Initiating Coverage

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PT Wijaya Karya (Persero) Tbk (WIKA)

A Very Attractive Risk-Reward Play

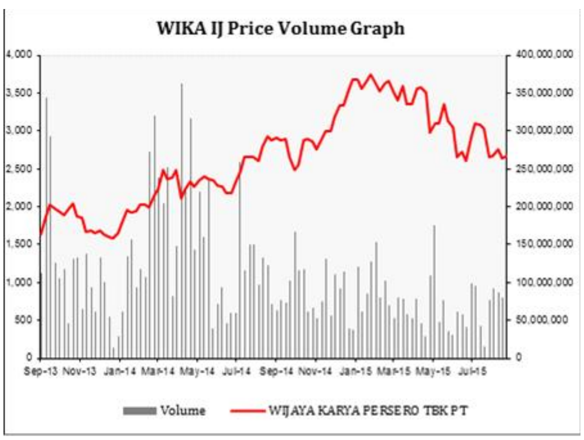
BUY

PT WIJAYA KARYA (Persero) Tbk

PT Wijaya Karya (Persero) Tbk is a construction-based company primarily engaged in construction, EPC, industry and real estate development. The company also invests in power plants and manufactures industrial precast concrete.

Current Price: IDR 2,995

52-Week Target Price: IDR 3,580



Share Price Performance	
Price (IDR)	2,995
52-Week High (12/30/14)	3,895
52-Week Low (08/24/15)	2,370
52-Week Beta	1.49
YTD Change/%	(725) / (19.7%)

Stock Information	
Market Cap (IDR)	18,416.9 B
Shares Out/Float (M)	6,149.2 / 2,144.3

Source: Bloomberg, Sinarmas Investment Research

We initiate coverage on PT Wijaya Karya (Persero) Tbk (WIKA) as a BUY, with a 52-week target price of IDR 3,580, representing a 19.5% upside. We used a DCF valuation (WACC: 12.8%, LTG: 8%) as the company sets to take advantage of current low expectations in power plants construction and several megaprojects that will highly benefit the company.

Expectations in power plants construction are so low that it represents a very attractive risk-reward scenario. Given the current 'stagnant' situation in the Batang power plant construction and concerns in electricity pricing, expectations of successful power plant construction and operation are currently very low. This, in our view, represents a very attractive risk-reward scenario in a segment where the government has roiled out various measures to show its determination and support.

The company is set to benefit from a significant jump in total contracts in the coming years. We attribute such a claim to part ownerships in several megaprojects currently amounting to c.IDR 150tn, with potential construction revenues amounting to c.IDR 61tn over the next four years. As the company maintains part ownership, it should have an advantage in the construction tendering process.

Incredibly soft 1H15 hugely priced in—bet on an upbeat Q4 15. Given that WIKA's share price has declined 23% from its high, the most among the top three contractors, we believe that a huge part of the bad news coming from the company's soft 1H15 results have been priced in. Government budget absorption, when compared to former president SBY's first year in office, isn't too shabby, either. With multiple positive feedback from the industry from early Q3, we are betting on an upbeat Q4 15, historically the company's strongest quarter.

However, the company's ownership in several megaprojects will cause short-term headwinds. As part owner in the non-subsidized Jakarta-Bandung high speed train and Java 5 & Java 7 power plants, WIKA will have to endure possible negative cash flows that could occur in the first few years of operations.

Financial Highlights	12/14	12/15F	12/16E	12/17E	12/18E
Revenue (IDR Bn)	12,463	11,050	19,322	25,429	27,257
% growth		*-11%*	*75%*	*32%*	*7%*
Gross Profit (IDR bn)	1,425	1,109	1,711	2,169	2,327
Net Profit (IDR bn)	751	606	794	1,051	1,108
% growth		*-19%*	*31%*	*32%*	*5%*
EV/EBITDA (x)		12.4	9.4	7.5	6.6
Gross Margin (%)	11.4%	10.0%	8.9%	8.5%	8.5%
Net Margin (%)	6.0%	5.5%	4.1%	4.1%	4.1%
Return on Equity (%)		18.3%	11.7%	9.1%	8.5%
Return on Assets (%)		5.3%	3.9%	3.8%	4.0%

Source: Company Data, Sinarmas Investment Research

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Company Background

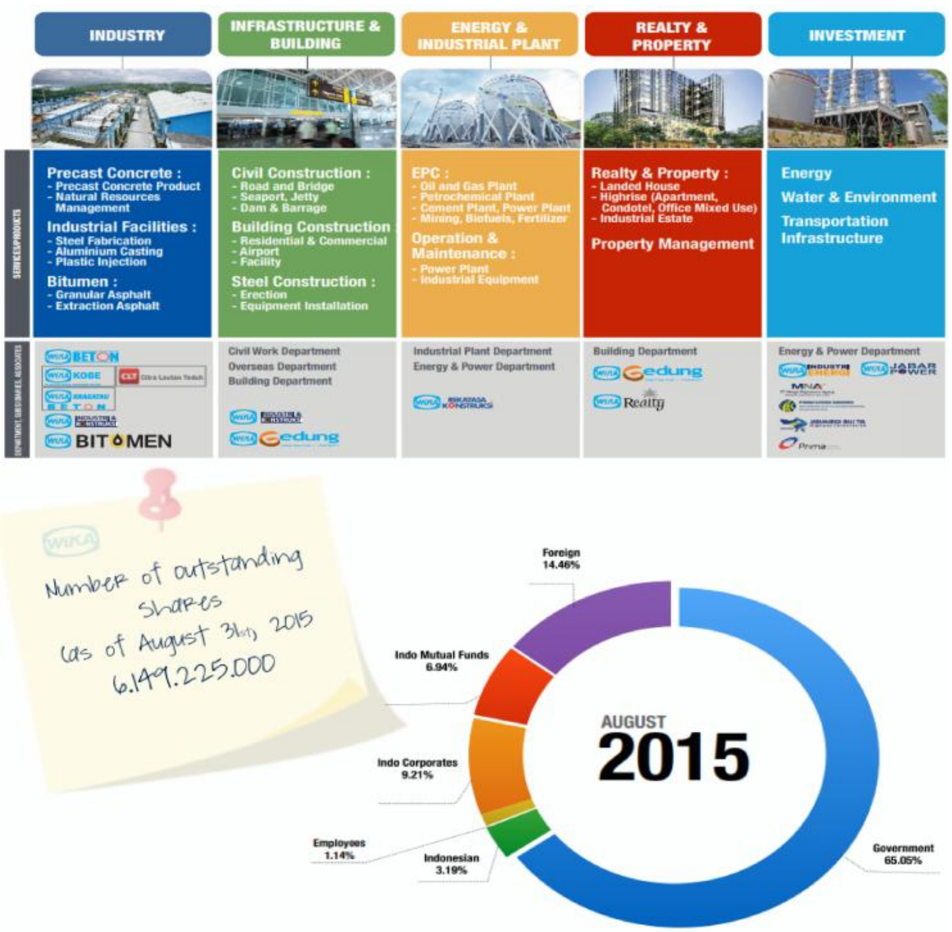
PT Wijaya Karya (Persero) Tbk (WIKA.IJ) is primarily involved in construction of buildings, roads, power plants, airports, dams, railways and docks. The company also provides EPC (Engineering, Procurement & Construction) services, manufactures precast concrete and also develops several residential properties. The company also invests in multiple projects for future recurring income.

PT Wijaya Karya still remains Indonesia's leading power plants contractor, with the company set to benefit from increased government concentration in the area. Although most of WIKA's contracts are now made up of buildings, we are seeing a general trend of increasing power plants & toll roads construction as these generally offer larger margins than traditional buildings. Also, the government is now pushing on increased infrastructure which would help tilt WIKA's construction portfolio towards more government-focused project types.

After spinning off its precast manufacturing division, PT Wijaya Karya Beton (WTON.IJ), through an IPO, WTON has largely suffered from decreasing market share as a result of increased competition from other SOE contractors. Other SOE contractors have aggressively expanded their own precast business as precast businesses both offer higher margins than traditional construction and SOE contractors can also become self-sufficient.

In 2014, WIKA Realty opened up into various new projects, including landed houses in Bogor and offices as well as apartments in Jabodetabek. However, it suffered from an expansion into the wrong segment at the wrong time; amid a property market slowdown, WIKA Realty expanded into the middle-high segment, and its 1H15 results had had to pay for what looks like a very costly mishap.

Company & Shareholder Organization Structure

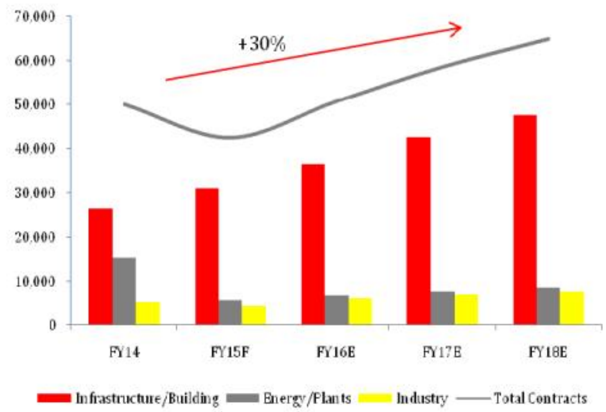


Source: Company data

Investment Theses

Catalysts:

Total Yearly Contracts, Excluding Megaprojects



Until FY18E, new contracts are set to jump 30%, excluding potential new contracts from the current Java 5&7 power plants and HSR, which could add a further IDR 61tn in contracts over four years.

Source: Company data, Sinarmas Investment Research

- **New contracts to improve significantly across various business lines—**WIKA is set to be one of the main beneficiaries from the government's construction-focused projects in the foreseeable future. Its infrastructure, power plants & precast divisions, which made up 90%/96% of total sales in FY14/FY15F, will see a massive jump in new orders in the coming few years due to various megaprojects such as the Jakarta-Bandung high-speed rail (HSR) and the Java-5/7 power plants. Total investments in these three projects alone are expected to exceed IDR 150tn, with potential construction revenues totaling c.IDR 61tn. As WIKA is part owner in all three megaprojects, it should have an advantage in the construction tendering process. The Jakarta-Bandung HSR project is also just a start of the government's plan for a trans-Java high speed rail system, where potential construction revenues from such a project could skyrocket. Also, WIKA will be able to leverage on its expertise as Indonesia's leading power plants contractor as the government pushes on with the 35 GW project by 2019.

Regulations aimed at easing IPP concession terms and introducing easier electricity price purchases are just the start of government support towards power plants.

- **Very attractive risk-reward with regards to power plant construction—**There have been a lot of negativity surrounding the construction and operation of power plants. A lot of this pessimism is backed by the continued delay of the financial closure of land acquisition of the 2 GW power plant in Batang, a delay that has dragged on for more than three years. However, we feel that the risk-reward for power plants construction is now more attractive than ever, as the government has rolled out multiple schemes to support land acquisition processes for nation-focused infrastructure projects. Furthermore, PLN has received an IDR 10tn budget in FY16, more than any other SOE. Power plants have also received a lot of regulatory changes in support of their implementation, such as the Energy Resources & Mineral Decrees no 1/2015 and 3/2015. This only further supports our view that the government is fully committed in following through on their plans of increasing the nation's electricity capacity.

WIKA's share price has corrected the most among the top three contractors, signaling most of the bad news has been priced in, in our view.

- **So much bad news has been priced into the share price—**So far in FY15, the stock price has corrected 23%, more than both the industry average and the JCI. We feel that this correction in the stock price has largely reflected the incredibly soft 1H15 performance, particularly the huge declines in incomes from WIKA's property and precast segments. In our opinion a piece of positive news going in favor for the company will send its share price soaring back up. Positive news, in our view, is not far away as WIKA is currently involved in multiple construction tenders in which it is also part owner. Going forward, WIKA's precast division will also become more and more significant towards WIKA's performance; we forecast WTON to make up 34%/43% of WIKA's FY15F/FY16E earnings. In our view, this is hugely positive for WIKA, as WTON will: i) continue to enjoy increased precast demand from nationwide government megaprojects amid losing market share, and ii) benefit from the government's theme of pushing for infrastructure growth outside of urban areas, where WTON has the largest geographical reach out of all the other precast manufacturers.

- **The government is acting to fix land acquisition concerns, and this is hugely positive for the industry—**Regulations have been laid in support of land acquisition relating to public works. Presidential Decree no 30/2015 and a revision of the UU no 2/2012 have been set to allow for a much easier land acquisition process. In our opinion, although both decrees have not yielded notable results, government support is necessary to fix concerns as large as this—government support that will only get stronger as time passes.

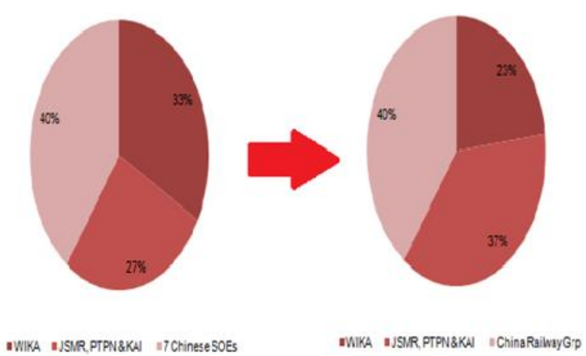
Key Risks

Although largely positive in the longer term, operations of power plants and non-subsidized transport routes will produce short term pain.

- **Part owner in megaprojects will cause short-term headwinds—**WIKA currently acts as part owner to multiple megaprojects and various other power plant projects, such as the Java-5/7 power plants and the Jakarta-Bandung HSR project. In the first few years of operations, these projects will have negative cash flows: power plants generally have a payback period of seven years while the Jakarta-Bandung train will take over 29 years to break even. Although these ownerships will provide the company with huge recurring incomes in the future, the short-term outlook in enduring with negative cash flows remains a key risk to us.

- **Optimism over Jakarta-Bandung high speed rail project could have been overdone—**We attribute the recent optimism over the stock to the confirmation of the Jakarta-Bandung HSR. No contracts relating to construction activities have been agreed upon, although we strongly agree that WIKA's role as part owner will benefit the company in the tendering process. Construction gross margins for the project will only be c.6%, lower than the 9-11% average for roads; this, in our estimates, will only translate to c.2% net margin. The company will also be subject to gains or losses resulting from the operations of the HSR. In our forecasts, it will take over 29 years for the initial investment to be repaid through plain ticket sales. Hence, the company has planned on developing TODs around the HSR stations to generate added revenue. Even if TOD sales go as expected, it will only generate c.IDR 34tn in revenues over 15 years, still a far cry from the initial IDR 77tn investment. Furthermore, history has shown that in other HSR cases in China, the first seven years of operations will produce negative cash flows. In conclusion, although WIKA will benefit from added construction and precast revenues from the project, margins are projected to be significantly lower than they usually are. The company will also have to endure initial negative cash flows from the operations of the high speed rail as no government subsidy is provided.

Jakarta-Bandung HSR Ownership Structure



As WIKA is no longer the major shareholder in the HSR consortium, it is able to book revenues generated from this project into its financial statements. The revised ownership structure also means that WIKA now bears less of the negative cash flows that will come from the train operation.

Source: Sinarmas Investment Research, Company data

Our Conclusion

- These risks are hence mainly concerned about the short-term performance of the company. Over the long term, we believe that WIKA will be one of the outperformers in the construction industry as it leverages on its expertise in constructing power plants. The added recurring income from many of its projects will also represent an added value to the company.

Drawing Comparisons to 2005

- **There has been a lot of criticism regarding the current government's lack of action.** On paper, realization of the state budget with respect to the FY15 target, from both the revenue and expenditure sides, have been disappointing. As of 7M15, total government revenue was IDR 771Tn, or 44% of the FY15 target; total expenditure only reached 46% of the target. For contractors and infrastructure players, total capital spending on infrastructure was only 14% of the full year target.

It would be unfair to compare the government's performance on a YoY basis.

- **Comparing the current budget realization to both 2005 and 2014.** In our view, comparing the government's performance this year to that of FY14 would not be fair; the current government has been in office for less than a year while in FY14, the government then had been in office for nearly five years. That being said, we compared our government's budget realization in FY15 to that in FY05, the first full year a new government was in office. In FY05, total capital spending realization was 60.1%, with absorption in Q4 05 almost triple that of 3Q05.

Several positive catalysts raise hopes that budget absorption in 4Q15 will pick up significantly...

- **Betting on an upbeat Q4 15.** Assuming similar absorption rates in capital spending this year to FY05, we could see a significant jump in capital spending absorption in Q4 15. Historically, contractors record the highest portion of revenue during this period of the year. Also, there have been several on-field reports that construction works and previously worrisome execution schemes are slowly improving. Therefore we also assume our target price in betting for a better 4Q15 than how the rest of this year had been.

Perpres no. 30/2015—can it soothe land acquisition concerns?

Land acquisition remains challenging despite new presidential orders.

- **Land acquisition remains a major concern.** Building of power plants in Batang and various toll roads have had to be stalled due to disagreements between the contractors and landlords in the land acquisition process. To smoothen the process, a new presidential decree (no. 30/2015) issued that any land to be used for the construction works of national importance should be acquired by the related government parties under a fair, independent valuation of the land. As simple as that sounds, ease of execution remains a concern and we believe that only time will tell, despite success stories of the implementation of this new bill in sections of the Pemalang-Batang and Solo-Kertosono toll roads.

There are still concerns over execution of constructing power plants.

- **The outlook for power plants construction will depend on developments of the Batang power plant.** At this point in time, investors will continue to monitor the land acquisition developments of the Batang power plant as an anchor for the whole power plant industry. As Indonesia's premier power plants contractor, WIKA will bet on the new presidential order to be executed smoothly. Going forward, a lot of WIKA's performance will be attributable to its ability to successfully build power plants as part of Pres. Jokowi's 35,000 MW program. Also, the government has shown its seriousness in executing this program as an IDR 10tn budget for 2016 has been allocated to PT PLN, the state-owned electricity supplier.

Current Megaprojects

We now discuss the megaprojects that WIKA is part owner in, which in our opinion will give them a plus when tendering for construction, EPC and precast contracts from these megaprojects.

Jakarta-Bandung High Speed Rail (HSR)

- The project will be owned by a consortium, with 60% of the consortium owned by four Indonesian SOEs (WIKA, JSMR, KAI, PTPN) and 40% owned by China. Total investment for this project is estimated to be c. USD 5.5Bn, with 75% of the funding coming from a net 1.7% interest rate USD loan, and 25% of the investment will be equity injections.

- Total construction and precast requirements for the total project is estimated to be around IDR 40tn. Estimated gross margins for the construction and precast works are expected to be c.6% and c.11-12% respectively.

- The consortium will generate revenue from two main sources: i) ticket sales, which are to be priced at IDR 200,000 per trip and whose prices are adjustable every two years as per inflation, and ii) TOD developments in and around stations, which are expected to generate up to IDR 30tn over 15 years.

- We are neutral in our view of this project toward WIKA. Although WIKA should see a significant rise in new contracts from this project, margins are lower than they normally are. Also, the first seven years of operations are expected to generate negative cash flows despite a longer term potential for added recurring income for the consortium.

Java 5 & Java 7 Power Plants

- These two power plants, each operating 2x1GW, will each have an estimated investment of IDR 37tn. Combined, these two projects are estimated to give out a combined IDR 20tn in construction contracts and IDR 44tn in EPC contracts, although most of the EPC work will be done by Chinese companies.

- Land acquisition is less of an issue in the construction of these two power plants. While land for the Java-7 has already been made ready by PLN, down payments for the land of the Java-5 power plant have already been paid by the consortium in charge.

- WIKA has already participated in the tender for construction of these two power plants. The winner is expected to be announced in mid-November 2015.

- Overall, WIKA owns 10% of the Java-7 plant and 15% of the Java-5 plant. The expected payback period from this power plant operation is seven years.

Appendix I: Major New Contracts & Valuations

Major Contracts	Size, IDR Bn	Location	Owner
Roads/Railways			
Solo-Kertosono Toll Road	718	Tangerang	Local consortium
Bogor-Ciawi Toll Road	323	Makassar	Local consortium
Elevated non-toll Ciledug	319	Makassar	Government
Power Plants			
PLTD Pesanggaran 50 MW	930	Bali	Government
PLTG Borang 2 x 30 MW	816	Palembang	Government
Gas Fire Power Plant 188 MW	322	Aceh	Government
Dam			
Pasellorang Dam	478	South Sulawesi	Government
Keureuto Dam	407	Aceh	Government
Railways			
MRT Underground CP 104 & 105	1,942	Jakarta	Government
MRT 101 & 102	1,030	Jakarta	Government
Double-Double Track Manggarai	330	Flores, NTT	Government
Airport			
Terminal 3 Ultimate Soetta Airport	1,796	Jakarta	Government
Oecusie Airport	910	Timor Leste	Government
Docks			
JICT Phase 6-8,10	409	Jakarta	Private
Belawan Phase 2	639	North Sumatera	Government
Others			
Gas Production Facility	1,738	Central Sulawesi	Government
Gasoline Terminal	1,140	Riau	Government
Gresik-Semarang Gas Transmission	780	Central Java	Government

DCF Assumptions

Assumptions	
Risk-free	8.74%
Market Risk Premium	5.50%
Equity	**3,989,590**
Cost	16.6%
Debt	**2,966,241**
After-tax Cost	7.20%
Terminal growth rate	8.1%
WACC	**12.6%**
Target Price	**3,580**

Source: Sinarmas Investment Research, Company data

Appendix II: Financial Statements

Balance Sheet, IDR Mn	FY13	FY14	FY15F	FY16E	FY17E
Assets					
Cash And Cash Equivalents	1,386,707	2,300,892	2,681,111	6,675,639	2,949,641
Total Receivables	2,132,198	2,639,364	2,303,235	2,668,482	2,985,563
Inventories	1,118,390	817,307	1,072,877	1,241,340	1,306,135
Total Current Assets	**7,994,288**	**9,514,447**	**9,319,433**	**14,408,208**	**11,670,909**
Joint Venture Investments	1,351,608	1,681,164	1,347,106	6,757,106	9,500,106
Fixed Assets, net of depreciation	1,640,292	2,676,043	3,097,276	3,205,063	3,308,018
Total Assets	**12,594,962**	**15,915,162**	**15,533,393**	**26,113,429**	**26,164,572**
Current Liabilities					
Short Term Bank Loans	278,244	928,515	701,534	1,846,331	203,873
Trade Payables	3,088,518	3,902,807	3,126,464	3,756,140	4,265,615
Advances From Consumers	376,771	316,364	314,197	395,942	431,878
Total Current Liabilities	**7,298,469**	**8,476,042**	**7,532,107**	**11,138,226**	**9,539,495**
Non Current Liabilities					
Long Term Liabilities	802,103	475,105	475,105	1,425,315	1,425,315
Medium Term Notes	466,000	800,000	1,341,000	541,000	1,341,000
Total Liabilities	**9,368,004**	**10,936,403**	**10,156,782**	**14,058,431**	**13,402,700**
Equity					
Share Capital & APIC	1,327,743	1,330,781	1,330,781	7,484,627	7,484,627
Retained Earnings	1,202,095	1,518,306	1,916,158	2,440,700	3,147,573
Total Liabilities & Equity	**12,415,669**	**14,611,865**	**19,751,694**	**24,318,710**	**26,890,382**

Income Statement, IDR Mn	FY13	FY14	FY15F	FY16E	FY17E
Revenue	**11,884,668**	**12,463,216**	**11,050,433**	**19,322,290**	**25,429,476**
Growth (%)	21%	5%	-11%	75%	32%
Cost of Goods Sold	(10,562,234)	(11,038,647)	(9,941,338)	(11,971,180)	(13,390,446)
Gross Profit	**1,322,433**	**1,424,569**	**1,109,094**	**1,711,110**	**2,169,029**
Gross margin (%)	11.1%	11.4%	10.0%	8.9%	8.5%
JV Profit	261,015	369,757	283,588	353,319	411,095
Gross Profit after JV	**1,583,448**	**1,794,326**	**1,392,682**	**2,064,428**	**2,580,124**
Selling Expenses	(4,776)	(6,837)	(7,131)	(9,178)	(8,527)
General/Admin Expenses	(362,710)	(386,569)	(315,709)	(560,543)	(757,264)
Opex/revenue (%)	3.1%	3.2%	2.9%	2.9%	3.0%
Operating Income	**1,215,963**	**1,400,921**	**1,069,842**	**1,494,707**	**1,814,333**
Other Income (Expenses)	(199,272)	(255,029)	(115,190)	(243,705)	(158,768)
Profit Before Tax	**1,016,691**	**1,145,892**	**954,651**	**1,251,002**	**1,655,565**
Income Tax	(392,319)	(395,094)	(348,768)	(457,035)	(604,836)
Net income	**624,372**	**750,798**	**605,884**	**793,967**	**1,050,729**
Net margin (%)	5.3%	6.0%	5.5%	4.1%	4.1%

Source: Sinarmas Investment Research

Appendix III: Financial Ratios Forecasts

Ratios	FY15F	FY16E	FY17E	FY18E	FY19E
Profitability					
ROE	11.7%	9.1%	8.5%	8.4%	7.3%
ROA	3.9%	3.8%	4.0%	4.0%	3.4%
Gross margin	10.0%	8.9%	8.5%	8.5%	9.4%
Operating margin	9.7%	7.7%	7.1%	7.2%	8.8%
Net margin	5.5%	4.1%	4.1%	4.1%	5.1%
Net income growth	-19.3%	31.0%	32.3%	5.5%	-8.4%
Liquidity					
Current Ratio (x)	1.12	1.24	1.29	1.22	0.98
Quick Ratio (x)	0.58	0.66	0.84	0.62	0.46
Cash Ratio (x)	0.27	0.36	0.60	0.31	0.18
Solvency					
D/E (x)	0.51	0.44	0.28	0.36	0.33
Debt/Assets (x)	0.18	0.20	0.14	0.16	0.16
Valuations					
P/E (x)	37.33	36.75	21.95	20.31	22.09
P/BV (x)	4.21	2.42	1.81	1.67	1.58
EV/EBITDA (x)	12.38	9.36	7.51	6.55	6.93

Source: Company Data, Sinarmas Investment Research

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