

Wijaya Karya

On the second stage of growth, initiate with OW

Seedlings
Initiation
Overweight

WIKA.JK, WIKA IJ

Price: Rp570

Price Target: Rp740

- **Initiate with an OW rating, Jun-12 price target of Rp740.** Indonesia is in the midst of a major investment cycle with the investment-to-GDP ratio running at its highest level in the past 18 years. Construction has grown from 4% of GDP to 10% over the past 18 years, and we see the sector continuing to outpace the overall economy. As the largest domestic contractor, with a balance of private and public sector business, we believe WIKA is a pure and direct play on this multi-year trend. We initiate coverage with an OW rating and a June-12 price target of Rp740, implying a forward P/E of 10.0x and 30% upside potential.
- **On the second stage of growth:** Over FY08-10, WIKA's selective focus on order-book quality drove its first stage of growth, with EBIT margins almost doubling from 4% to 7% in 1H11. After the expansion in margins, we expect the next driver of growth will be volumes. We expect the company to grow its order book by 21% Y/Y to Rp25tr in FY11E. We forecast back-ended spending could drive 2HFY11 earnings and stock performance.
- **We expect 23% earnings CAGR in FY11-13, with ample upside risks:** We estimate 23% earnings CAGR over FY11E-13E from Rp324bn to Rp487bn. Despite 30% Y/Y growth in revenues, the company's 1H11 earnings were flat Y/Y at Rp141bn as it awaits PLN's additional compensation for power plant projects in South Kalimantan and North Sulawesi. Our forecasts imply 2HFY11 EPS growing 27% Y/Y.
- **Consistent earnings delivery is key to outperformance:** Our Jun-12 price target is based on a forward P/E of 10.0x, in line with the company's previous 3-year average of 9.5x. Consistent growth in earnings delivery is the key for outperformance, with ample upside risks via infrastructure reforms. **Key downside risks are:** 1) Poor spending realization; 2) potential political controversies and investigations into recent SEA games projects.

Indonesia

Infrastructure

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Price Performance

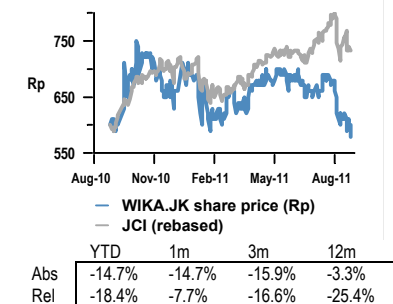
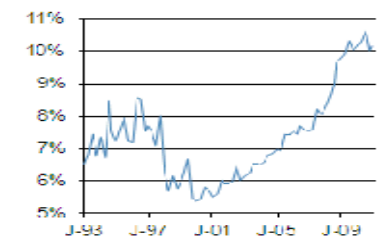


Figure 1: Construction-to-GDP ratio

Source: CEIC



Wijaya Karya (Reuters: WIKA.JK, Bloomberg: WIKA IJ)

Rp in mn, year-end Dec	FY09A	FY10A	FY11E	FY12E	FY13E
Revenue (Rp mn)	6,590,857	6,022,922	7,333,058	8,770,529	10,588,480
Net Profit (Rp mn)	189,222.1	284,922.2	323,748.6	403,303.8	486,940.3
EPS (Rp)	32.37	47.47	53.94	67.20	81.14
DPS (Rp)	7.79	9.47	14.24	16.18	20.16
Revenue growth (%)	9.6%	-6.8%	24.5%	17.3%	18.6%
EPS growth (%)	21.3%	46.7%	13.6%	24.6%	20.7%
ROCE	26.6%	25.0%	28.5%	33.0%	35.0%
ROE	13.0%	17.1%	16.8%	18.2%	19.1%
P/E (x)	17.6	12.0	10.6	8.5	7.0
P/BV (x)	2.2	1.9	1.7	1.4	1.3
EV/EBITDA (x)	5.7	6.3	5.2	4.3	3.6
Dividend Yield	1.4%	1.7%	2.5%	2.8%	3.5%

Source: Company data, Bloomberg, J.P. Morgan estimates.

Company Data

Shares O/S (mn)	6,023
Market cap (Rp mn)	3,433,197
Market cap (\$ mn)	402
Price (Rp)	570
Date Of Price	07-Sep-11
Free float (%)	33.6%
3mth Avg daily volume	5,201,000.00
3M - Avg daily Value (Rp mn)	3,375.85
3M - Avg daily Value (USD)	0.40
(\$ mn)	
JCI	3,890
Exchange Rate	8,542.00
Fiscal Year End	Dec

See page 16 for analyst certification and important disclosures, including non-US analyst disclosures.

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Company description

Wijaya Karya is a state-owned construction contractor, with 55% of revenues derived from construction, 24% from concrete business (linked to its construction business) and the rest from trading and realty businesses (as of FY10). The company's focus on its contracting business is mainly government projects and infrastructure projects.

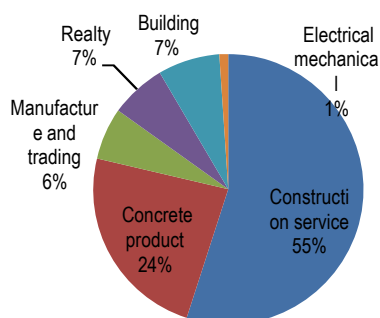
P&L sensitivity metrics	OP	EPS
FY11E	impact (%)	impact (%)
Construction revenue (Rp3,977bn)		
5% change	3.3%	4.0%
Construction service gross margin (10.0%)		
1% change	6.0%	10.7%

Source: J.P. Morgan estimates.

Price target and valuation analysis

WIKA's June-12 price target is Rp740. Our PT is based on an implied forward P/E of 10.0x, in-line with previous 3-yr average of 9.5x. WIKA's P/E target is in-line with the regional contractors valuation.

Revenue breakdown (parent basis, 2010)



Source: Company data, * Based on FY10 parent basis.

Key risks to our price target are:

Key downside risks: (1) Poor spending realization, (2) potential political controversies and investigations into recent SEA games project. There is currently 10 analysts covering the stock.

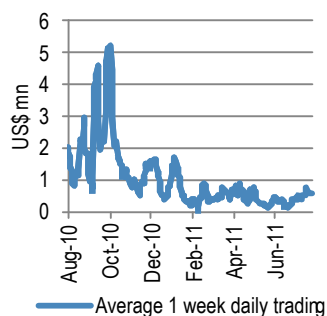
EPS estimates: J.P. Morgan vs. consensus

	J. P. Morgan	Consensus
FY11E	54	56
FY12E	67	66
FY13E	81	74

Source: Bloomberg I/B/E/S, J.P. Morgan estimates.

Valuation and rating analysis

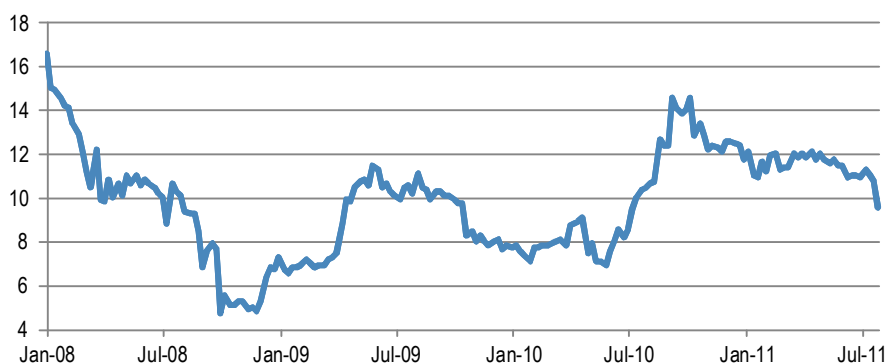
Figure 2: One-year history of daily trading volume



Source: Bloomberg.

We initiate coverage on WIKA with an OW rating and a Jun-12 price target of Rp740, implying a forward P/E of 10.0x, which is in line with the company's previous 3-year average of 9.5x. Our price target has around 30% upside from the current share price level. The stock tends to trade in the range of 10.0-12.0x forward P/E and, in the past one year, it has traded at an average 1-year P/E of 12.0x. It is currently trading at FY12E P/E of 9.0x.

y driven by expensive valuations. We expect WIKA to maintain its valuation at 10x forward P/E



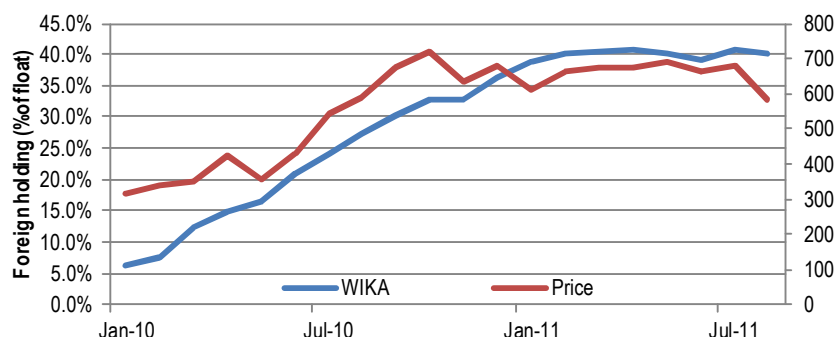
Source: Bloomberg.

Table 1: J.P. Morgan regional contractors' valuation comparison

	Stock Code	JPM Rating	Local Currency	Share price (LC)	JPM PT	P/E (x) (FY11E)	P/E (x) (FY12E)	ROE (%) (FY11E)	ROE (%) (FY12E)	P/B (x) (FY11E)	P/B (x) (FY12E)
WIKA	WIKA IJ	OW	IDR	570.0	740.00	10.8	8.6	16.4	18.0	1.7	1.5
ADHI	ADHI IJ	NR	IDR	590.0	NA	4.8	2.7	21.9	20.1	1.0	0.9
PTPP	PTPP IJ	NR	IDR	475.0	NA	6.8	5.7	21.0	22.1	1.7	1.5
TOTL	TOTL IJ	NR	IDR	320.0	NA	8.8	7.6	17.5	17.6	1.7	1.5
CCCC	1800 HK	OW	HKD	5.50	8.60	6.3	6.0	15.6	14.0	0.9	0.8
CRCC	1186 HK	N	HKD	3.70	6.40	6.0	5.0	10.7	11.9	0.6	0.6
CRG	390 HK	N	HKD	2.01	3.80	5.3	4.5	9.0	9.7	0.5	0.4
CSR	1766 HK	OW	HKD	4.10	12.00	11.1	8.0	17.4	20.7	1.5	1.2
GMR	GMRI IN	OW	INR	29.10	50.00	NM	NM	1.1	4.4	1.2	1.1
GVK	GVKP IN	UW	INR	18.10	17.00	20.5	38.6	4.0	2.1	0.8	0.8
ADE	ADE IN	N	INR	559.45	665.00	15.9	12.1	20.4	21.9	3.0	2.4
Punj	PUNJ IN	N	INR	63.75	68.00	19.1	11.3	-1.7	3.7	0.7	0.7
L&T	LT IN	OW	INR	1689.10	2100.00	19.7	17.1	17.8	17.2	6.4	5.4
CIMC-A	000039 CH	N	CNY	16.86	27.5	12.6	12.0	21.8	18.7	2.4	2.1
ZZ CSR	3898 HK	NR	HKD	16.98	NA	11.3	9.8	27.1	27.4	2.8	2.3
GAM	GAM MK	N	MYR	3.04	3.80	12.7	10.9	13.9	14.8	1.6	1.5
WCT	WCT MK	OW	MYR	2.57	3.70	10.6	8.8	12.0	12.5	0.6	0.5
IJM	IJM MK	OW	MYR	5.85	7.00	15.7	12.2	9.8	11.9	1.5	1.4
Daelim	000210 KS	N	KRW	111,500.0	129,000.0	8.6	6.8	11.5	12.8	0.9	0.8
GS E&C	006360 KS	N	KRW	99,100.0	128,000.0	12.2	14.0	11.0	8.8	1.3	1.2
Hyundai Dev.	012630 KS	N	KRW	22,650.0	33,000.0	5.7	6.7	17.9	13.3	0.7	0.6
Hyundai E&C	000720 KS	N	KRW	62,600.0	89,000.0	10.8	7.8	17.4	21.3	1.8	1.5
Samung ENG	028050 KS	OW	KRW	227,500.0	330,000.0	17.4	12.1	42.1	41.5	6.1	4.3
E&C incl. Indo						11.6	10.7	14.2	14.9	1.7	1.5

Source: Bloomberg and J.P. Morgan estimates. Prices are as of 7 September 2011.

Figure 4: WIKA's foreign holding is currently at around 40%



Source: KSEI

WIKA's share price has underperformed the JCI index by 8% in the past one month and by 12% in the past one year. The underperformance, in our view, was driven by significantly high valuations (WIKA trades at 12-14x forward P/E versus the average valuation range of 10-12x). Our price target of Rp740 is currently 5% below the 52-weeks high of Rp770, touched in Oct-10, when the stock traded at a forward P/E multiple of 13-14x.

We expect WIKA to trade at a reasonable forward P/E of 10x and believe our price target as achievable, as we think the stock's share price performance would be in line with the earnings growth momentum. Consistent earnings delivery (we expect 2H11 earnings to be up by 25% Y/Y) should be a positive catalyst for the stock. We expect the stock to recapture its 2010 peak levels, given higher earnings.

Positive price drivers

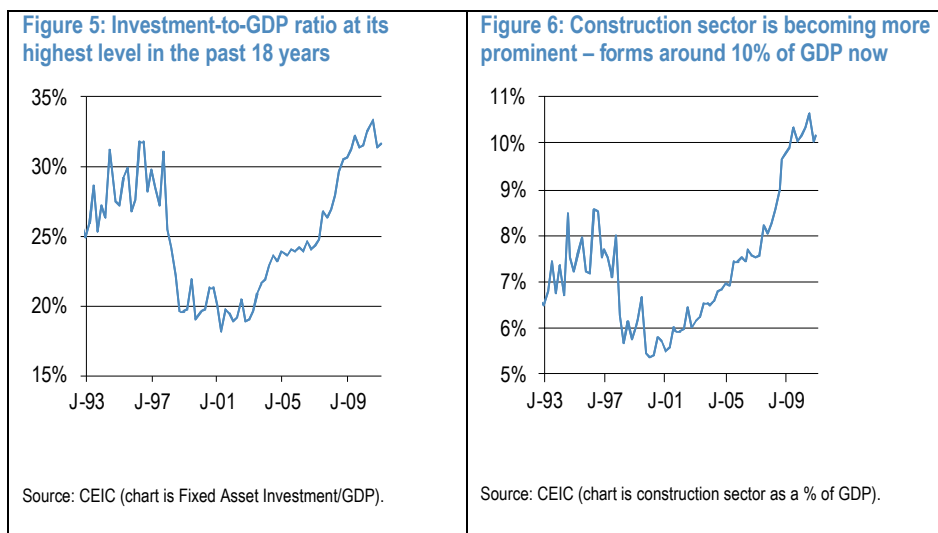
Riding the new investment cycle

Indonesia's investment-to-GDP ratio is currently at its highest level in the past 18 years. We think it is a multi-year trend given the multiple drivers, including recovering export competitiveness, firm foreign investment inflows and a sharp uptick in domestic investment. Construction growth has averaged 18% Y/Y over the past six quarters. Real growth in construction sector has accelerated to 7.3% in 2Q11, and we see the sector continuing to outpace the overall economy. Construction sector has contributed to around 10% of the GDP since FY10 vs 6-8% during FY01-07.

As we believe that the construction sector would benefit from the multi-year trend in the new investment cycle, we initiate Wijaya Karya (WIKA) with an OW rating and a Jun-12 price target of Rp740. WIKA's market cap is the largest among its peers at US\$422mn. As one of the largest domestic contractor, with over 40% of its order-book from the private sector and 60% from Government projects, we believe WIKA is a direct play on the rising investment-to-GDP ratio.

Company dividend policy	Dividend track Record
30% dividend payout ratio	Has consistently paid dividends since its IPO
# Days To Publish Quarterly Report	# Days To Consolidated Annual Report
30 days in 1Q and 3Q results, but the company did limited review every 2Q, hence it is allowed two months to publish	2-3 months

Source: Company.

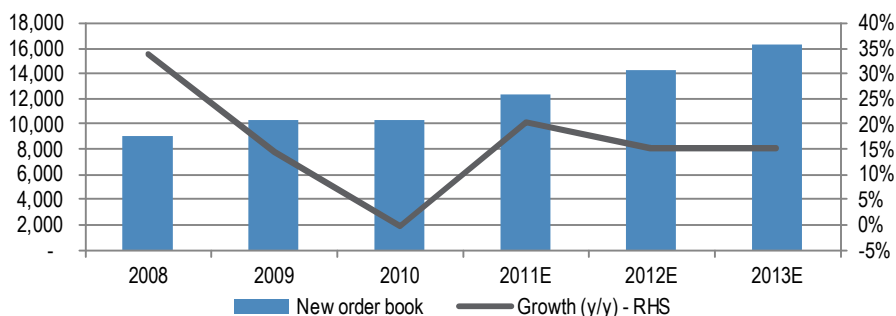


Focusing on the second stage of growth

WIKA’s focus in the past three years has been on margin improvement. The company has almost doubled its EBIT margins from 4% in FY08 to 7% in 1H11 by choosing only high-margin construction projects. The company expects such margins to be sustainable as they continue to be selective in choosing the projects.

We believe that the second stage would be a growth in revenues and order book. The company’s new order-book growth has flattened in the past few years as it has cleaned up its low-margin order book, and we forecast the next focus will be an order book growth of 21% in FY11E to Rp25tr (in line with the company’s guidance). Around 60% of the company’s order book is from the government and state-owned enterprises.

Figure 7: WIKA's order book growth has slowed as the company has cleaned up its order book – the next stage would be volume growth



Source: Company, J.P. Morgan estimates.

Table 3: We expect WIKA’s order book to grow by 20% p.a. in FY11-13E

Rp bn	2007	2008	2009	2010	2011E	2012E	2013E
New order book	6,715	8,983	10,251	10,223	12,299	14,144	16,265
Carry over	4,384	6,528	7,656	10,616	12,899	16,103	19,726
Order book	11,099	15,511	17,907	20,839	25,198	30,247	35,991
Revenue	4,285	6,559	6,591	6,023	6,940	8,095	9,521

Source: Company, J.P. Morgan estimates.

Realization of the government budget has been 90% from total budget. Even with a 90% realization, estimated growth of spending would be around 56%

WIKA's order book growth has been from Indonesia's infrastructure projects. Indonesia's infrastructure budget was up by almost 79% in the FY11E budget to Rp102tr (US\$12bn). With 60% of its order book mainly focusing on the government projects, we believe that WIKA could potentially benefit from the government's drive to build infrastructure. Budget realization on national government spending has averaged at around 90% in the past two years.

Table 4: Indonesia government budget grew by 79% Y/Y in FY11E

National government infra spending - Rp tr (realized and planned)	2009A	2010A	2011E	2012E	1H11A	% of budget
Ministry of Public Works	40.1	32.7	56.5	61.2	12.3	21.7%
Ministry of Transportation	15.6	15.6	23.1	26.8	5.8	24.9%
Ministry of Energy and Mineral Resources	6.6	5.6	15.7	15.6	1.0	6.5%
Ministry of Communication and IT	1.4	2.2	3.5	3.2	0.7	19.0%
Ministry of Housing	1.3	0.9	3.5	4.6	0.3	8.8%
Total	65.0	57.0	102.3	111.5	20.0	19.6%
Realization (%)	91%	89%				

Source: Ministry of Finance

EPS growth of 23% CAGR for FY11E-13E with risks to the upside

We estimate that the company's net profit would be able to grow by around 23% CAGR over FY11E-13E from Rp324bn to Rp487bn, with the bulk of the growth mainly coming from a 17% CAGR growth in the top-line revenue. We expect 20% CAGR growth from its construction business in FY11-13E. The company also benefits from the growth in the concrete business, in which it enjoys a 60-65% market share. With the rapid growth of real estate development (estimated at 20-25% p.a.), we believe that such growth from the concrete business should be sustainable.

Negative price drivers and risks to thesis

Investigation over Hambalang Stadium project

According to Tempo Interactive and Metro TV, there was an accusation by the ex-treasurer of Democrat Party (which is currently under investigation over corruption) that both WIKA and ADHI paid Rp100bn of bribes to win Rp1.5tr of Hambalang Stadium tender (sports stadium for the 2011 SEA games). The Hambalang Stadium project is a joint operation between WIKA and ADHI, in which ADHI has a 70% stake and WIKA has 30%. WIKA has denied involvement in certain irregularities to win the tender for Hambalang Stadium. WIKA has denied all alleged wrongdoing. The investigation over the bribes could be an overhang to WIKA's stock performance, in our view.

Lack of infrastructure reform

The lack of infrastructure reforms could hinder potential upside for WIKA. The lack of reforms includes the delay of approval of the land acquisition bill, which was expected to ease land acquisition for public use; and improve the flow of budget spending (as the Indonesian government tends to under-spend its budget). If the flow of budget to the government projects is halted, or if Indonesia does not increase the budget spending on infrastructure, WIKA's construction revenue could remain flat, providing a 13-24% EPS downside to our estimates for FY11E-12E.

A rise in construction costs

In 2008, WIKA's EBIT margins declined from 5.6% to 4.4%. The company attributed such compression in margins to the rise in construction costs. We believe that during a period of rising construction costs, some of the customers might attempt to pass on a part of the costs to the contractor, hence the compression in margins.

Financial summary

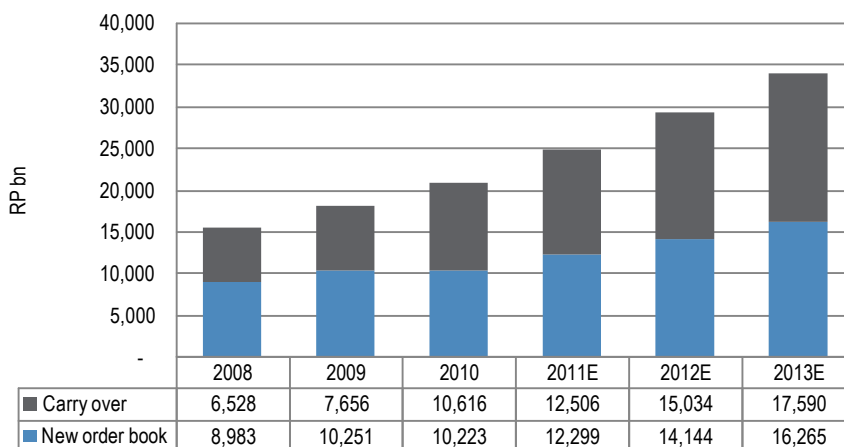
EPS growth of 23% CAGR for FY11E-13E

We estimate that the company's net profit would be able to grow by around 23% CAGR over FY11E-13E from Rp324bn to Rp487bn. Our FY11E earnings estimate is broadly in line with the company's FY11E earnings estimate of Rp350bn. Historically, WIKA has always met its earnings guidance.

We estimate the company's gross margins to be relatively stable at around 10%. We estimate a slight expansion in EBITDA margins, as we estimate the revenue growth to outpace operating-expenses growth. A bulk of the WIKA's EPS growth in FY11-13E should mainly come from a 20% CAGR growth in revenues.

The company's order book has grown by 16% in FY08-10E, and we estimate an order book growth of 21% in FY11E to Rp25tr (in-line with the company's guideline). Around 60% of the company's order book is from the government and state-owned-enterprise projects.

Figure 8: WIKA's order book for FY11E is Rp25tr, in which Rp7tr will be realized this year



Source: Company, JP Morgan estimates

**WIKA's top 10 order book
comprise of 46% from total 2011
order book**

Table 5: WIKA's top-10 projects in the order book based on construction revenue

Top 10 order book (RpB) in 2011	
Surabaya - Mojokerto Toll Road	1,400
ICA Alumina Plant	1,400
Combined Cycle Power Plant Borang 60MW	815
Outpit of Crushing & Conveying Adaro	738
Design & Build Palm Oil Plant Simedarby	559
Kualanamu Aviation System	385
Double Track Cikampek - Cirebon	372
Sepinggan Airport Balikpapan	335
LPG Spherical Gas Tank	314
Soekarno Aviation System	308
Coal Fired Power Plant Ketapang 2X10MW	300

Source: Company

Table 6: WIKA's revenue breakdown

	2010	2011F	% of revenue
Construction service	3,313.72	4,307.84	58.7%
Concrete product	1,425.62	1,710.74	23.3%
Manufacture and trading	372.74	260.92	3.6%
Realty	402.65	483.18	6.6%
Building	446.00	446.00	6.1%
Electrical mechanical	62.19	124.37	1.7%
Net sales	6,022.92	7,333.06	

Source: Company

About 55% of WIKA's revenue is derived from construction, and 24% from concrete business (which has a 60-65% of market share). The rest of the revenue is derived from realty and trading businesses. Its margins from the non-construction business are relatively stable, with the exception of trading business, which is operating at a loss. Management is currently thinking about phasing out its distribution business. We believe that the company's foray into coal trading business is not aligned with its construction business.

Table 7: Margins on WIKA's business are relatively stable, with the exception of trading business

Gross margin	2006	2007	2008	2009	2010
Construction services	8.0%	8.2%	5.6%	6.5%	12.2%
Concrete product	8.9%	8.7%	9.8%	11.7%	10.3%
Realty	11.7%	14.4%	14.8%	17.5%	17.8%
Trading	3.3%	4.8%	5.5%	12.7%	-8.7%

Source: Company

1HFY11 results analysis

In 1H11, the company's earnings were flat Y/Y at around Rp141bn. This comprises around 43% of our FY11E estimate. We estimate the company's FY11 earnings to reach Rp324bn, as Indonesia's budget spending tends to be back-ended in 4Q. Although the construction revenue grew by 38% Y/Y to Rp1.8tr, EBIT margins were only 5% versus previous year's of 9%. The company said the weak margins from the construction business were due to Rp1tr of construction revenue from PLN (Indonesia's state-owned electricity company), in which WIKA needs additional payments (around Rp150bn) for the construction of its power plant project in South Kalimantan and North Sulawesi. The additional payments from PLN to WIKA are

currently under negotiations. Including the Rp150bn of additional payments, we estimate that the EBIT margins for the construction revenue should be around 10% in 1H11.

Table 8: Quarterly analysis

Income statement	FQ1 2010	FQ2 2010	FQ3 2010	FQ4 2010	FQ1 2011	FQ2 2011	Y/Y	Q/Q
Revenue	1,139.89	1,395.59	1,446.24	2,081.36	1,565.93	1,747.18	25.2%	11.6%
- Cost of Revenue	997.50	1,267.55	1,288.13	1,836.83	1,415.69	1,592.51	25.6%	12.5%
Gross Profit	142.39	128.04	158.11	244.53	150.25	154.66	20.8%	2.9%
- Operating Expenses	45.82	52.48	60.43	73.48	46.50	48.92	-6.8%	5.2%
Operating Income	96.58	75.56	97.68	171.05	103.75	105.74	39.9%	1.9%
- Interest Expense	(5.81)	-	(7.55)	-	-	-		
- Foreign Exchange gains or losses	(3.12)	2.21	(1.31)	(1.89)	(1.90)	18.75	746.9%	-1087.3%
- Net Non-Operating gains or losses	3.56	(5.01)	3.76	37.59	22.23	(19.46)	288.3%	-187.5%
Pretax Income	91.21	82.79	92.58	206.75	124.08	105.03	26.9%	-15.3%
- Income Tax Expense	27.52	32.30	26.69	75.57	31.71	45.89	42.1%	44.7%
Income Before XO Items	63.69	50.48	65.89	131.18	92.37	59.14	17.2%	-36.0%
- Extraordinary Loss Net of Tax	-	(33.53)	-	33.53	-	-		
- Minority Interests	(0.59)	7.53	2.52	16.86	6.44	4.05	-46.2%	-37.1%
Net Income	64.28	76.48	63.37	80.80	85.93	55.09	-28.0%	-35.9%
Gross Margin	12.5%	9.2%	10.9%	11.7%	9.6%	8.9%		
Operating Margin	8.5%	5.4%	6.8%	8.2%	6.6%	6.1%		
Profit Margin	5.6%	5.5%	4.4%	3.9%	5.5%	3.2%		
Tax as % of revenue	2.4%	2.3%	1.8%	3.6%	2.0%	2.6%		

Source: Company

Peer comparison

WIKA's margins are broadly in line with the Indonesia contractor peers. The company's pre-tax ROE is also broadly in line at around 25%. We believe that WIKA deserves a premium over its Indonesia peers due to better risk management and better management forecast.

Table 9: Indonesian contractors are operating at similar EBITDA margins

Company	Gross margin (%)			Operating margin (%)			EBITDA Margin (%)			Net profit margin (%)		
	1Q11	4Q10	FY2010	1Q11	4Q10	FY2010	1Q11	4Q10	FY2010	1Q11	4Q10	FY2010
Wijaya Karya	9.59	11.75	11.10	6.63	8.22	7.27	7.83	8.16	7.27	5.49	3.88	7.27
Adhi Karya	10.89	15.91	12.52	4.24	9.37	6.98	7.79	7.21	6.98	0.40	4.37	6.98
Pembangunan Perumahan	11.10	12.25	9.50	7.40	10.86	6.72	7.60	7.19	6.72	3.82	7.11	6.72
Total Bangun Persada	16.33	13.96	12.71	10.26	7.73	6.55	8.57	7.18	6.55	7.39	5.82	6.55

Source: Company.

Table 10: Indonesian contractors are also trading at similar pre-tax ROE (WIKA has the highest ROCE among its peer group – and has a lower gearing than its peers)

Dupont Analysis (as of 1Q11)			
RpB	PTPP	WIKA	ADHI
Operating margin	7.4	6.6	4.2
Sales/assets	0.9	1.1	1.0
Operating profit/assets	6.8	7.3	4.4
Assets/equity	4.2	3.5	5.7
Pretax ROE	28.7	25.3	25.1
Post-tax ROE	18.7	16.4	16.3

FY2011 Forecast (company's guidance) incl WIKA? Why aren't you using your forecasts?			
RpB	PTPP	WIKA	ADHI
Order book	22,618	25,198	19,523
Growth (%)	103.4	20.9	44.2
Net profit	269	342	202
Growth (%)	34.0	20.0	16.9

Source: Company, Bloomberg, J.P. Morgan estimates.

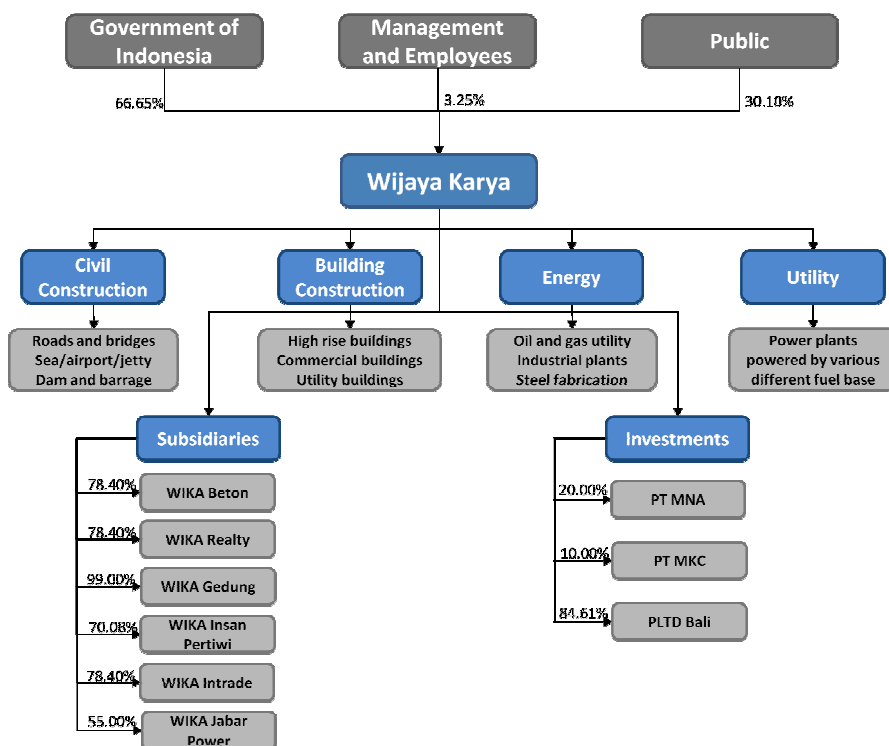
SWOT analysis

<p>Strengths</p> <ul style="list-style-type: none"> • Strong experience in managing government projects as 60% of the company's revenue is based on government and infrastructure projects. • By being selective about its target markets and focusing on certain projects, WIKA has been able to manage the recovery rate of its accounts receivable and also maintain margins. • Diversified source of revenue, such as realty and pre-cast concrete. WIKA's pre-cast concrete business has grown by 10% CAGR in FY08-10. We believe that the company's 20% addition to the capacity of pre-cast concrete business in FY11 would enable further growth in this business. 	<p>Weaknesses</p> <ul style="list-style-type: none"> • The company's diversification into selling fertilizers is not aligned with its other business. However, the company is phasing out its trading business. • We believe the company's foray into coal trading is not aligned with its overall business. The coal business with PLN (Rp3.8tr of order book) currently comprises 15% of the overall order book.
<p>Opportunities</p> <ul style="list-style-type: none"> • Infrastructure reform could provide an upside to WIKA. This includes: (1) better clarity on the cash inflow (payments of accounts receivable); and (2) faster progress of infrastructure development. • Bappenas (Head of National Planning Agency) has around Rp1,429tr of potential infrastructure projects. As around 60% of WIKA's contracting business is from government's projects, we see a potential upside if these projects go through. • Infrastructure reform via land acquisition law would enable some of the infrastructure projects in WIKA's order book to commence, as some of the development has been hindered due to lack of land acquisition. 	<p>Threats</p> <ul style="list-style-type: none"> • Indonesia's contracting business is highly fragmented. We also see a lack of differentiation between one contractor and another. • The recent investigation into bribes over ADHI WIKA Joint Operations in Stadium Hambalang could be an overhang for WIKA's share price performance. It could also hinder the growth in its order book.

Company Background

State-owned Wijaya Karya (WIKA) was founded in 1960 with initial operations in electrical network installation projects. It has since developed into one of the largest contractors in Indonesia covering four business areas: civil construction (infrastructure), commercial and residential building construction, utilities, and energy (integrated EPC). The company went public in Oct-07, floating 30% and reducing the Government of Indonesia's stake to 70%. Some of WIKA's completed projects include the Surabaya-Madura (Suramadu) Bridge, Adi Soemarmo Airport in Solo, and diesel power plant in Bali with 50MW capacity.

Figure 9: WIKA's company structure



Source: Company.

WIKA currently has six subsidiaries:

- 1) WIKA Beton: Manufactures pre-cast concrete through its 8 factories located across Indonesia and in Algeria.
- 2) WIKA Intrade: Established by merging WIKA's metal products and trading divisions, the subsidiary engages in trading automotive parts, coal, as well as construction and engineering materials.
- 3) WIKA Realty: Develops residential real estate projects under the Tamansari brand, mostly located in Java and Kalimantan. The properties are developed on either the company's own landbank or through collaborations with third-party landowners.
- 4) WIKA Gedung: The subsidiary handles WIKA's residential and commercial building projects in constructing and maintaining developed properties.
- 5) WIKA Insan Pertiwi: WIKA Insan Pertiwi specializes in civil construction of EPC, industrial, and oil and gas projects, including power plants. Most of the projects are from the Department of Utilities and Energy.

- 6) WIKA Jabar Power: A company established to explore, produce and harness electricity from a geothermal well in Gunung Tampomas, West Java. The geothermal power plant has a planned capacity of 45MW with an estimated total investment of US\$110mn.

The company also has a 20% stake in Surabaya-Mojokerto toll road and a 10% stake in Cengkareng-Kunciran toll road, in which the majority stake belongs to Jasa Marga. By acquiring a minority stake in these toll roads, the company has been able to garner orders for these projects. Going forward, the company plans to do forward integration by participating in several infrastructure projects.

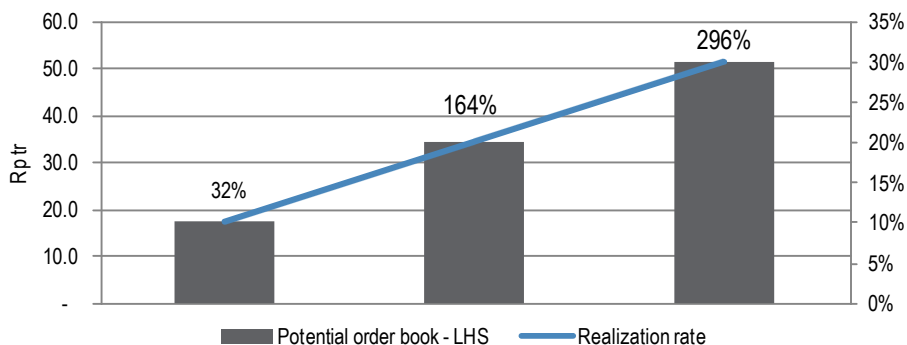
Infrastructure projects in the pipeline

Indonesia currently has many infrastructure projects in the pipeline, but the execution has been patchy at best so far. Consequently, we view that the reforms in infrastructure are key for earnings upside beyond current forecasts for the infrastructure sector. Bappenas estimated that Indonesia needs to spend around Rp1,429tr (US\$170bn) on infrastructure, such as water, ports, toll roads and power plants over the next five years. Around Rp511tr will come from the state budget, Rp407tr from the private sector through the PPP scheme, and the rest would come from the state-owned companies and regional government.

As per our estimates, WIKA gets 11-13% of the government orders (even though WIKA's market share in total construction is only 3-4%). At the current juncture, the Indonesia's infrastructure budget is only Rp99tr p.a., versus the estimated Bappenas spending of Rp285tr p.a. If the project's pace is at Rp143tr p.a. (10% realization) versus Rp99tr p.a., this could give an additional 32% upside to WIKA's current order book. If the realization of Bappenas project is 30%, this could give almost 300% upside to WIKA's order book.

These are the potential upside risks that are not currently in our estimates.

Figure 10: WIKA's order book could have 32-296% upside potential if a small percentage of Bappenas project is realized



Source: J.P. Morgan estimates.

The challenge on the infrastructure front has been difficulties in acquiring land for public use, which we believe could be resolved via the land acquisition law (estimated to be passed in 4Q11). The second challenge would be funding, as Bappenas has estimated that the government will only be able to provide Rp511tr. The government has tried to resolve some of the issues by introducing new regulations, such as Presidential Regulations No. 13/2010, to tackle debottlenecking of infrastructure provisions and providing harmonization with other regulations. With the government's support towards PPP projects, we think that such a gap in spending could be narrowed.

Indonesia has extensive infrastructure projects in the pipeline that has been announced recently. They include:

- 1) Construction of Pelindo 2 extension in Tanjung Priok Port, which costs Rp11.1tr. The project is expected to commence in end-FY11E. Funding has been secured from Bank Mandiri.
- 2) Construction of new airport facilities in Soekarto Hatta at around 129,000m2, with a total investment of Rp1.9tr.
- 3) Construction of International Harbour at Batu Ampar, with a total investment of US\$412.7bn.
- 4) PPP infrastructure, which includes IPP for Central Java (2,000 MW), Airport Soekarno-Hatta to Manggarai Railway; Puruk Cahu -Bangkuang Railway; Tanah Ampo Cruise Terminal (Bali); Umbulan Spring Water Project; and Waste to Energy Gedebage (West Java).

Despite the slower pace in reforms, we believe that the Indonesian government has a firm commitment to improve regulations towards infrastructure. The Ministry of Finance is also committed to ensure that the PPP system works in Indonesia. With the low base of infrastructure progress, we think that Wijaya Karya has ample upside if the infrastructure development goes through.

Wijaya Karya: Summary of Financials

Income Statement						Cash flow statement					
Rp in millions, year end Dec	FY09	FY10	FY11E	FY12E	FY13E	Rp in millions, year end Dec	FY09	FY10	FY11E	FY12E	FY13E
Revenues	6,590,857	6,022,922	7,333,058	8,770,529	10,588,480	EBIT	484,951	477,611	601,565	729,355	890,445
% change Y/Y	9.6%	(6.8%)	24.5%	17.3%	18.6%	Depr. & amortization	45,871	34,657	48,810	56,070	63,329
EBITDA	530,822	512,269	650,374	785,425	953,774	Change in working capital	712,056	207,859	-537,700	-169,193	-301,021
% change Y/Y	63.1%	-3.5%	27.0%	20.8%	21.4%	Taxes	-	-	-	-	-
EBIT	484,951	477,611	601,565	729,355	890,445	Cash flow from operations	928,996	200,402	166,233	422,357	429,117
% change Y/Y	68.4%	NM	26.0%	21.2%	22.1%	Capex	-81,710	-106,471	-358,000	-208,000	-208,000
EBIT Margin	6.8%	7.1%	7.2%	7.5%	7.7%	Disposal/(purchase)	0	0	0	0	0
Net Interest	-21,347	19,302	13,376	11,789	10,909	Net Interest	-21,347	19,302	13,376	11,789	10,909
Earnings before tax	348,109	473,326	575,759	706,307	852,754	Other	-	-	-	-	-
% change Y/Y	35.8%	36.0%	21.6%	22.7%	20.7%	Free cash flow	847,286	93,931	-191,767	214,357	221,117
Tax	141,585	162,085	219,992	263,116	317,654	Equity raised/(repaid)	9,175	46,247	17,669	0	0
as % of EBT	40.7%	34.2%	38.2%	37.3%	37.3%	Debt raised/(repaid)	-517,104	246,764	-276,227	0	0
Net income (reported)	189,222.1	284,922.2	323,748.6	403,303.8	486,940.3	Other	20,017	12,371	32,019	39,887	48,159
% change Y/Y	21.3%	50.6%	13.6%	24.6%	20.7%	Dividends paid	-45,524	-56,810	-85,477	-97,125	-120,991
Shares outstanding	5,846	6,002	6,002	6,002	6,002	Beginning cash	1,051,432	1,210,888	1,227,705	729,690	689,247
EPS (reported)	32.37	47.47	53.94	67.20	81.14	Ending cash	1,210,888	1,227,705	729,690	689,247	641,626
% change Y/Y	21.3%	46.7%	13.6%	24.6%	20.7%	DPS	7.79	9.47	14.24	16.18	20.16
Balance sheet						Ratio Analysis					
Rp in millions, year end Dec	FY09	FY10	FY11E	FY12E	FY13E	Rp in millions, year end Dec	FY09	FY10	FY11E	FY12E	FY13E
Cash and cash equivalents	1,210,888	1,227,705	729,690	689,247	641,626	EBITDA margin	7.4%	7.6%	7.8%	8.0%	8.2%
Accounts receivable	872,071	899,690	1,069,770	1,246,584	1,543,144	Operating margin	6.8%	7.1%	7.2%	7.5%	7.7%
Inventories	1,044,473	853,257	1,140,635	1,440,312	1,686,319	Net margin	2.6%	4.3%	3.9%	4.1%	4.2%
Others	1,835,099	2,142,021	2,127,156	2,418,044	2,835,510	Sales per share growth	9.6%	(9.3%)	24.5%	17.3%	18.6%
Current assets	4,962,530	5,122,673	5,067,250	5,794,186	6,706,599	Sales growth	9.6%	(6.8%)	24.5%	17.3%	18.6%
LT investments	121,509	150,108	352,108	504,108	656,108	Net profit growth	21.3%	50.6%	13.6%	24.6%	20.7%
Net fixed assets	332,207	405,546	669,761	776,716	876,411	EPS growth	21.3%	46.7%	13.6%	24.6%	20.7%
Total Assets	5,700,614	6,286,305	6,536,817	7,615,757	8,871,259	Interest coverage (x)	24.87	-	-	-	-
Liabilities						Net debt to equity	-71.4%	-48.0%	-35.5%	-29.2%	-23.5%
Short-term loans	116,735	87,272	0	0	0	Sales/assets	1.25	1.12	1.30	1.38	1.41
Payables	1,202,789	1,221,036	1,363,016	1,687,069	2,045,839	Assets/equity	3.72	3.49	3.18	3.22	3.25
Others	2,116,001	2,333,719	2,371,423	2,804,453	3,305,726	ROE	13.0%	17.1%	16.8%	18.2%	19.1%
Total current liabilities	3,435,525	3,642,027	3,734,439	4,491,522	5,351,565	ROCE	26.6%	25.0%	28.5%	33.0%	35.0%
Long-term debt	0	276,227	0	0	0						
Other liabilities	629,374	451,283	597,650	573,441	554,792						
Total Liabilities	4,064,899	4,369,537	4,332,089	5,064,963	5,906,357						
Shareholders' equity	1,532,941	1,801,624	2,057,564	2,363,744	2,729,693						
BVPS	262.20	300.19	342.84	393.86	454.83						

Source: Company reports and J.P. Morgan estimates.

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Wijaya Karya (WIKA.JK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends.

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