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CIMB Research Report

Wijaya Baru Global

UPDATE REPORT	
	19 September 2007
RECOM	Sell
PRICE	RM1.04
MKT CAPITALISATION	RM286.95m
BOARD	Main
SECTOR	Forestry

MALAYSIA

WIJ MK / WIJA.KL

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Investment highlights

- **Total development cost rises from RM1.1bn to RM4.6bn.** The recent issue over Wijaya Baru Global's land sale in Pulau Indah to the Port Klang Authority (PKA) was sparked by the government's revelation of the project's cost. The cost of the free zone project has gone up from an initial RM1.1bn to RM4.6bn due to other works done on the plot of land.
- **Premature exit by Jebel Ali Free Zone Authority (Jafza).** Jafza, a Dubai-based port operator, recently withdrew from its 15-year contract to operate and manage the Port Klang free zone. The port operator's premature departure has raised concerns over the sustainability of the project as it was initially contracted to operate and help rope in potential occupants and users for the free zone.
- **RM4.6bn government soft loan.** Due to the significantly higher cost, the government recently stepped in and announced that it will extend a seven-year RM4.6bn soft loan to PKA at an interest rate of 4%. According to press reports, we gather that the government may not have paid cash outright for the land and development costs but instead could have issued a letter indicating its commitment to make payments on a deferred basis
- **No earnings impact.** The RM4.6bn soft loan extended to PKA is good news for Wijaya Baru as it means that the payment for the development costs is now supported by the government. This leads us to believe that Wijaya Baru's earnings should not be affected. We, therefore, maintain our earnings forecasts.
- **Maintain SELL recommendation.** Although our earnings projection is kept intact, our end-CY07 target price is reduced to RM0.98 (RM1.12 previously) as we widen the discount to the 8x average P/E for small-cap contractors from 20% to 30% to reflect its limited earnings prospects. We reiterate our SELL recommendation with the key de-rating catalysts being i) poor quarterly results, ii) a persistently underperforming medical services division, and iii) uncertainty over the prospects for its recently acquired instant rice production business. We recommend Eksons Corporation (EKSON MK; Outperform) for exposure to timber stocks and MRCB (MRC MK; Buy) or Mudajaya (MDJ MK; Buy) for a smaller-cap construction play.

Key stock statistics

FYE Dec	2006	2007F
EPS (sen)	26.1	9.8
P/E (x)	4.0	10.6
Dividend/Share (sen)	6.0	6.0
NTA/Share (RM)	0.88	0.75
Book Value/Share (x)	0.88	0.75
Issued Capital (m shares)	110.4	110.4
52-weeks Share Price Range (RM)		RM1.01/RM1.88
Major Shareholders:		%
Dato' Seri Tiong King Sing		32.08
Sui Diong Hoe		4.96
Lee Thiam Fah		4.42

Per share data

FYE Dec	2004	2005	2006	2007F
Book Value (RM)	0.05	0.54	0.88	0.75
Cash Flow (sen)	24.9	55.4	44.1	28.5
Earnings (sen)	7.6	36.6	26.1	9.8
Dividend (sen)	3.0	6.0	6.0	6.0
Payout Ratio (%)	28.3	11.8	16.6	44.1
P/E (x)	13.6	2.8	4.0	10.6
P/Cash Flow (x)	4.2	1.9	2.4	3.6
P/Book Value (x)	20.1	1.9	1.2	1.4
Dividend Yield (%)	2.9	5.8	5.8	5.8
ROE (%)	11.7	35.6	20.7	8.8
Net Gearing (%)	net cash	net cash	net cash	net cash

Source: Company, CIMB estimates, Bloomberg

Recent developments

There has been active newsflow on the Port Klang Free Zone (PKFZ) in recent months, with talk intensifying after the i) withdrawal of Jebel Ali Free Zone (Jafza) from the 15-year management concession agreement and ii) the government's revelation of the project's higher cost. Wijaya Baru is involved as it sold the 405ha Pulau Indah land to the Port Klang Authority (PKA) in 2002.

Total development cost rises from RM1.1bn to RM4.6bn. The issue lies in the sale of the Pulau Indah land by Wijaya Baru's associate company Kuala Dimensi Sdn Bhd (KDSB) to PKA for RM1.1bn or RM25 psf. According to press reports, KDSB had bought this land for RM95m or an average of RM2.18 psf in 1999 for the construction and development of the PKFZ, which was slated to be an international cargo distribution and consolidation centre to allow easier co-ordination and smoother supply chain management.

Press reports also indicated that a corporate deal involving the same property was initially rejected by the Securities Commission on the grounds that the price was excessive. But PKA went ahead with the purchase in 2002, attributing the high land sale price on the basis of work done on the site such as land reclamation, drainage, construction of access roads, installation of street lights, water supply services and payments to utility agencies. In addition to the sale of land to PKA, KDSB was awarded a RM1bn construction job to develop the piece of land into a free trade zone.

Associate does construction works. Even though PKA appointed KDSB as the turnkey developer to design, build, complete and finance the development of the land, the bulk of the construction works was subcontracted to Wijaya Baru's 45% associate, Wijaya Baru Global Sdn Bhd. Work on PKFZ has largely been completed.

Increased cost a concern? The government recently announced that PKFZ's entire development cost is RM4.6bn comprising the RM1.1bn land acquisition, RM1.8bn development costs, the 7.5% interest rate on the loan to buy the land, 10% professional fee and 20% variation order. This compares with an initial cost estimate of around RM1.1bn. The higher cost led to concerns over PKA's ability to self-finance the project.

A surprise exit. Jafza, a Dubai-based free zone operator, withdrew from its 15-year contract with Port Klang Free Zone in Jul 07. It had been appointed to manage and operate the free zone and help rope in clients to fill up the space in the free zone. But it opted out because of a change in strategy. Instead of maintaining a purely operational and management contract, Jafza wanted an equity stake in the ports it handles.

Government to the rescue. Due to the higher cost, the government has stepped in to shoulder part of the financial burden. It recently agreed to extend a seven-year RM4.6bn soft loan to PKA at a 4% interest rate. With the government's entry, Wijaya Baru may be able to recover its cash as soon as it has delivered on its work.

Minimal earnings impact on WBGB... Despite the higher costs and Jafza's exit, the government's recent announcement of the RM4.6bn soft loan to PKA is comforting. With the government in the picture, we do not think that PKA will default on its payments to Wijaya Baru. For this reason, we think its earnings should not be impacted.

… but negative sentiment. Nevertheless, negative newsflow on this front will dampen sentiment on the stock.

Earnings outlook

Associates no longer the saviour? At the core operations level, the high depreciation incurred by its core medical services division continues to wipe out the small profits delivered by its timber division. The group's earnings are kept afloat by contributions from its construction associate, Wijaya Baru Global Sdn Bhd. However, with the associate's outstanding order book standing at only RM460m and having the limited prospects for expansion as it is not actively bidding for projects in the near term, its earnings visibility is limited.

Earnings forecasts unchanged. Despite recent news on the Pulau Indah land sale, WBGB's earnings should not be impacted as the land sale has already been concluded and cannot be reversed. In addition, the government's move to support the free zone project through the extension of a RM4.6bn soft loan is good news for the company as payment for the development costs is now assured. Thus, our earnings forecasts remain unchanged.

Figure 1: P&L analysis (RM m)

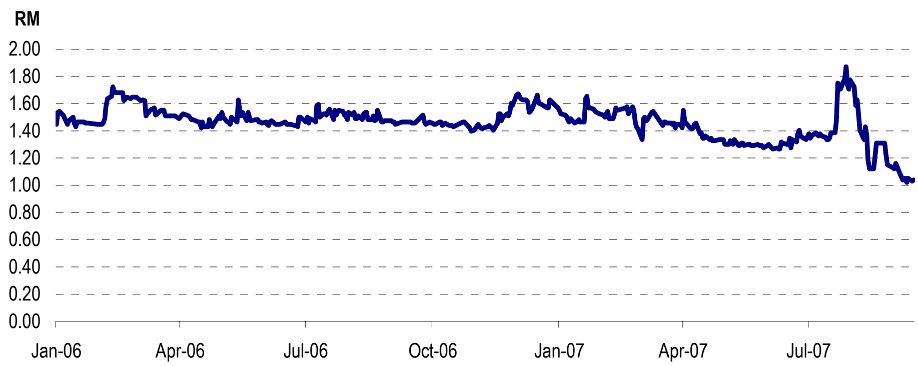
FYE Dec	2004	2005	2006	2007F
Revenue	891.7	73.8	55.2	56.5
Operating Profit (EBIT)	6.2	1.7	(7.2)	(3.0)
Depreciation & Amortisation	(14.6)	(14.7)	(18.6)	(19.5)
Interest Expenses	(0.2)	(0.1)	(0.0)	(0.1)
Pretax Profit	12.8	46.4	30.1	12.0
Effective Tax Rate (%)	*34.4*	*13.0*	*4.3*	*10.0*
Net Profit	8.4	40.4	28.8	10.8
Operating Margin (%)	*0.7*	*2.3*	*N/M*	*N/M*
Pretax Margin (%)	*1.4*	*62.9*	*54.5*	*21.2*
Net Margin (%)	*0.9*	*54.7*	*52.2*	*19.1*

Source: Company, CIMB estimates

Recommendation

Maintain SELL recommendation. Although our earnings projection is kept intact, our end-CY07 target price is reduced to RM0.98 (RM1.12 previously) as we widen the discount to the 8x average P/E for small-cap contractors from 20% to 30% to reflect its limited earnings prospects. We reiterate our SELL recommendation with the key de-rating catalysts being i) poor quarterly results, ii) a persistently underperforming medical services division, and iii) uncertainty over the prospects for its recently acquired instant rice production business. We recommend Eksons Corporation (EKSON MK; Outperform) for exposure to timber stocks and MRCB (MRC MK; Buy) or Mudajaya (MDJ MK; Buy) for a smaller-cap construction play.

Figure 2: Share price chart (RM)



Source: Bloomberg

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