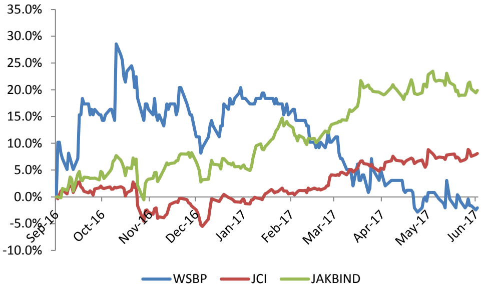
PT Wakita Beton Precast, Tbk (WSBP)

Company Update: June 21, 2017.

BUY

Current Price	**478**
2017E P/E	12.6
Target Price	**670**
2017E P/E	17.7
Precast	
Bloomberg Ticker	WSBP.IJ
Reuters Ticker	WSBP.JK
52 week High	645
52 week Low	474
Market Cap *(Rp tn)*	12.60
Shares Outstanding *(millions)*	26,361
Daily avg vol *('000 shares)*	79,337
Major Shareholders (%):	
WSKT	60.00
Public	40.00

Relative performance vs JCI JKSE & basic industry index:



Source: Bloomberg, Reliance Research

PT Waskita Beton Precast Tbk (WSBP) is a subsidiary of PT Waskita Karya Tbk that specializes in precast and readymix production.

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Company Update and an In-Depth Analysis on Turnkeys

We upgrade our call from **HOLD** to **BUY (TP: 670)** for the following reasons:

1. Possible higher growth in this year than we originally anticipated as the company adds service to its business mix.
2. Our reassessment on turnkey projects which is likely to taper off after this year that we will describe in details.
3. We share the company's optimism of rising precast demand this year that would bring its utilization rate to 75% as land acquisition will make headway progress in the second quarter.

Recent Developments

The company has added service as additional revenue source starting from this year. Just like its major competitor, the company is also facing specification issue of its products. Precast demand comes in different specification, such as length and width. A major specification issue is related with the diameter (width) of precast. Different project by different costumer often requires different precast diameter. For example, building piles often requires precast in a certain width for different builders, hence requiring further work to be done in order to match intended specification. Starting from this year, the company is giving the installment service that contributes to 11% of revenue with a peculiar gross margin of 35% which needs to be scrutinized.

There are two other developments that were in focus in the news lately, but of lesser importance in our view. The first is the inclusion of WSBP in MSCI Indonesia Index Small Cap in mid May that was expected to increase its transaction volume, but nevertheless, the gain was quickly erased several days later and there is no change in transaction volume. The second is the buy back plan that would be decided by the end of July. The 2.5% appreciation was immediately zeroed in just three days.

Of more importance in our stock call is our reassessment on turnkey impact on the company financial performance going forward which will be detailed in the following pages. In a nutshell, we expect turnkey values would be reduced gradually as targeted by the company in medium term and its impact on the company cash flow would start to soften after escalating further this year.

Another reassessment is regarding to capital expenditure. Capital expenditure is expected to expand by the end of this year due to purchases in quarry, plants, and trucks. Considering that by the end of this year the company has plants in all of strategic places in West and Central Indonesia and also own almost all of its trucks, we could expect capital expenditure to start slowing down starting from next year as the following expenditures would likely just improving capacity on existing plants which requires less capital than acquiring a new plant. The slowdown in CapEx however, would not necessarily compromise the company's ability to generate revenue as there is still a lot of slack in precast demand as reflected in capacity utilization rate which stood at 59% last year.

Valuation and Recommendation

We are upgrading WSBP to Buy rating with target price of Rp 670 based on DCF method, although to be noted that we still have not incorporated the newly added service segment in our model given its peculiar gross margin that still needs to be monitored. We use cost of capital of 11.68% and a stable growth rate at 5%. Our target is equal to 17.7x of 2017F P/E Ratio and 13x of 2018F P/E Ratio.

Turnkey projects put particularly large burden on the company' cash flow. While it has its benefits such as higher margin, these projects put the company in cash shortage which may not be beneficial to investors as the cash flow is only realized after the project is finished. Due to its particular importance on the company financial performance, we present an in depth research on this subject.

Turnkey is a project where the payment is deferred until the project is 100% complete, hence putting the constructor as a temporary owner of the project as the constructor is obliged to fund the entire project during construction. A common thread of turnkey projects taken by the company is that they have contract values over IDR 2 T and owned by companies associated with parent company. The projects are scheduled to be paid 6 months after the completion and no cash payment in between. In the balance sheet, it is recognized in long term asset as long term account receivables.

At the end of 2016, the company had three big turnkey projects: Becakayu (IDR 3.05 T) and Cimanggis-Cibitung section II (IDR 2.23 T) which totaled IDR 5.28 T or 34.3% of its order book. In Q1 2017, the company added one more turnkey project: Legundi Bunder (IDR 2.67 T), owned by PT Waskita Bumi Wira which made turnkey projects' contribution totaled 54.5% of its order book in Q1 2017. The importance of these projects to the company is more visible when we consider the fact that order book in Q1 2017 consisted of 101 projects, yet there were only 3 turnkey projects. That means the number of turnkey projects are only 3% of the company total projects, yet its value is so enormous that it makes up 54.5% of its order book value.

However, it is important to note that the recognition of revenue generated from turnkey and its corresponding long term asset is based on the progress of the projects. For example, in Q1 2017, long term asset associated with Becakayu value is IDR 2.86 T, while long term asset associated with CCTW II is IDR 614 Bn which reflected their completion rate of 92.6% and 27.5% respectively, or in terms of revenue, it has already recognized 92.6% revenue that could be generated from Becakayu and 27.5% from CCTW II project, while the cash received is still zero.

From the time completion perspective, turnkey project is expected to finish in 3-4 years time. Add a 6 month delay for cash payment, then from the beginning of assignment to cash collection, turnkey project payment day is around 3.5 – 4.5 years (if a turnkey contract is signed in July 2017, investors could only see the reported cash payment by the end of 2020 or 2021). However, realistically speaking, by the progress of existing projects, a three years completion target may look to be too optimistic. Legundi-Bunder, the newest turnkey project, seemed to give better completion rate which showed 24.8% completion in 15 months, nonetheless we think it will still take 4 years to complete it. That means we do not think project CCTW II and Legundi Bunder will be completed in three years as targeted.

Projecting turnkey project and its effect to the company's long term asset, and hence, value, is a bit tricky for two reasons: First, the time of completion as described before must be taken in consideration. Second, as the company is trying to diversify its customers' base, turnkey projects would be reduced as well. However, by taking the bigger outlook, it is reasonable to expect the reduction of turnkey values to order book over time that would be less than 34% as project owners diversification comes into play, while also following management guidance, we could expect a jump of turnkey values to order book by the end of this year could possibly exceed 50%.

Since the company expects a surge of turnkey projects this year, we assume an addition of IDR 3.5 T turnkeys (an increase of 117% from prior year) that would contribute to 50.7% of IDR 22.6 T targeted order book this year (Figure 3). However, since big projects are usually slow in starting point, we could expect a modest contribution from new turnkey project to revenue and long term asset.

Turnkey Contribution to Revenue

As we previously stated, turnkey revenue is not recognized immediately, but by progress on the project. The progress is usually slow in the first year (less than 10% completion) and starts to pick up pace afterwards. By the end of 2016, turnkey projects contribute to 27% of revenue. The high contribution came mainly from Becakayu (11.8%) and CCTW II (11.7%), while Legundi Bunder placed as major contributor in Q1 2017 as it entered its second year (Figure 1). As of the first quarter of this year, Becakayu still has IDR 221 Bn revenue left to be recognized, while CCTW II and Legundi Bunder have consequently IDR 1.6 T and IDR 2.5 T revenue left to be recognized. To have an idea how turnkey projects could contribute to revenue generation going forward, we make assumptions that each turnkey project have 4 years time of completion and the work progress completion is as follows: 10% for the first year, 40% in the second year, 70% in the third year, and completed in the fourth year.

Figure 1

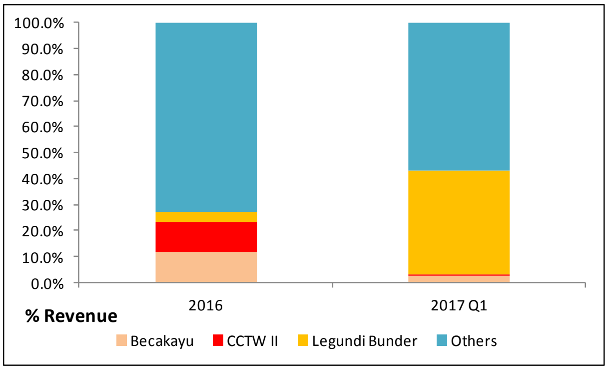
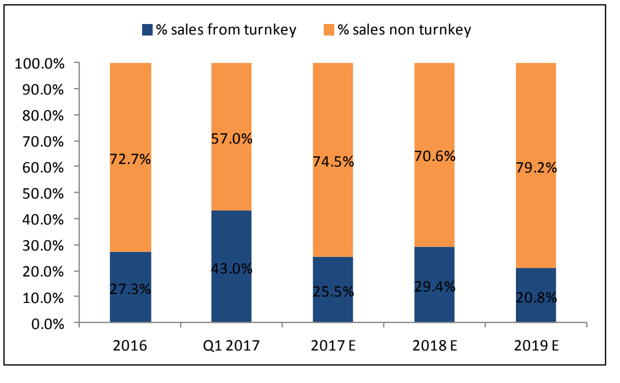


Figure 2



Source: Reliance Research

Assuming after this year the company still takes one turnkey project per year that has values around Rp 2.6 T, the contribution to revenue would be around 21% in 2019 and reached its peak in 2018 as CCTW II enters its final stage (a major push; from 50% completion this year to 100% next year) and Legundi Bunder as well as the other turnkey taken this year (which we expect Becakayu phase B – a turnkey with massive value) are speeding up. This contribution would eventually decline as the company would maintain its turnkey projects to reduce its portion from order book as directed by company's target or simply the absence of massive turnkey projects (above Rp 3 T) in the future as there could be a joint operation in the future if these massive turnkey were to show up, hence limiting the size of turnkey values the company will be taking in either scenarios (Figure 2).

Figure 3

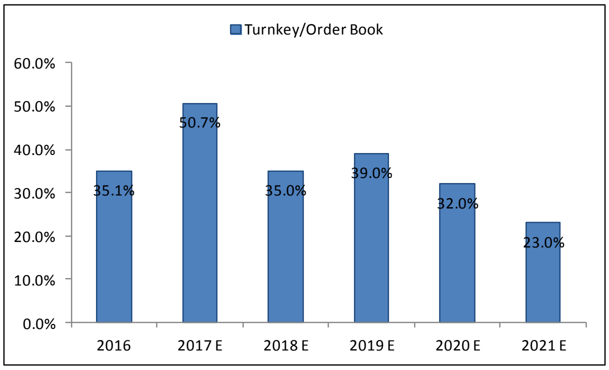
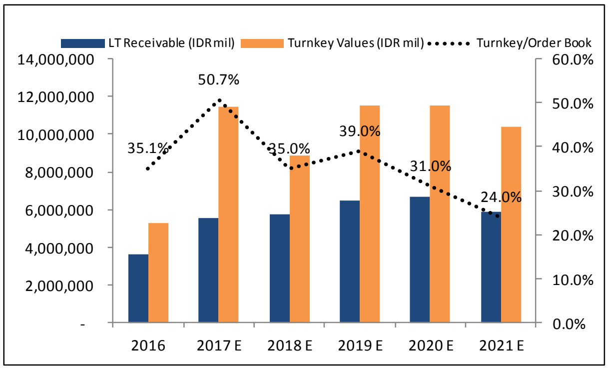


Figure 4



Source: Reliance Research

Turnkey Impact on Debt

As turnkey is only paid after the project is completed (plus six month), turnkey projects have to be financed during the entire project without relying on cash flow from project owners. In typical projects, cash payment is settled depending on the agreement of completion, usually in stages. As such, typical projects put less pressure on company's liquidity. The company is covering its funds needs mainly by debts denominated in local currencies (*Figure 5*). Prior becoming a public company, the company is more heavily funded by long term debt, but since it had received almost IDR 6 T, the company leaned more on short term debts to finance its turnkey projects (*Figure 6*). More importantly, the company is in better shape since it became a public company last year. Its current ratio is less than one and its operation profits could cover over twenty times its interest expense. Therefore, as long as the payment of turnkey is going well, there is little reason to worry about its financial health.

Figure 5

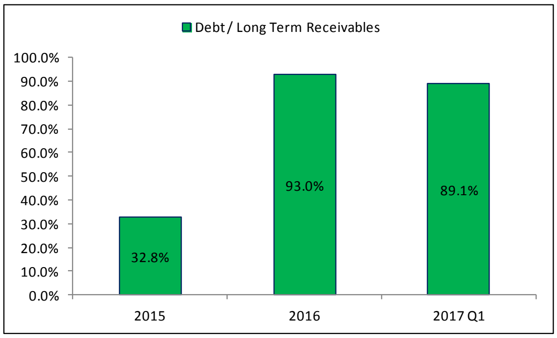


Figure 6

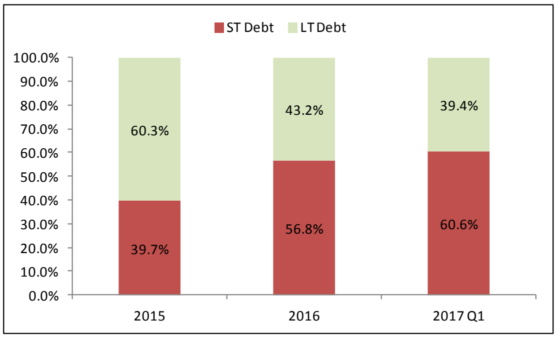


Figure 7

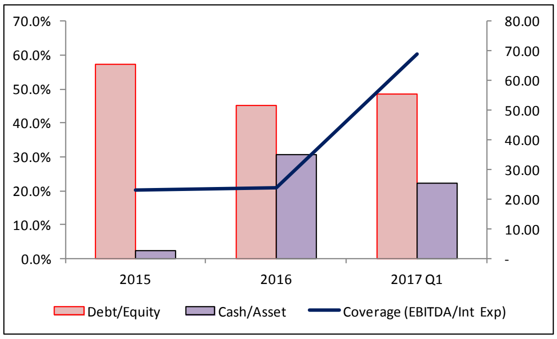
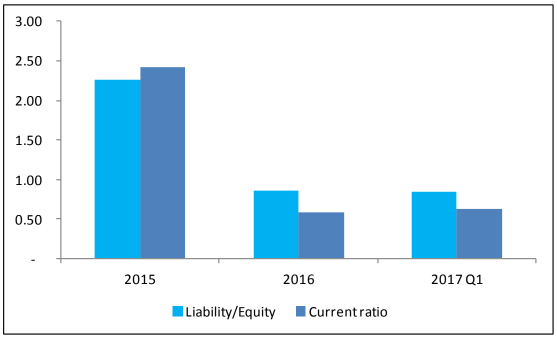


Figure 8



Source: Reliance Research

How Does Turnkey Affect Value?

Turnkey makes the task of maximizing shareholder's wealth harder because it defers cashflow that could be distributed to investors. Moreover, as we have shown, turnkey projects force the 'owner' to finance its entire process using its own capital, which usually would require additional capital from banks, thus putting the company vulnerable to a rising cost of capital as investors are generally risk averse when too much debt is involved. The company mitigates some of its effects by deferring its payment to suppliers and extracting more payments from customers through negotiating higher margin for its turnkey projects.

As could be seen below, both products from the company have rather consistent gross margins. This is unusual, especially with readymix which has a lot of players than precast as it does not require as much capital as its other product which requires a factory. In Q1 2017 however, gross margin declined for both products. There are two reasons for this: First, cement price is picking up after in decline for more than two years due to oversupply when China began to switch its economic model from export oriented to domestic consumption. Second, is the demand for each products. Precast is dominantly used for highway roads, while readymix is dominantly used in level and undergrounds. In Q1 the demand for readymix is picking up, accounting 41% of total precast revenue from 36% at the end of last year.

This high margin for readymix however, could not be expected to continue in near future as there is simply too many competitors that extract margin lower than the company's readymix product. Hence, while turnkey projects would still elevate gross margins for both products, an increase in cement price and eventual competition coming into ready mix segment would reduce overall gross margin from last year.

Figure 9

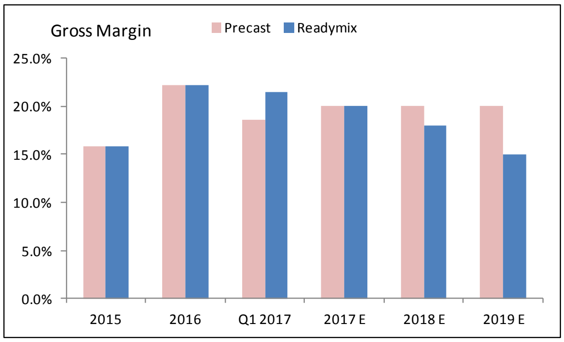
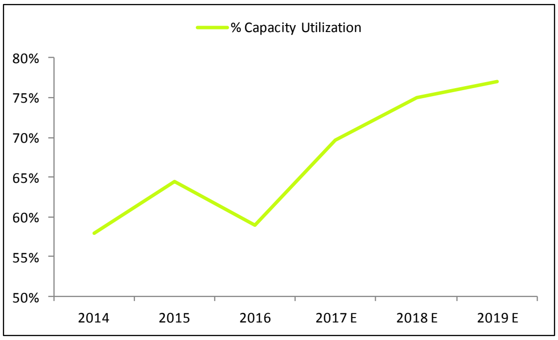


Figure 10



Source: Reliance Research

For the company, turnkey projects are also a significant source of growth as it contributes more than 20% revenue. If the company were to stop its works on its turnkeys, it could lose around 26% growth this year. This contribution would likely to increase in the next year as CCTW II (scheduled to be finished this year which we see as unlikely) completion would be hurried and Legundi-Bunder construction would also be sped up. The increase would also be caused by a possible big new turnkey project signed this year that would enter its second year (see Figure 2 & 4).

Financial Highlights & Forecasts

Exhibit 1. Income Statement

(In Rp mn)	2016	2017 E	2018 E	2019 E
Revenue	4,717,150	7,736,126	10,995,496	13,667,401
Gross Profit	1,050,062	1,547,225	2,122,131	2,494,301
Operating Income	953,050	1,384,767	1,891,225	2,207,285
Pretax Income	967,345	1,329,757	1,803,883	2,095,581
Net Income	634,820	1,050,508	1,425,067	1,655,509
EPS	24	40	54	63

Exhibit 2. Balance Sheet

(in Rp mn)	2016	2017 E	2018 E	2019 E
Cash & mark. Sec	4,205,820	3,071,645	4,075,682	4,786,930
Account Receivable	3,046,134	2,924,891	4,157,201	5,167,401
Inventories	231,947	423,897	607,765	765,281
Prepaid taxes	291,621	464,168	659,730	820,044
Other current assets	357,098	618,890	879,640	1,093,392
Net Fixed Assets	1,932,852	3,634,941	4,628,163	5,849,545
Long term receivable	3,627,649	5,578,987	5,766,581	6,455,714
Other	41,146	67,479	95,910	119,216
Total Assets	**13,734,267**	**16,784,900**	**20,870,671**	**25,057,523**
Liabilities & Equity				
Account Payables	1,541,851	2,034,707	2,917,271	3,673,348
Short term debts	1,907,061	2,395,765	3,018,686	3,760,098
Other ST liab.	1,317,405	2,041,867	2,903,905	3,612,841
Long term debts	1,448,924	1,937,628	2,560,549	3,301,961
Other LT liab.	113,525	234,076	331,857	412,014
Total Liabilities	**6,328,766**	**8,644,043**	**11,732,267**	**14,760,263**
Total Equity	**7,405,501**	**8,140,857**	**9,138,404**	**10,297,260**

Exhibit 5. Other Key Assumptions

	2016	2017 E	2018 E	2019 E
Order Book (IDR Mil)	15,051,000	14,600,000	22,583,000	25,269,610
Turnkey Values (IDR Mil)	5,276,172	11,446,011	8,844,364	11,505,014
Capacity (tons)	2,650,000	3,250,000	3,800,000	4,180,000
Production (ton)	1,561,229	2,265,854	2,850,000	3,218,600
Blended ASP (IDR Bn/ton)	3.02	3.41	3.86	4.36

Exhibit 3. Cash Flow Statement

(in Rp mn)	2016	2017 E	2018 E	2019 E
Net Income	634,820	1,050,508	1,425,067	1,655,509
Depr. & Amor.	117,127	231,942	436,193	555,380
Change in work. Cap. & Others	(3,599,968)	(1,239,066)	(315,481)	(765,903)
CFO	**(2,848,021)**	**43,384**	**1,545,780**	**1,444,986**
CAPEX	(828,374)	(1,934,032)	(1,429,414)	(1,776,762)
Other	(19,897)	(26,333)	(28,430)	(23,306)
CFI	**(848,271)**	**(1,960,365)**	**(1,457,845)**	**(1,800,068)**
Dividends	(379,287)	(315,153)	(427,520)	(496,653)
Change in debts	2,594,945	977,408	1,245,841	1,482,825
Change in cap. Stock	5,819,143	-	-	-
Other	3,379	120,551	97,781	80,157
CFF	**8,038,180**	**782,806**	**916,102**	**1,066,330**
Net Changes in Cash	**4,341,888**	**(1,134,175)**	**1,004,037**	**711,247**

Source: Company, Reliance Securities

Exhibit 4. Key Ratios

	2016	2017 E	2018 E	2019 E
Growth				
Revenue	78.4%	64.0%	42.1%	24.3%
EPS	89.9%	65.5%	35.7%	16.2%
Profitability				
Gross Margin	22.3%	20.0%	19.3%	18.3%
EBIT margin	20.2%	17.9%	17.2%	16.2%
Net margin	13.5%	13.6%	13.0%	12.1%
ROA	4.6%	6.3%	6.8%	6.6%
ROE	8.6%	12.9%	15.6%	16.1%
ROIC	10.6%	13.3%	16.9%	17.0%
Leverage				
Total debt to assets	24.4%	25.8%	26.7%	28.2%
Current Ratio	1.7	1.2	1.2	1.1
Gearing Ratio	0.5	0.5	0.6	0.7
Activity				
Days receivable	138	138	138	138
Inv turnover days	23	25	25	25
Days payable	166	120	120	120

Source: Company, Reliance Securities

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