Initiating Coverage

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PT Wijaya Karya Beton Tbk (WTON)

When a Door Closes, Another Opens

NEUTRAL

PT Wijaya Karya Beton Tbk (WTON) is an Indonesian-based company primarily involved in the manufacturing of precast concrete. The company mainly produces prestressed concrete poles, prestressed concrete piles, concrete open channels and bridge girders.

Current Price: IDR 935

52-Week Target Price: IDR 880

Share Price Performance

Price (IDR)	935
52-Week High (04/02/15)	1,440
52-Week Low (26/08/15)	830
52-Week Beta	1.20
YTD Change/%	(360)/(27.69%)

Stock Information

Market Cap (IDR)	8,192.5B
Shares Out/Float (M)	8,715.5/2,422.6

Source: Bloomberg, Sinarmas Investment Research

We initiate coverage on PT Wijaya Karya Beton Tbk (WTON) as a NEUTRAL, with a 52-week target price of Rp. 880/share, implying a 5.9% downside from the current market price of Rp. 935/share. At these forecasts this would imply a forward P/E of 36.01x (v.s. T12M P/E of 33.5x) as we forecast net income to decrease by 34.1% in FY15E on the back of lackluster 1H2015 performance. We project the company's gross margin to slump to 14% (v.s. 14.9% in FY14) as infrastructure projects slowed down in 1H15 and only started to pick up in 3Q15. Going forward, government infrastructure absorption remains a major concern; a lack thereof contributed to a 47% YoY decrease in sales in 1H15. With the company losing market share in Java, the management has to take a stand regarding its premium pricing: do they lower margins to gain back lost market share?

Expansions out of Java will help improve the company's margins and businesses going forward. Gross margins in the precast business is very sensitive to competition. WTON has focused its expansions ex-Java, where there is less competitors, resulting in a GPM expansion from 13.1% to 14.9% in FY12 and FY14, respectively. Going forward (except lower FY15E GPM as a result of an incredibly soft 1H15), we expect WTON's GPM to continue to expand up until 15.2% in FY17E, before shrinking slightly to 14.8% over the next two years, as out-of-Java expansions continue to contribute more significantly to its overall portfolio. With the current government spending more than ever on improving rural area infrastructure, WTON stands to benefit by being the largest precast supplier, especially ex-Java.

The company faces deteriorating market share; must make up 12% share in coming years. Based on 1H15 results, 44% of WTON's revenue came from infrastructure projects; 26% of this from SOE contractors (ADHI, PTPP, WSKT, WIKA); WIKA contributed 8%. As ADHI, PTPP, WSKT aggressively expands in the precast business, the company stands to lose up to 18% of its business going forward. Company estimates that it could lose up to 12% market share in this aspect; market share which stands at 42.8% as of FY14, and was at ~60% in FY11. In-Java businesses, although shrinking w.r.t. total portfolio, still account for 52.6%/46.2% of FY15E/FY16E operations; hence we forecast net income to stay relatively flat over the next four years.

Financial Highlights	12/13	12/14	12/15E	12/16E	12/17E
Revenue	2,644	3,277	2,525	2,829	2,923
%growth		*24%*	*-23%*	*12%*	*3%*
Gross Profit (IDR bn)	388	487	260	439	454
Net Profit (IDR bn)	241	322	155	297	309
%growth		*34%*	*-52%*	*91%*	*4%*
EV/EBITDA (x)	27.8	15.6	14.7	13.2	12.1
Gross Margin (%)	14.7%	14.9%	10.3%	15.5%	15.5%
Net Margin (%)	9.1%	9.8%	6.2%	10.5%	10.6%
Return on Equity (%)	36.2%	21.8%	6.8%	12.4%	12.0%
Return on Assets (%)	9.1%	9.6%	4.1%	7.6%	7.5%

Source: Company Data, Sinarmas Investment Research

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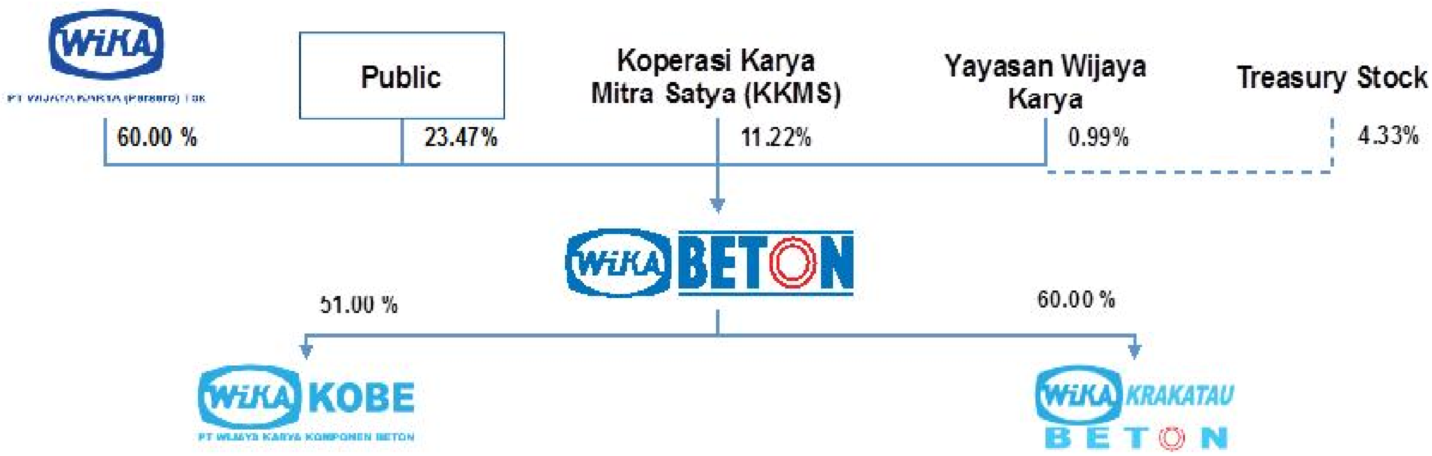
Company Background

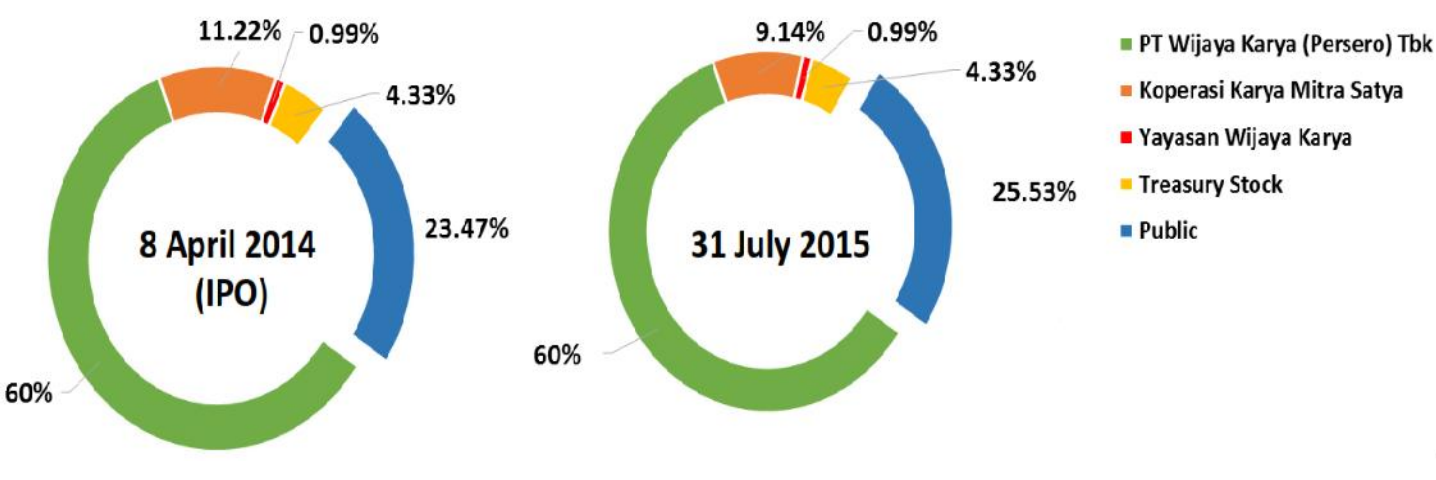
PT Wijaya Karya Beton Tbk (WTON) is an Indonesian-based company primarily involved in the manufacturing of precast concrete. As of FY14, the company's productions includes prestressed concrete poles, prestressed concrete piles, concrete open channels and bridge girders.

WTON is a spin off from its parent company, PT Wijaya Karya (Persero) Tbk (WIKA). Since its IPO in April 2014, WIKA has retained 60% ownership of WTON. As WTON's businesses generate higher margins than WIKA's (FY13/14 net margin 9.1%/9.8% v.s. 4.8%/4.9%), WTON's contribution to WIKA's consolidated statements is also growing. In FY13/14, WTON contributed 6%/8% to total WIKA sales, but net income contribution was 38%/42%.

The two subsidiaries, WIKA Kobe and WIKA Krakatau Beton, were set up to fulfill its own responsibilities. WIKA Kobe was set up in joint operations with WIKA's Japanese counterparts, and currently holds a major stake in Jakarta's MRT project. WIKA Krakatau Beton was set up in coordination with PT Krakatau Steel (KRAS:IJ) to provide precast products in KRAS' industrial estate.

Shareholder and Corporate Structure





Source: Company data

Investment Theses

Catalysts:

Company guidance has come in very positive in Q3 to date...

- **Incredibly soft 1H15, yet APBN absorption has started to take place—**The company reported very disappointing 1H15 results, with revenue falling 47% YoY and gross margin shrunk from 15.3% to 12.9%. This is on the back of a fall in utilization rates across multiple factories, with the total utilization rate falling to 65%/75% in 1Q15/2Q15, v.s. long term company target of 85%. The downturn in operations is largely due to lack of translation from order book to revenue. However, performance in a few regions have picked up in July/August : i) North Sumatera, accounting for 16% of FY14 total sales, have seen utilization rates of over 100% in 3Q15 due to toll road projects; ii) Karawang/Bogor, due to faster APBN absorption in Western Java and iii) the opening of South Lampung factory, which has the land bank to potentially triple South Sumatera operations, is connected to a seaport, lowering transport costs. This somewhat surprising upturn in performance since the results release will provide the company with a positive boost.

Because precast is not economically feasible over large distances, location is king.

- **Delicately positioned to fulfill government ambitions.** The current administration has a clear set goal: to improve rural area infrastructure. The budget for the said cause has been increased from Rp41tn—Rp 79tn in FY15—FY16, while sacrificing the infrastructure budget through the ministries, which is hugely responsible for projects in larger cities. With this, WTON is the best positioned among its industry peers as it operates multiple plants in Kalimantan, Sulawesi and Sumatera to provide precast concrete to local construction works. The maximum distance concrete can be transported to still profit is 250 km by land; this makes "going local" the norm in the precast business.

With the average working contract amounting to Rp1Bn/yr, WTON can afford to have some delays

- **Hugely diversified business portfolio—** WTON currently has around 2,400 outstanding project contracts. Considering FY14 revenues, This assumes ~Rp1.7Bn per contract as yearly revenue; a very modest number in the construction space. This goes to show the nature of WTON's overall business, which is hugely diversified. WTON's top ten customers also only account for less than half of overall sales. This diversification will help the company, especially in economic slowdowns where project delays and cancellations are inevitable,

- **A pioneer in innovation—** WTON's products have always been known to sell at a premium to its competitors. Yet this is hugely due to perceived superior quality as a result of innovation. Their newest product, precast blocks for taller buildings, allow for much more efficient construction. This product has so far been selling well, with total contracts of up to Rp80Bn over five locations in 2015 YTD.

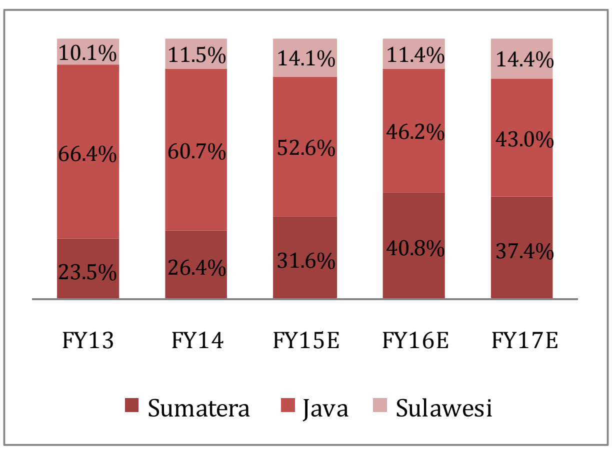
Source: Sinarmas Investment Research

Key Risks

In Java, currently WTON's largest geographic operations, SOE contractors are building plants to self-fulfill their precast needs. As a result WTON faces a lot of structural headwinds in the region.

Source: Sinarmas Investment Research

Geographical regions % of total revenue



Going forward, Java will share a smaller piece of total sales, making WTON's expansions into areas outside Java very crucial to its growth.

Source: Company data, Sinarmas Investment Research

- **Huge in-Java competition to challenge WTON—** Java will continue to be a struggle for WTON, seeing as Java's portion to total revenue has continued to decrease from FY13/FY14/FY15E to 66.4%/60.7%/52.6% of revenue. Going forward, we forecast Java to make up 43%/41% of revenue going into FY18E/FY19E. Competition in Java has intensified over the past due to: i) SOE contractors are buying their precast products from their own factories, who are now able to make very similar products to WTON; ii) major delays and pushbacks in government projects as a result of weak APBN absorption; iii) lack of private projects due to the economic slowdown. As a result, we see that in-Java revenue fell 62% YoY in 1H15, becoming the largest drag on the company's lackluster 1H15 performance.

- **Large fixed costs incurred as a result of availability across multiple locations—** A major downside to having a huge, diversified portfolio and plants across different locations is the fixed costs. Net margin fell from 10% to 5.8% from 1H14/1H15 and revenues recorded at Rp1.7tn/Rp891Bn in 1H14 and 1H15, as a result of a lack of new orders and slower APBN absorption. During tough economic times, the impact to the company's financial results will be more severe than it would be to precast companies with a more concentrated portfolio.

- **Significant exposure into mining and property—**Together precast sales to companies within the mining and property sectors made up 30% of WTON's total sales (mining: 13%, property: 17%). The Indonesian mining and property sectors are currently undergoing a slowdown, with mining the more exposed of the two given multi-year low commodity prices. Property is also undergoing an oversupply problem that looks to be staying, at least in the near term. With the slowdown in these two sectors, combined with the problem with WTON's infrastructure sector sales, the company is faced with a huge market share potential loss that could hurt the company going forward.

Shift in the company's growth driver

- **In FY13, WTON dominantly enjoyed 60-65% market share over the Indonesian precast concrete market; since then, it has gone downhill.** Over the past few years, WTON has seen its market share decrease to 43% in FY14, and is expected to keep decreasing going forward. This has primarily been caused by increasing competition from other contractors who have turned to manufacturing concrete, particularly in Java.

ADHI,WIKA,WSKT,PTPP precast factories/land banks throughout the nation

- **Of the SOE contractors, WTON has the farthest reach.** While industrial estates in Western, Central and Eastern Java seem saturated, areas in Kalimantan, Sumatera and Sulawesi look like they have ample room to grow. Outside of WTON, only one company (Waskita Precast) operates a plant outside of Java. Going forward, WTON will be able to best capture developments outside of Java by expanding on their already operational factories.

Premium Prices for Premium Products

- **WTON is known for its premium products, which sell for premium prices.** On average, WTON products sell for 10-20% above the industry average. This is due to the company's constant emphasis on quality and R&D superiority. Historically, WTON has also had no major complaints or re-constructing requests as a result of poor quality. Company data also shows that via a rating agency that surveyed different customers, WTON has managed to significantly outperform its competitors in terms of customer satisfaction. This might, to a certain extent, justify the premium prices that the company is currently charging.

Tabel indeks kepuasan pelanggan 2014 — Table of Customer Satisfaction Index of 2014

CSI Store	WP-1	WP-2	WP-3	WP-4	WP-5	WP-6	Rata-rata Average
WIKA Beton	4.50	4.47	4.09	4.34	4.13	4.32	4.31
Pesaing / Competitors	4.07	2.32	3.41	3.39	3.67	3.41	3.38
GAP	0.43	2.15	0.68	0.95	0.46	0.91	0.93
% THDP WB	9.54%	48.14%	16.55%	21.84%	11.22%	21.01%	21.58%

*skala 1-5 / scale of 1-5

Source: Company filing, Sinarmas Investment Research

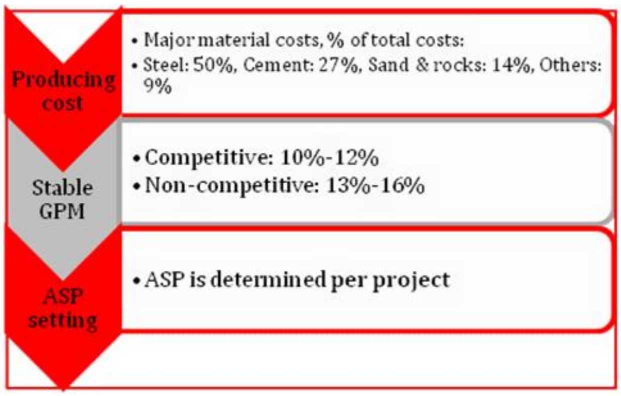
- **Questions remain on how management would like to take the company forward.** The company has managed to maintain its premium pricing on products as it faced less competition. The situation is different now. SOE contractors who can produce most of the products WTON can will purchase precast produced by their own precast divisions. As WTON continues to lose market share, the management will have to make a decision to either maintain prices and aim for premium customers, or lower prices and therefore margins to compete via price wars. We remain cautious of premium prices during economic slowdown as many companies will tend to shave off margins to maintain businesses.

Business Operations

In this section we discuss the highlights of the company's operations—the methods it has used so far to become Southeast Asia's largest precast manufacturer.

Pricing Method

In choosing ASP for the different precast products that the company sells, it always adopts a cost plus method. With this method, the company will look to maintain relatively stable margins for each project, and will hence adjust ASP according to cost of production. The company has set a goal of: i) in Java, and other highly competitive regions, gross margin (GPM): 10-12%; ii) outside Java and other non-highly competitive regions, GPM: 13-16%.



WTON rough method of determining ASP of products

Source: Company

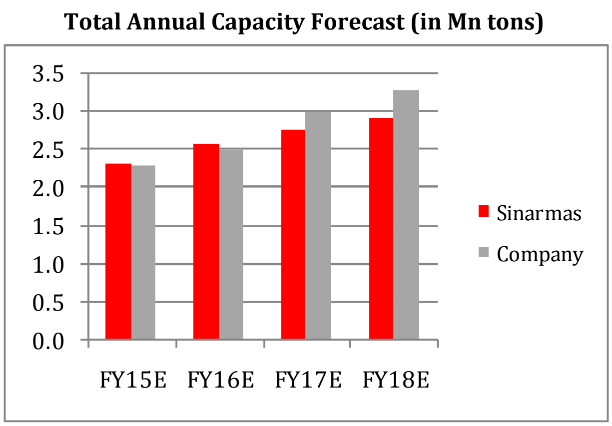
There are three main raw materials that WTON purchases to manufacture its precast concrete products:

- **Steel:** The company buys steel on three-month fixed price contracts. Steel is the largest cost component in WTON's precast manufacturing.
- **Cement:** Cement is also bought on three-month fixed price contracts. The company buys cement from local distributors at project sites.
- **Sand/rocks:** These are also bought from local distributors to minimize transport costs.

Capacity

Two things worth highlighting regarding production capacity are:

- The production capacity often assumes a five-day working week, with two shifts operating daily. Under extremely busy conditions, the company can increase factory production capacity by up to 40% of the stated capacity by utilizing six-day work weeks with three shifts daily. Factories will require a minimum of one day per week for maintenance.
- Maximum capacity for each factory is not fixed and can be slightly altered across factories, although aggregate maximum capacity across all factories is relatively fixed. This means that smaller machinery can be transported from one location to another, depending on the needs.



The company has given out forecasts of 3 Mn tons/year production capacity. In our forecasts, we have chosen to remain conservative with sticking to 2.88 Mn tons/year in capacity.

Source: Sinarmas Investment Research, Company data

Transport Methods

- **Land:** Transporting via land is much more expensive than via sea. Company estimates show that the largest distance between precast factory to the project site that is economically feasible is 250 km. This suggests that companies that have factories across multiple locations will benefit from the nationwide infrastructure boom.
- **Sea:** With the opening of the South Lampung factory, WTON is now able to transport their produce via sea. This is a much lower cost alternative compared to land transport: transport is still economically feasible when transporting produce from the said factory to Central Indonesia.

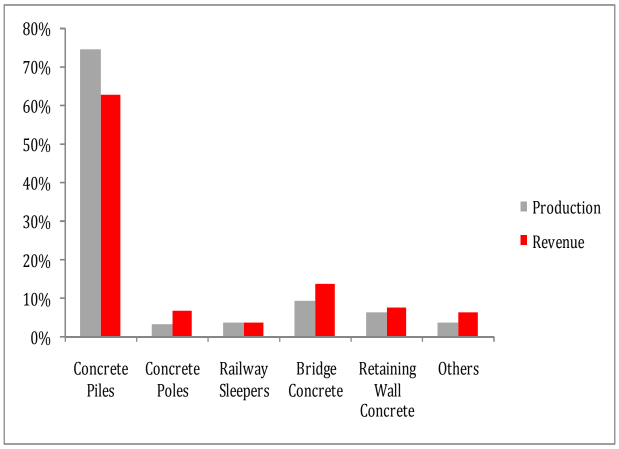
The Product Lines

WIKA Beton is the largest manufacturer of precast concrete, with market share of 42.8% as of 1H15. The company, and its subsidiaries, produces different types of concrete and is involved in overseas projects, including:

Concrete Piles

Concrete piles, also known as *tiang pancang,* are mainly used for foundations of high-rise & industrial buildings, bridge, power plants and port constructions. Concrete piles are by far the main contributor to WTON's total concrete sales. In FY13/14, sales of concrete piles amounted to 51%/63% of total sales. As concrete piles are the major contributor to both production and revenue, they come in various sizes: from 300mm to 1,200mm in diameter. Only a select few precast manufacturers are able to produce concrete piles with 1,000+ mm in diameter, which puts WTON at a competitive edge.

Per product % of total



Source: Sinarmas Investment Research, Company data

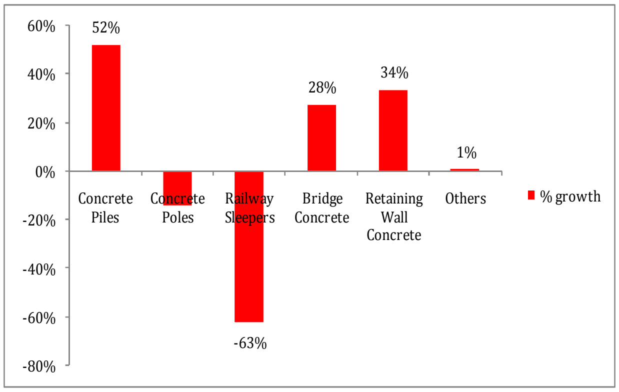
Concrete Poles

Concrete poles are mainly used for electrical distribution, telecommunications and railway overhead poles. Several projects that made use of concrete poles were those used by Perusahaan Listrik Negara (PT PLN) as well as various private companies spread all across the nation, ranging from Sumatera to the Nusa Tenggara Islands.

Railway Sleepers (Railway Pads)

The newest version of railway sleepers, first manufactured in 1989, were introduced as a substitute to wooden railway sleepers. In addition to this, the company has also manufactured additional railway-based products that have been recognized in this segment. The sleepers are intended for various Indonesian railway infrastructure projects, such as the double-track railway passing through Cirebon-Kroya, Soekarno-Hatta Int'l Airport train, as well as railways in North Sumatera.

FY13/FY14 Revenue Growth Per Segment (%)



Source: Sinarmas Investment Research, Company data

Bridge Girders

Bridge girders, coming in two different types based on the timing of steel wire pulling, is used to support the elevated portions of roads and railways. They provide support for the actual railways and roads. As of FY14, these were the second largest contributor to both production/revenue, making up 9%/13% of the total. Major projects that made use of WTON's bridge girders include international projects in Algeria, Timor Leste and Australia, as well as national projects in the non-toll flyovers near the BORR toll road and within Jakarta.

Retaining Walls

Retaining walls are used for dock retainers, dock walls, temporary or permanent constructions and water control gates. Improvements in the Pantura Road of Central Java, JORR toll road and Steam Power Plant in Asam -Asam, Kalimantan, are just a few projects of many that made use of WTON's retaining walls.

Appendix I: Valuations & Forecasts

Assumptions

- Long-term total utilization rate is assumed to be ~75%.
- Shorter term utilization rates: full capacity: 105%, effective capacity: 85%, low capacity: 65%
- Valuations: DCF, with terminal growth rate of 8.1% and market risk premium of 5.5%

Financial Statements—Balance Sheet & Income Statement

Balance Sheet (IDR Mn)	FY13	FY14	FY15E	FY16E	FY17E	FY18E
Assets						
Cash & Equivalents	413,027	1,038,475	753,184	693,669	817,538	1,014,711
Account Receivables	421,907	475,689	347,534	388,327	401,810	418,783
Inventories	846,027	457,603	502,235	562,584	581,394	606,330
Total Current Assets	**1,896,018**	**2,127,039**	**1,729,492**	**1,813,198**	**1,953,821**	**2,204,538**
Fixed Assets	1,012,107	1,671,205	2,071,205	2,171,205	2,271,205	2,321,205
Total Non - Current Assets	**1,021,383**	**1,675,294**	**2,074,577**	**2,174,577**	**2,274,577**	**2,324,577**
Total Assets	**2,917,401**	**3,802,333**	**3,804,070**	**3,987,775**	**4,228,398**	**4,529,116**
Short Term Loans	172,519	198,959	198,959	198,959	198,959	198,959
Notes Payable - current	-	366,000	-	-	366,000	-
Notes Payable - LT portion	366,000	-	366,000	366,000	-	458,775
Total Liabilities	**2,187,383**	**1,576,556**	**1,485,006**	**1,498,554**	**1,560,293**	**1,676,948**
Share Capital & APIC	667,000	1,844,740	1,844,740	1,844,740	1,844,740	1,844,740
Retained Earnings	71,319	379,828	461,794	618,475	781,317	946,282
Total Liabilities & Equity	**2,917,401**	**3,802,333**	**3,804,070**	**3,987,775**	**4,228,398**	**4,529,116**

Income Statement (IDR Mn)	FY13	FY14	FY15E	FY16E	FY17E	FY18E
Revenues	**2,643,724**	**3,277,195**	**2,525,137**	**2,828,561**	**2,923,132**	**3,048,508**
Growth (%)	30.2%	24.0%	-22.9%	12.0%	3.3%	4.3%
Cost Of Sales	(2,255,749)	(2,790,105)	(2,264,638)	(2,389,170)	(2,469,587)	(2,586,069)
Gross Profit	**387,976**	**487,090**	**260,499**	**439,392**	**453,545**	**462,440**
Gross margin (%)	14.7%	14.9%	10.3%	15.5%	15.5%	15.2%
Operating Expenses	(51,773)	(78,192)	(50,729)	(59,902)	(63,458)	(63,994)
Operating Income	**336,203**	**408,898**	**209,770**	**379,490**	**390,087**	**398,445**
Operating margin (%)	12.7%	12.5%	8.3%	13.4%	13.3%	13.1%
Other Income (Expense)	(7,681)	2,623	(15,427)	(7,997)	(3,986)	(7,310)
Profit Before Income Tax	**328,522**	**411,521**	**194,343**	**371,493**	**386,102**	**391,135**
Net Income	**241,206**	**322,404**	**155,474**	**297,194**	**308,881**	**312,908**
Growth (%)	34.5%	33.7%	-51.8%	91.2%	3.9%	1.3%

Source: Sinarmas Investment Research

Appendix II: Financial Ratios Forecasts

Ratios	FY15E	FY16E	FY17E	FY18E	FY19E
Profitability					
ROE	9.3%	11.8%	11.6%	11.0%	10.4%
ROA	5.6%	7.3%	7.3%	7.0%	6.5%
Gross margin	14.0%	15.1%	15.2%	14.9%	14.8%
Operating margin	12.0%	12.9%	13.0%	12.8%	12.6%
Net margin	8.4%	10.1%	10.3%	10.1%	9.7%
Net income growth	-34.1%	34.7%	5.2%	1.7%	0.7%
Liquidity					
Current Ratio (x)	1.69	1.73	1.32	1.94	1.43
Quick Ratio (x)	1.08	1.04	0.83	1.26	0.97
Cash Ratio (x)	0.74	0.68	0.56	0.90	0.72
Solvency					
D/E (x)	0.24	0.22	0.21	0.23	0.25
Debt/Assets (x)	0.15	0.14	0.13	0.14	0.15
Valuations					
P/E (x)	36.01	26.70	25.12	24.60	24.60
Yield	1.3%	1.8%	190.0%	1.9%	1.9%
P/BV (x)	3.26	3.04	2.81	2.63	2.49
EV/EBITDA (x)	19.22	15.98	14.88	13.77	12.77

Source: Company Data, Sinarmas Investment Research

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