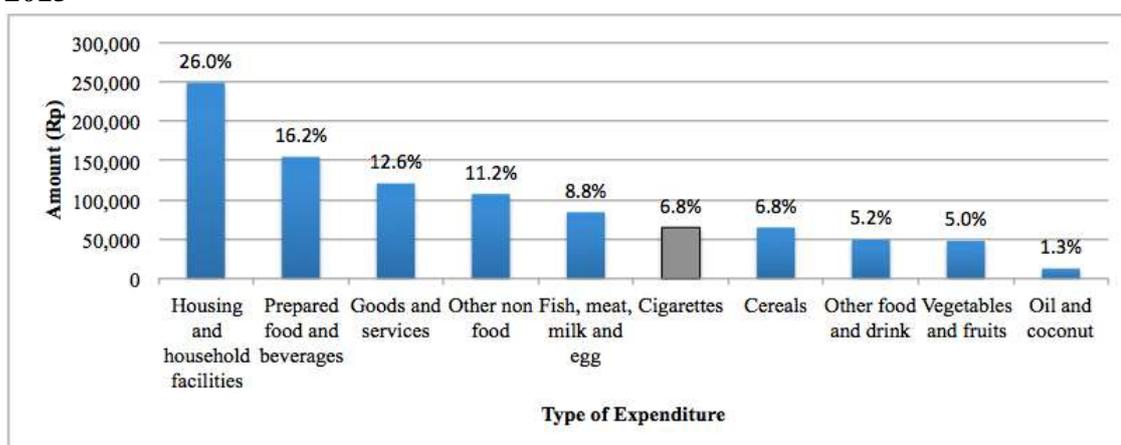
Top players in tobacco and cigarette industry are PT. HM Sampoerna, Tbk. (popular brand: Marlboro, A Mild, Dji Sam Soe), PT. Gudang Garam, Tbk., PT. Bentoel Internasional Investama, Tbk., PT. Wismlak Inti Makmur, Tbk. and the other two non-listed companies who play a significant role in this market are PT. Djarum and PT. Nojorono Tobacco International.

An investor should be familiar with the local investment policy on the form of corporation, percentage of ownership, type of sectors and fields open for investment, amount of investment, as stipulated in the Investment Law No. 25/2007. Foreign direct investment in cigarette industry sector is categorized in the negative investment list based on Presidential Regulation No. 39/2014, it requires authorization from the Minister of Industry. The purpose of negative list is to limit foreign investment in several key business sectors. Therefore, many foreign investors enter the business through local partnership to fulfill certain government requirements.

As detailed in Figure 2, households spent on average 6.8% expenditures per capita on cigarette products, compared with 26.0% for housing and household facilities, 16.2% for prepared food and beverages, 12.6% for goods and services, 11.2% for other non food (such as clothing, durable goods and taxes), and 8.8% for fish, meat and dairy products (BPS, 2015). The information presents if cigarette domestic market share is considered quite significant.

The tobacco and cigarette industry becomes one of the major government revenue contributions in terms of taxation. The Directorate General of Customs and Excise (DJBC) recorded Rp180.4 trillion of import duty, export duty and excise in government revenue period 2015. This excise revenue increased by 22.2% compared to period 2014 of Rp147.6 trillion, which 95% was contributed by cigarette excise (Ministry of Finance, 2016). Assuming the contribution level remains the same, total cigarette excise revenue was estimated to Rp171.4 trillion in 2015. The Indonesian government also announced increase in cigarette excise tax of 11.5%, in average, effectively starting from 1 January 2016 (Ministry of Finance, 2015). Currently, Indonesian Ministry of Finance has yet to issue new regulation on cigarette retail price, following the increment on cigarette excise tax.

Figure 2. Top 10 Monthly Households Expenditure per Capita as of 30 September 2015



Source: BPS (2015)

CONCLUSIONS, IMPLICATIONS AND SUGGESTION

Conclusions

This study has two main objectives related to review on tobacco and cigarette companies performance, and to explore investment opportunity in this industry sector. Regarding the first queries, this study finds that it is worth every penny to invest in PT. HM Sampoerna, Tbk. as it has a sound financial performance (high investment return, high revenue and low business risks). The second queries finds that tobacco sector also has a promising investment opportunity because of its labor intensive (more employment creation), great source of income, and shortage between current demand and supply.

Implications

This research has implications on both theoretical and managerial aspects. In theoretical aspect, fundamental analysis can become a reference for evaluating a business from economic and financial perspectives to support investment decision making process. In managerial aspect, it covers involvement of the company management in all levels to maintain their business growth and to maximize company value.

Suggestion

Based on the research findings, this research suggests the investors to perform the fundamental analysis properly and to consider the industry carefully, before deciding to buy a certain stock in order to avoid further investment loss.

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Senior Consultant at Transaction Advisory Services at PT. Ernst & Young Indonesia (Jakarta)
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