Reliance
Sekuritas Indonesia

PT Wijaya Karya, Tbk (WIKA)

Company Update: September 14th, 2017.

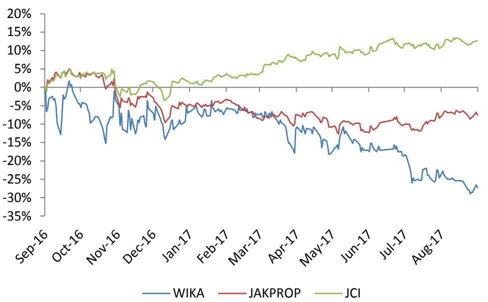
BUY

Current Price	**1,855**
2018E P/E	7.0
Target Price	**2,500**
2018E P/E	9.4

Property: Constructions	
Bloomberg Ticker	WIKA.IJ
Reuters Ticker	WIKA.JK
52 week High	2,899
52 week Low	1,865
Market Cap *(Rp tn)*	16.64
Shares Outstanding *(millions)*	8,970
Daily avg vol *('000 shares)*	15,275

Major Shareholders (%):	
Government	65.00
Public	35.00

Relative performance vs JCI JKSE & property index:



PT Wijaya Karya, Tbk (WIKA) is one of Indonesia biggest SOEs in construction industry. The company also handles Engineering, Procurement, and Construction (EPC) works.

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Looking Beneath Price Weakness

WIKA stock price weakness still continues despite government's commitment to push infrastructure development and its credibility as a top notch construction company when it received two hallmarks projects: MRT and High Speed Railway. We have noted that WIKA has been struggling to maintain revenue growth relative to its peers since 2015. Recent HSR project has put optimism back to WIKA future prospect. yet apparently, the market has not shared this optimism although it posted extraordinary earning growth in the first quarter compared to the previous year. The market development that has not been encouraging so far pushed us to look deeper into WIKA's underlying value.

In a nutshell, our reassessment has put our optimism back in check due to:

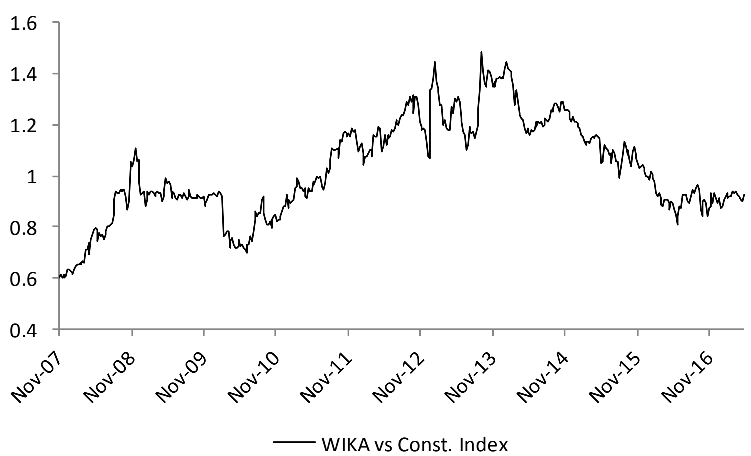
1. Possible weak revenue growth in the following years as WIKA would likely faced uphill battle to maintain even modest growth new contracts after extraordinary growth this year.
2. Based on our estimates, even to maintain modest growth, WIKA would likely need to rely more on Joint Operation (JO) projects and accepting more turnkeys projects which would tie its capital, however we expect turnkeys would also uplift WIKA's overall gross margin at the same time.

Nonetheless, even with our reassessment, we view that WIKA share price is **undervalued** at current level. Accordingly, we maintain our **BUY** recommendation, but with a lowered target price of IDR 2.500 per share. Our target price is derived from our DCF estimate. The estimated value is comparable to forward PE 2018E 9.4.

Price Performance Development

Since the end of 2013 WIKA has been underperforming its peers and it was more noticeable during 2015 when WIKA's return turned negative from its peak of IDR 3328 in February 2015 and has been entering downtrend ever since. **This development however, in our view, is not separated from its fundamentals as we will try to give light in this report.**

Relative chart: WIKA / Construction Index*



*Index consisted of ADHI, WIKA, WSKT, and PTPP (price equal weighted)
Source: Reliance Sekuritas Research

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Sub-Par Revenue Growth Performance

Since 2014, WIKA revenue growth has been lagging with its industry. The industry revenue growth rate averaged 19.6% for the last 5 years, while WIKA was delivering sub-par 17.6% growth when revenue from Joint Operations (JO) could not give a hump anymore as it was prior to 2015. Revenue growth including JO was hampered during 2015 when sales from JO was declining in absolute terms, and has since been unable to deliver its sales number back to its peak in 2013.

Outside JO which will be detailed in the next section, WIKA sales big ticket would come from HSR - a project with contract value of IDR 15.7 T. Recent announcement of funding delay in HSR put a scare to investors, but as we will discuss in the next section, there is little to worry about HSR being cancelled. WIKA expects to grow its revenue outside from JO by 64% this year to IDR 25.7 T, a record high which is supported by enormous contract growth last year. However, we think such growth in new contract is unsustainable and the contraction in new contract target this year suggests that may be the case.

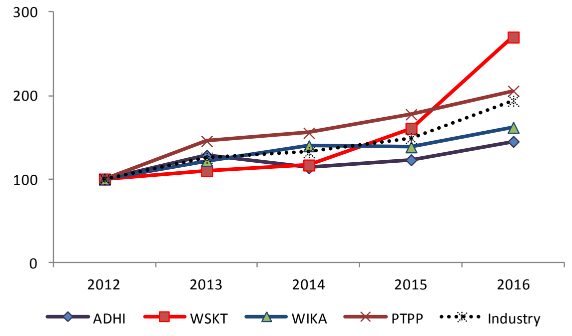
Putting China Perspective On High Speed Railway

A much less likely scenario where China cancels its funding entirely would definitely put WIKA growth prospect out of favor as the full year HSR construction could contribute around 20% to WIKA revenue excluding JO based on our estimation. The delay in construction due to a halt of funding by China Development Bank as it demands 100% land clearing first put fear into investors of the possibility of China backing out of the deal and has been shadowing WIKA stock price performance ever since.

However, looking at the bigger picture, we notice that China investment in HSR is not exclusive to Indonesia. In this year also, China agrees to invest in HSR development in Thailand and Iran. Although HSR investment needed in Thailand is cheaper than Indonesia (USD 5.2Bn to build 256km Thailand railway vs USD 5.9Bn for 142km Indonesia railway), the investment is directed by Beijing's One Belt, One Road (OBOR) ambitious agenda.

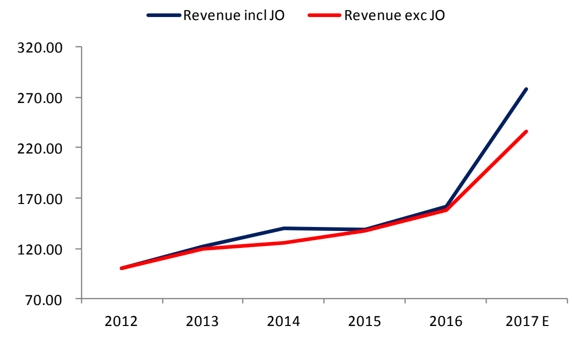
Given the OBOR imperative, it is to be expected that China would give Indonesia a 'lesson' when Patimban Port and HSR phase two projects were given to Japan's hand. However, China is in need for better investment outside its country that could secure its position in Asia Pacific. It would take any opportunity it has to better secure its trade route. However, HSR in Java island is an investment that could wait as China has more immediate incentives to strengthen its trade routes in its neighboring countries first that is not separated by seas.

Revenue Growth (2012 = 100)



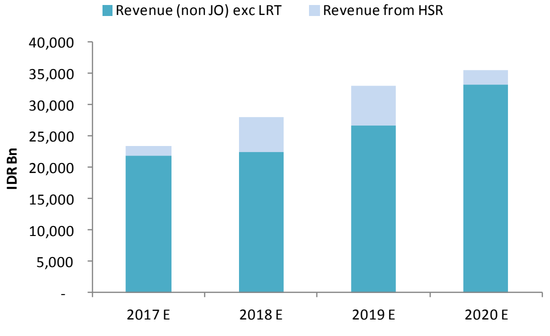
Source: Companies, Reliance Sekuritas Research

WIKA Revenue Including vs Excluding JO



Source: Company, Reliance Sekuritas Research

HSR Impact on Projected WIKA Revenue



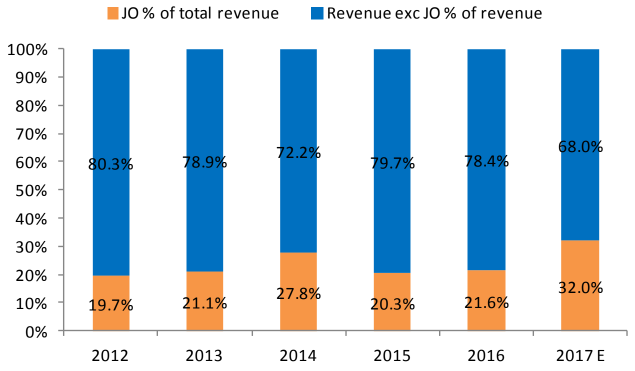
Source: Reliance Sekuritas Research

Finding Growth

We are not of view that WIKA growth is constrained by its financing capabilities as WIKA still has 54% debt to equity, thus it has a lot of room to leverage its growth. The issue then comes from the availability of the projects themselves.

To pursue growth, WIKA has been relying on JO. After a rough year in 2015, WIKA has been targeting higher revenue growth from its JO and significantly so in this year.

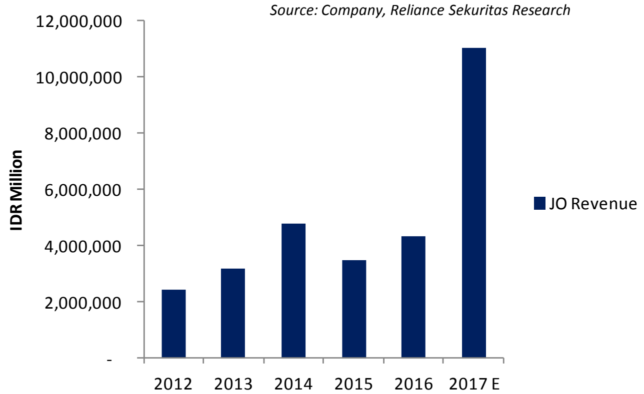
Revenue Composition



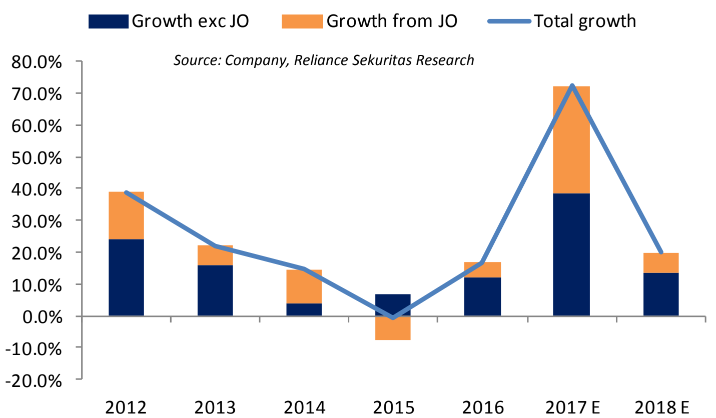
Source: Company, Reliance Sekuritas Research

Revenue from Joint Operation (JO)

Source: Company, Reliance Sekuritas Research

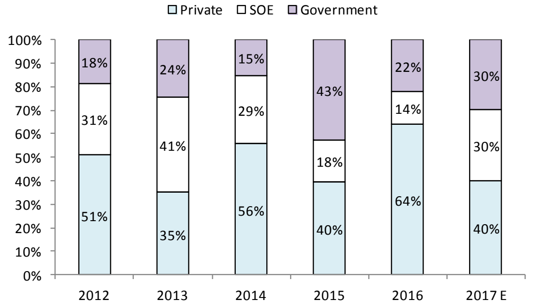


Revenue Growth Decomposition



JO would likely be essential for WIKA to achieve modest growth in coming years as depicted by management target for this year revenue from JO that would make up 32% of its revenue.

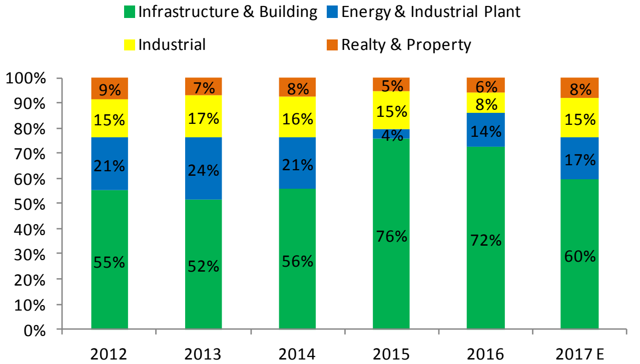
New Contracts Source



Source: Company, Reliance Sekuritas Research

In addition to JO, WIKA would likely to rely on turnkey projects outside industrial segment as foreshadowed by its presence in toll road construction. Recently, WIKA signed a significant IDR 2.85 trillion Serang-Panimbang toll road construction under turnkey scheme. A huge portion of new contracts are allocated to infrastructure & building contracts in which WIKA is taking more of toll road constructions. This development may indicate more turnkeys to come.

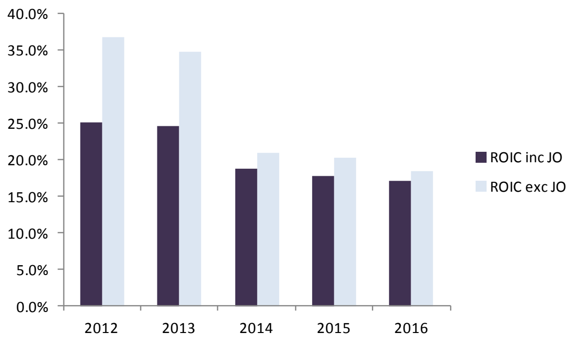
New Contracts Composition



Source: Company, Reliance Sekuritas Research

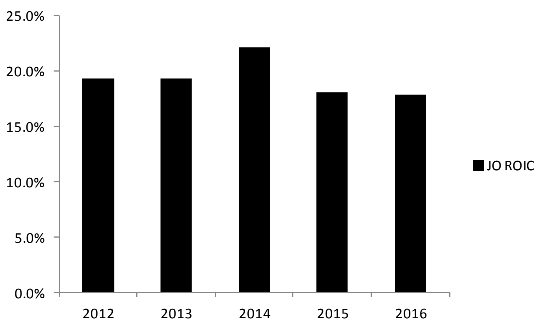
Analysis

ROIC including vs excluding JO



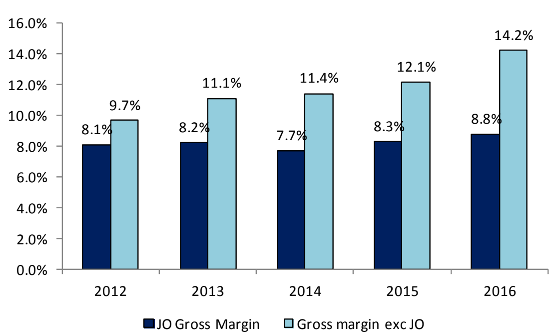
Source: Reliance Sekuritas Research

Joint Operation ROIC



Source: Reliance Sekuritas Research

Gross Margin (JO vs non-JO)



Source: Company, Reliance Sekuritas Research

New Normal of Lower Return on Invested Capital

Since 2015, WIKA performance either in growth or return on invested capital has not been satisfying: JO projects could not give boost to revenue growth as it used to be since the end of 2014 and projects outside JO is pushing ROIC down substantially as the projects require both higher working capital and fixed asset investments despite the increase in gross margin.

Prior to 2014, WIKA operating working capital investment was negative, an unsustainable condition that has been reversed quickly in the following years to a more sustainable level in our view. Looking deeper, the jump in operating working capital in last year was caused by substantial increase in real estate assets which, in our view, is a normal development given that the parent company wants to spin off its WIKA Gedung in this November. Hence, it is likely that WIKA would need higher investment in working capital going forward when it expands its real estate segment.

To operate in joint venture, WIKA needs to invest historically above 40% of its share of revenue. This investment has been increasing since 2014, but it has not been able to give a bang for its buck as good as it was prior to 2014 as measured by its return on invested capital. We think WIKA would continue to invest heavily in JO as it is the strategy that WIKA seems to pursue to bring vigor back to its growth.

Another key factor that leads to significant increase in operating working capital was the fact that WIKA has been pursuing infrastructure and building construction contracts. Projects related to these contracts such as toll road construction typically carries high nominal values and usually given under turnkey payment scheme where cash is collected only after the project is fully completed.

Hence, WIKA's increasing invested capital since 2014 has been influenced by four factors: First, a normal reversal of working capital investment prior to 2014. Second, it has been investing more in JO as part of its strategy to pursue growth. Third, it has been pursuing aggressively in infrastructure and building contracts which have rendered its working capital in high level as the big projects are often signed under turnkey scheme. Fourth, WIKA is also pursuing growth in real estate segment and therefore, has been expanding its assets.

Gross margin has been increasing since 2014, and notably in 2016, thus keeping its return on capital in check, although in case for JO, its gross margin has been relatively flat.
The increase of gross margin could be attributed to two factors:
1. WIKA dominant revenue source comes from infrastructure & building segment. This segment has been enjoying increasing gross margin and went to 11.7% in 2016 from 9.9% in 2015 when it started to take up toll road construction under turnkey scheme.
2. WIKA has been increasing gradually its exposure to property segment which enjoys the highest gross margin and increased notably in 2016.

Valuation

Key points for Valuation

Our valuation assumes that in the next year WIKA would keep only little growth in new contract, while focusing more on completing its order book. Hence, we expect WIKA to still have high growth in 2018. However, even with joint operations, we doubt that WIKA would be able to maintain this high revenue growth after that as it is likely harder just to maintain its current level of all time high book order.

It is likely harder for WIKA to grow its record high book order from 2018 onwards, while book order burn rate improvement would likely remain limited.

The reason we think that WIKA is likely to have difficulties in growing its record high order book is as follows: The four construction SOEs total targeted new contract growth in this year only grows 6.5%, despite government effort to boost infrastructure spending by 22%. Moreover, the government 2018 proposal revision assigns lower infrastructure spending in nominal term albeit still maintaining its current portion to total budget. To add, Waskita Karya, the SOE with the most new contract target thanks to its major role in toll road construction, has expressed its skepticism in achieving the IDR 80 T new contract target this year, which the CEO suspected that it could only achieve IDR 60 T. That makes current year new targeted new contracts for the combined 4 SOEs to actually shrink by 5% from prior year.

Hence, we view that maintaining new contract achievement in excess of IDR 40T is challenging enough and we prefer to be conservative on new contracts achievement from 2018 onwards despite WIKA's past achievement on growing its new contract from 2012-2016 by 33.7% on average.

As for the contract burn rate (Revenue/Order Book), it would be hard to achieve high burn rate. The reason for this difficulty is because we could expect that the pattern of high new contracts which comes in the fourth quarter would not change anytime soon since government agencies related to construction (public works and housing ministry and transportation ministry) are aiming to get more work done in the following years. Hence, government would put effort to push contracts scheduled for 2018 to be signed early in the fourth quarter of 2017. As a lot of new contracts are added in the last quarter of the year, WIKA would record it to its existing book order without ample time to generate revenue from them. We think that this persistence of low burn rate would be hard to reverse especially if WIKA is relying more of its new contracts from the government.

Hence, based on hampered revenue growth assumption due to low new contract growth and limited room for improvement on its return on capital due to turnkey and JO contracts which are likely require higher capital investment, we still maintain our BUY recommendation but with a lowered target price of IDR 2.070 per share which is derived from our DCF estimation. We assume that the company's cost of capital to be 13.8% and would still be able to earn its return above its cost of capital albeit not significantly in perpetuity.

Upside Risks
Recent news informed us that Waskita Karya, a dominant SOE in toll road construction, failed to divest its owned toll roads which potentially limit its new contracts financing capabilities. This event could open opportunity for WIKA to win more toll road contracts and consequently may surprise our conservative new contracts growth estimate. We view that is pretty possible scenario considering that WIKA was once a major toll road constructor before Waskita Karya took its position.

Downside Risks
We assume an improvement on gross margin especially in infrastructure and building segment as we expect turnkeys to uplift higher margin. In Q1 2017 however, there seemed to be a sign of decreasing gross margin in that segment compared to the same period last year. We however, still remain optimistic of increasing gross margin for the year end. A missed new contract target for this year end which only targets 10.7% growth excluding HSR would also gives us indication of difficulties in achieving above IDR 40 trillion of new contracts going forward and may warrant further lower growth.

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Financial Highlights

Stated in IDR Million

Income Statement	2015	2016	2017 E	2018 E	2019 E
Revenue	13,620,101	15,668,833	23,403,000	28,044,689	33,062,977
COGS	(11,965,441)	(13,441,729)	(19,784,428)	(23,708,420)	(27,950,780)
Profit (Loss) from JO	288,403	378,836	969,496	1,161,380	1,369,196
Gross Profit after JO	**1,943,063**	**2,605,940**	**4,588,068**	**5,497,650**	**6,481,394**
SGA	(429,157)	(526,936)	(795,702)	(953,519)	(1,124,141)
EBIT	**1,513,906**	**2,079,004**	**3,792,366**	**4,544,131**	**5,357,253**
Others	(415,823)	(483,498)	(613,200)	(862,971)	(972,314)
EBT	**1,098,083**	**1,595,506**	**3,179,166**	**3,681,159**	**4,384,938**
Income tax expense	(395,077)	(448,360)	(1,112,708)	(1,288,406)	(1,534,728)
Net Income	**703,006**	**1,147,146**	**2,066,458**	**2,392,754**	**2,850,210**

Key Ratios	2015	2016	2017 E	2018 E	2019 E
Growth					
Revenue	9.3%	15.0%	49.4%	19.8%	17.9%
NOPLAT	5.9%	54.2%	64.9%	19.8%	17.9%
Profitability					
Gross margin inc JO	14.3%	16.6%	19.6%	19.6%	19.6%
EBIT margin	11.1%	13.3%	16.2%	16.2%	16.2%
Net margin	5.2%	7.3%	8.8%	8.5%	8.6%
ROIC	17.7%	17.1%	18.0%	18.0%	18.0%
ROE	12.9%	9.2%	14.6%	14.9%	15.5%
ROA	3.6%	3.7%	5.2%	5.2%	5.4%
Capital Efficiency					
Days Receivable	190	185	185	185	185
Days Inventory	28	29	29	29	29
Days Payable	118	115	115	115	115
Revenue/Inv Cap.	3.12	2.28	2.51	2.52	2.52
Leverage					
Debt to Equity	65%	54%	59%	58%	56%

Balance Sheet	2015	2016	2017 E	2018 E	2019 E
Cash and eq	2,560,125	9,270,000	7,602,340	7,712,732	8,041,291
Account Receivable	7,080,597	7,942,196	11,861,795	14,214,432	16,757,947
Accrued income	251,511	384,205	577,060	691,513	815,251
Inventories	1,031,278	1,247,710	1,859,416	2,228,208	2,626,921
Others	1,636,779	2,708,387	3,849,126	4,570,425	5,350,247
Total Current Assets	**12,560,290**	**21,552,498**	**25,749,737**	**29,417,310**	**33,591,659**
LT AR	22,966	1,222,495	1,795,299	2,151,373	2,536,338
LT Lease	278,925	168,794	257,433	308,492	363,693
Fixed Assets	3,184,400	3,465,843	3,510,450	4,206,703	4,959,447
Investment in JV	1,597,379	2,114,559	5,508,500	6,598,750	7,779,524
Goodwill	4,847	66,370	66,370	66,370	66,370
Others	1,953,602	2,505,981	3,162,619	3,533,954	3,935,417
Total LT Assets	**7,042,119**	**9,544,042**	**14,300,671**	**16,865,643**	**19,640,789**
ST Debt	1,817,831	5,407,001	5,804,278	6,053,897	6,323,769
AP	4,419,882	4,916,440	7,343,413	8,799,886	10,374,528
Others	4,359,824	4,282,721	6,396,393	7,665,036	9,036,610
Total Current Liab	**10,597,537**	**14,606,162**	**19,544,083**	**22,518,819**	**25,734,907**
LT debts	1,692,432	1,340,873	2,569,429	3,216,781	3,917,274
Others	1,874,338	2,650,790	3,785,014	4,481,267	5,234,011
Long Term Liab	**3,566,770**	**3,991,663**	**6,354,443**	**7,698,048**	**9,151,285**
Equity	**5,438,102**	**12,498,715**	**14,151,882**	**16,066,086**	**18,346,255**

Key Assumptions	2015	2016	2017 E	2018 E	2019 E
Book Order (IDR Bn)	48,523	83,290	102,937	108,532	115,767
New Contract (IDR Bn)	25,221	54,764	43,245	46,770	50,647
Revenue (inc JO)/BO	35.2%	24.0%	33.4%	38.0%	42.0%
JO as % total Revenue	20.3%	21.6%	32.0%	32.0%	32.0%
JO gross margin	8.3%	8.8%	8.8%	8.8%	8.8%

Source: Reliance Sekuritas Research

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