INITIATION

CIMB

Salcon

SALC MK / SLCN.KL

COMPANY NOTE

Market Cap	Avg Daily Turnover	Free Float
US$154.6m	US$0.83m	82.7%
RM581.6m	RM3.02m	674.6 m shares

Current	RM0.85
Target	RM1.30
Prev. Target	N/A
Up/Downside	52.4%

STOCK RATING
ADD
HOLD
REDUCE

Notes from the Field

Sharizan ROSELY
T (60) 3 2261 9077
E sharizan.rosely@cimb.com

Company Visit	☑	Expert Opinion	☑
Channel Check	☑	Customer Views	☐

Contents

A diamond in the rough

Salcon is an under-researched and in our view still-undervalued small/mid-cap water and sewerage contractor. It exhibits the qualities of its bigger peers in their early years of M&A and is positioned strongly in two major sectors that drive the domestic construction space.

Salcon's rail-based fibre optic asset through 50.1%-owned VBT is a concession that is still in its infancy but offers prospects of dominating the captive rail transport segment. We initiate coverage with an Add rating and a target price of RM1.30, pegged to a 20% RNAV discount (52% upside). Potential catalysts are job wins and VBT's new contracts.

Water infra and property

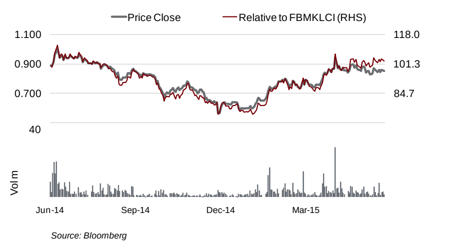
Salcon operates in a market segment that contains fewer players but offers good margins. It is a play on the recovery of the government's nationwide water infrastructure spending and backlog of water capex in Selangor. Salcon made headlines last year when its consortium won the largest ever water treatment plant (WTP) project (Langat 2 phase 1). On the property side, the possibility of more JVs with Eco World suggests exciting prospects. Also, Salcon is one of the three largest land owners around the KL118 tower, which could benefit from a transformation of the entire area similar to Petronas Twin Towers.

Owns rail rights of way

Salcon owns a 50.1% stake in an arguably lucrative concession asset. Volksbahn Technologies (VBT) owns the 15-year rights-of-way for 108km of mostly LRT infrastructure, to be monetised by laying fibre optic cables and selling bandwidth wholesale to telco operators, with more scope of revenue generation. For Salcon, here lies the longer-term potential of: 1) moving from volatile but above-industry average construction margins to stable high-double-digit pretax margins, and 2) predictable cash flows, with potentially higher dividend. VBT had inked an MOU with Celcom on 20 April, and may sign an official contract in the short term. We believe other telco's could join the bandwagon.

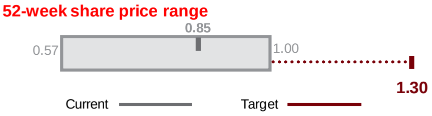
Unlocking value

We believe Salcon deserves to be valued at a narrower 20% RNAV discount versus its peers, as it is comparable to the bigger and more mature construction conglomerates. Its net cash constitutes 30% of its market cap (1QFY15 NCPS: 25.2 sen). There is still upside to RNAV, as our base-case DCF value for VBT accounts for 5% (7.3 sen/share) of RNAV. (See RNAV sensitivity). We forecast 3-year EPS CAGR of 76% driven by new profit streams.



Source: Bloomberg

52-week share price range



Financial Summary

	Dec-13A	Dec-14A	Dec-15F	Dec-16F	Dec-17F
Revenue (RMm)	164.6	201.9	202.6	255.2	298.4
Operating EBITDA (RMm)	(27.84)	(9.01)	10.80	34.04	50.73
Net Profit (RMm)	24.94	4.51	5.72	22.37	29.10
Core EPS (RM)	(0.098)	(0.057)	0.008	0.033	0.043
Core EPS Growth	(1084%)	(42%)	NA	291%	30%
FD Core P/E (x)	NA	NA	101.7	26.0	20.0
DPS (RM)	0.030	0.030	0.030	0.030	0.035
Dividend Yield	3.53%	3.53%	3.53%	3.53%	4.12%
EV/EBITDA (x)	NA	NA	28.54	7.61	4.78
P/FCFE (x)	NA	7.46	NA	20.71	20.60
Net Gearing	(16.1%)	(31.1%)	(44.5%)	(48.5%)	(47.6%)
P/BV (x)	1.15	1.05	1.05	0.95	0.88
ROE	(14.5%)	(7.3%)	1.0%	3.8%	4.6%
% Change In Core EPS Estimates					
CIMB/consensus EPS (x)					

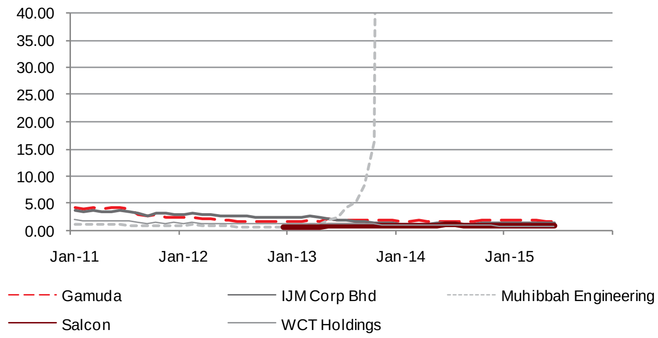
SOURCE: CIMB, COMPANY REPORTS

PEER COMPARISON

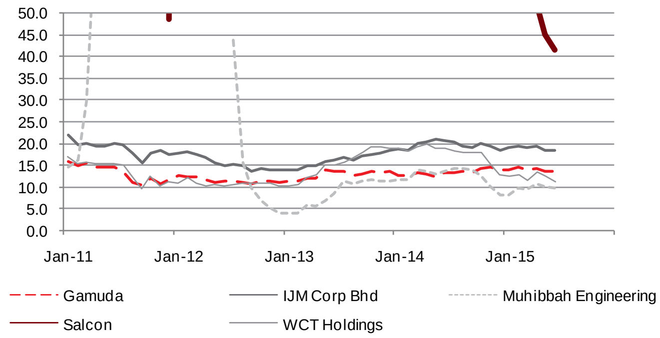
Research Coverage

	Bloomberg Code	Market	Recommendation	Mkt Cap US$m	Price	Target Price	Upside
Gamuda	GAM MK	MY	ADD	3,198	5.00	6.20	24.0%
IJM Corp Bhd	IJM MK	MY	ADD	3,324	7.00	8.00	14.2%
Muhibbah Engineering	MUHI MK	MY	ADD	294	2.36	3.06	29.7%
Salcon	**SALC MK**	**MY**	**ADD**	**155**	**0.85**	**1.30**	**52.4%**
WCT Holdings	WCTHG MK	MY	HOLD	459	1.59	1.80	13.2%

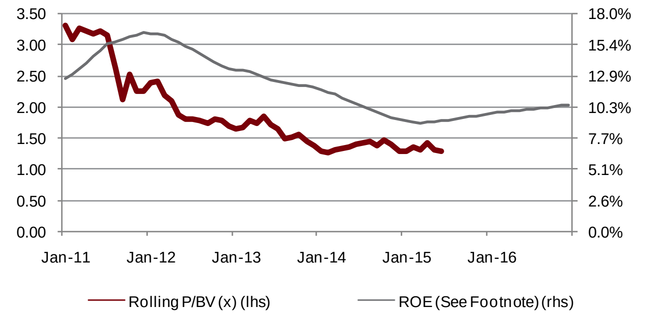
Rolling P/BV (x)



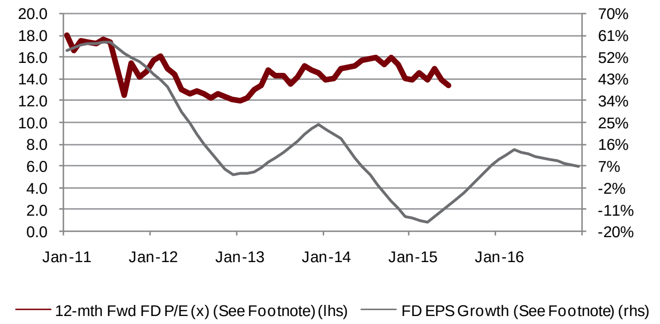
12-month Forward Rolling FD P/E (x)



Peer Aggregate: P/BV vs ROE



Peer Aggregate: 12-mth Fwd FD P/E vs FD EPS Growth



Valuation

	FD P/E (x) (See Footnote)			P/BV (x)			EV/EBITDA (x)		
	Dec-14	Dec-15	Dec-16	Dec-14	Dec-15	Dec-16	Dec-14	Dec-15	Dec-16
Gamuda	14.06	13.84	13.54	1.78	1.72	1.71	21.23	16.23	16.18
IJM Corp Bhd	21.73	19.48	18.02	1.44	1.69	1.76	16.94	14.92	14.00
Muhibbah Engineering	11.64	10.08	9.62	NA	NA	NA	9.20	6.57	5.96
Salcon	**NA**	**101.66**	**25.97**	**1.05**	**1.05**	**0.95**	**NA**	**28.54**	**7.61**
WCT Holdings	14.71	12.79	10.41	0.69	0.64	0.66	30.74	12.45	11.63

Growth and Returns

	FD EPS Growth (See Footnote)			ROE (See Footnote)			Dividend Yield		
	Dec-14	Dec-15	Dec-16	Dec-14	Dec-15	Dec-16	Dec-14	Dec-15	Dec-16
Gamuda	7.9%	1.6%	2.2%	13.2%	12.6%	12.7%	2.31%	2.31%	2.32%
IJM Corp Bhd	-10.1%	11.5%	8.1%	7.0%	8.1%	9.6%	2.50%	2.35%	2.54%
Muhibbah Engineering	-4.2%	15.4%	4.7%	13.5%	14.6%	15.2%	1.69%	1.91%	2.33%
Salcon	**-42.1%**	**NA**	**291.5%**	**-7.3%**	**1.0%**	**3.8%**	**3.53%**	**3.53%**	**3.53%**
WCT Holdings	-51.7%	15.0%	22.8%	5.0%	5.5%	6.6%	3.91%	4.09%	4.40%

SOURCE: CIMB, COMPANY REPORTS

Calculations are performed using EFA™ Monthly Interpolated Annualisation and Aggregation algorithms to December year ends.
NPAT/EPS values for calculations and valuations are based on recurring and normalised values for GAAP and IFRS accounting standard companies respectively.

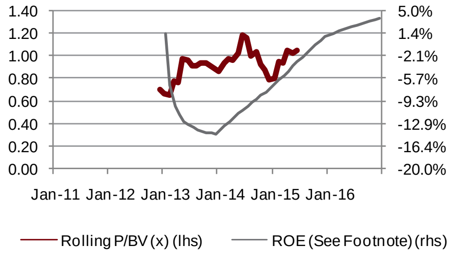
BY THE NUMBERS

Share price info

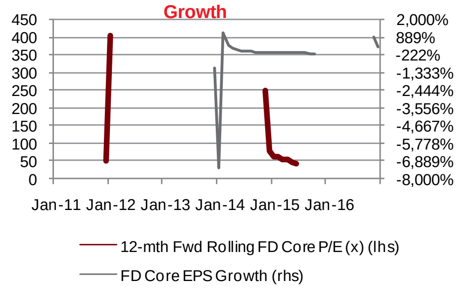
Share px perf. (%)	1M	3M	12M
Relative	0.7	18.5	8.1
Absolute	-2.9	15.6	0.6

Major shareholders	% held
Naga Muhibbah Sdn Bhd	11.0
Havenport	6.3

P/BV vs ROE



12-mth Fwd FD Core P/E vs FD Core EPS Growth



Volatility of earnings is expected to diminish. FY15 remains a transition year. Major turnaround in net profit expected in FY16, driven by a large chunk of order book crossing critical milestones, new recurring income (VBT) and property development.

Profit & Loss

(RMm)	Dec-13A	Dec-14A	Dec-15F	Dec-16F	Dec-17F
Total Net Revenues	**164.6**	**201.9**	**202.6**	**255.2**	**298.4**
Gross Profit	**22.2**	**26.4**	**30.4**	**40.8**	**50.7**
Operating EBITDA	**(27.8)**	**(9.0)**	**10.8**	**34.0**	**50.7**
Depreciation And Amortisation	(4.6)	(4.6)	(4.8)	(5.2)	(5.5)
Operating EBIT	**(32.4)**	**(13.6)**	**6.0**	**28.9**	**45.2**
Financial Income/(Expense)	(6.1)	7.2	3.4	7.1	7.7
Pretax Income/(Loss) from Assoc.	3.2	3.4	3.2	3.1	3.9
Non-Operating Income/(Expense)	0.0	0.0	0.0	0.0	0.0
Profit Before Tax (pre-EI)	**(35.4)**	**(3.0)**	**12.6**	**39.1**	**56.8**
Exceptional Items					
Pre-tax Profit	**(35.4)**	**(3.0)**	**12.6**	**39.1**	**56.8**
Taxation	1.1	(3.7)	(3.8)	(9.7)	(14.2)
Exceptional Income - post-tax	91.9	43.2			
Profit After Tax	**57.6**	**36.5**	**8.8**	**29.3**	**42.6**
Minority Interests	(32.6)	(32.0)	(3.1)	(6.9)	(13.5)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Net Profit	**24.9**	**4.5**	**5.7**	**22.4**	**29.1**
Recurring Net Profit	(66.9)	(38.7)	5.7	22.4	29.1
Fully Diluted Recurring Net Profit	**(66.9)**	**(38.7)**	**5.7**	**22.4**	**29.1**

Improving operating cash flow to be underpinned by stable and more lucrative recurring income streams.

Cash Flow

(RMm)	Dec-13A	Dec-14A	Dec-15F	Dec-16F	Dec-17F
EBITDA	(27.8)	(9.0)	10.8	34.0	50.7
Cash Flow from Invt. & Assoc.					
Change In Working Capital	(60.0)	(119.8)	(105.2)	50.6	41.1
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	(18.3)	(66.8)	(30.1)	(31.6)	(34.8)
Other Operating Cashflow	3.4	(7.0)	0.0	0.0	0.0
Net Interest (Paid)/Received	(6.1)	7.2	3.4	7.1	7.7
Tax Paid	1.1	(3.7)	(3.8)	(9.7)	(14.2)
Cashflow From Operations	**(107.8)**	**(199.2)**	**(124.9)**	**50.4**	**50.6**
Capex	(62.7)	(18.6)	(3.8)	(1.6)	(1.6)
Disposals Of FAs/subsidiaries	2.9	0.1	0.0	0.0	0.0
Acq. Of Subsidiaries/investments	(62.7)	(18.6)	(3.8)	(1.6)	(1.6)
Other Investing Cashflow	149.2	244.2	48.5	3.5	3.5
Cash Flow From Investing	**26.7**	**207.2**	**40.9**	**0.3**	**0.3**
Debt Raised/(repaid)	(108.8)	69.9	(22.8)	(22.7)	(22.7)
Proceeds From Issue Of Shares	48.4	45.9	0.0	0.0	0.0
Shares Repurchased	0.0	(4.0)	0.0	0.0	0.0
Dividends Paid	(7.3)	(65.0)	(20.5)	(20.5)	(23.9)
Preferred Dividends	0.0	0.0	0.0	0.0	0.0
Other Financing Cashflow	(25.9)	(84.8)	(98.7)	(102.2)	(140.9)
Cash Flow From Financing	**(93.6)**	**(38.0)**	**(142.0)**	**(145.4)**	**(187.5)**
Total Cash Generated	(174.7)	(30.0)	(225.9)	(94.6)	(136.7)
Free Cashflow To Equity	**(189.9)**	**77.9**	**(106.8)**	**28.1**	**28.2**
Free Cashflow To Firm	**(73.8)**	**9.3**	**(78.8)**	**55.3**	**55.2**

SOURCE: CIMB RESEARCH, COMPANY

CIMB

BY THE NUMBERS

There is upside to net cash of 25.2 sen/share in 1QFY15 due to repayment of borrowings. Net cash makes up a third of Salcon's market cap of RM582m/US$155m.

Balance Sheet

(RMm)	Dec-13A	Dec-14A	Dec-15F	Dec-16F	Dec-17F
Total Cash And Equivalents	147	303	343	388	401
Total Debtors	243	212	182	179	179
Inventories	26	146	142	128	149
Total Other Current Assets	662	143	1	1	1
Total Current Assets	**1,078**	**804**	**668**	**695**	**730**
Fixed Assets	83	76	80	82	84
Total Investments	36	36	36	36	36
Intangible Assets	4	31	31	31	31
Total Other Non-Current Assets	6	6	6	6	6
Total Non-current Assets	**129**	**150**	**154**	**155**	**157**
Short-term Debt	10	14	13	13	13
Current Portion of Long-Term Debt	0	0	0	0	0
Total Creditors	450	194	164	140	134
Other Current Liabilities	1	2	2	2	2
Total Current Liabilities	**461**	**209**	**179**	**155**	**149**
Total Long-term Debt	21	85	81	77	73
Hybrid Debt - Debt Component	0	0	0	0	0
Total Other Non-Current Liabilities	0	0	0	0	0
Total Non-current Liabilities	**21**	**85**	**81**	**77**	**73**
Total Provisions	4	5	5	5	5
Total Liabilities	**486**	**299**	**265**	**237**	**227**
Shareholders' Equity	506	556	554	610	657
Minority Interests	214	99	3	3	4
Total Equity	**720**	**654**	**557**	**614**	**660**

Revenue growth surges in FY16 as order book crosses critical milestones. Rising NCPS supports higher-than-forecasted DPS payouts assuming no major M&A moves in the next 2-3 years.

Key Ratios

	Dec-13A	Dec-14A	Dec-15F	Dec-16F	Dec-17F
Revenue Growth	(52.1%)	22.7%	0.4%	25.9%	17.0%
Operating EBITDA Growth	(167%)	(68%)	NA	215%	49%
Operating EBITDA Margin	(16.9%)	(4.5%)	5.3%	13.3%	17.0%
Net Cash Per Share (RM)	0.17	0.30	0.36	0.44	0.46
BVPS (RM)	0.74	0.81	0.81	0.89	0.96
Gross Interest Cover	(4.45)	(10.51)	1.15	6.39	10.46
Effective Tax Rate	0.0%	0.0%	30.0%	25.0%	25.0%
Net Dividend Payout Ratio	NA	NA	359%	92%	82%
Accounts Receivables Days	612.3	410.9	355.2	258.9	218.7
Inventory Days	67.3	179.0	305.1	230.0	203.9
Accounts Payables Days	510.0	301.6	247.9	215.0	202.4
ROIC (%)	(2.9%)	(1.8%)	1.1%	7.8%	11.9%
ROCE (%)	(3.58%)	(0.68%)	2.06%	5.94%	7.84%
Return On Average Assets	(2.44%)	(1.13%)	0.71%	2.87%	4.24%

Burn rate of RM200-250m p.a. suggests that current outstanding order book is good for 2-3 years. High domestic tender book of RM1.4bn is likely to translate into new highs for order wins. Higher job win assumptions for FY16-17 is backed by the backlog of water infa jobs and the 11MP.

Key Drivers

(RMm)	Dec-13A	Dec-14A	Dec-15F	Dec-16F	Dec-17F
Outstanding Orderbook	350	650	696	746	1,096
Order Book Depletion	200	220	250	250	250
Orderbook Replenishment	100	600	300	600	600
ASP (% chg, main prod./serv.)	N/A	N/A	N/A	N/A	N/A
Unit sales grth (%, main prod./serv.)	N/A	N/A	N/A	N/A	N/A
Util. rate (%, main prod./serv.)	N/A	N/A	N/A	N/A	N/A
ASP (% chg, 2ndary prod./serv.)	N/A	N/A	N/A	N/A	N/A
Unit sales grth (%,2ndary prod/serv)	N/A	N/A	N/A	N/A	N/A
Util. rate (%, 2ndary prod/serv)	N/A	N/A	N/A	N/A	N/A

SOURCE: CIMB RESEARCH, COMPANY

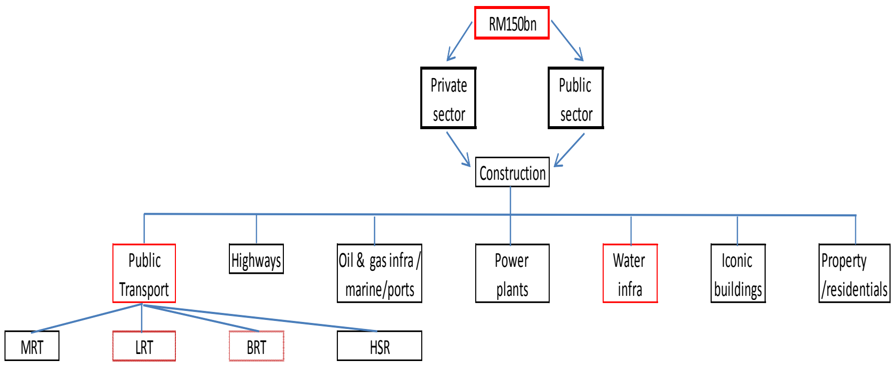
A diamond in the rough

BACKGROUND

Domestic growth story

Salcon's main market segment is the domestic water infra space, where there are fewer highly specialised players compared to the broad construction sector. The group has over 40 years of domestic water infrastructure experience and raised its profile last year by successfully securing large-scale water infra tenders. The group's core focus over the next few years will be on the spillover from the restructuring of water and sewerage assets in Peninsula Malaysia. It has expertise in almost the entire spectrum of jobs related to water works, which means that its tender book potential is not limited to turnkey jobs but also includes the whole value chain (main and sub-contracting, upgrading, non-revenue water) for water treatment plants (WTPs), sewerage treatment plants (STPs) and wastewater facilities. More than 90% of its order book exposure comprises local contracts, with above-industry average margins.

Figure 1: Direct play on the water infra space and indirect play on rail public transport



SOURCE: CIMB RESEARCH, COMPANY

Rebuilding its track record last year

In the past, the group participated in several major water infra works, such as the 2,000 MLD Sg. Selangor Phase 1 and 2 (SSP 1 & 2), sewerage treatment plants in Medini, Iskandar and Sabah, as well as turnkey water supply projects in Sri Lanka and Vietnam. Salcon's first major contract win (after several years) was the RM994m Langat 2 water treatment plant (WTP), which underscores the group's competitiveness and track record. Its competitors in the water/wastewater segment include WET (subsidiary of Loh & Loh), CWM, ABC and Ranhill Construction. However, we believe that Salcon has the dominant market share. The other project that it secured in late 2014 was the Langat sewerage treatment plant (STP) subcontract work worth RM235m (50% share).

Figure 2: Salcon's turnkey capabilities

INVESTMENT
- Design
- Finance
- Construct
- Public Private Partnership (PPP)
  - Concession/ BOOT
  - Build Operate Transfer (first in Vietnam)
  - Transfer Operate Transfer
  - Refurbish Build Operate Transfer

TURNKEY CONTRACTING
- In house design capacity
- Civil & structural works (C&S)
- Mechanical, electrical, instrumentation works (M&E&I)
- Project management (PM)
- Testing & commissioning (T&C)
- Operation & maintenance (O&M)

ASSET MANAGEMENT
- Service goals & standards
- Water consumption, demand management
- Leakage control/ management
- Data management – GIS
- Operation & maintenance
- Materials & workmanship
- System reliability & renewal

SOURCE: COMPANY

Figure 3: Salcon's major jobs in the past

WATER - LOCAL
- Involved in biggest WTP in ASEAN (2000 MLD) – SSP 1 & 2
- Design and construction of Sungai Labu Water Treatment Plant in Sungai Labu, Selangor with total nominal capacity of 105 MLD
- Design and construction of Sungai Terip Water Treatment Plant, Phase 3 in NS with maximum capacity of 179 MLD

Aerial view of Sg. Labu Water Treatment Plant

WATER - OVERSEAS
- Design and construction of Binh An Water Supply Scheme, Ho Chi Minh City, Vietnam under BOT concept with total capacity of 100 MLD
- Construction of Hambantota Water Supply Project, Sri Lanka with total capacity of 15 MLD

Water Treatment Plant in Hambantota, Sri Lanka

WASTEWATER
- Medini Development, Iskandar Malaysia, Johor Sewage Treatment Plant with population equivalent of 500,000 people
- Kota Kinabalu Sewerage Project, Sabah with ultimate population equivalent of 300,000 people

Aerial view of Medini Iskandar Sewage Treatment Plant

SOURCE: COMPANY

All-time high order book

Last year, Salcon succeeded in ramping up its order book to an all-time high at end 2014. It emerged with the largest JV share (36%) of the RM994m Langat 2 WTP contract. The group's package value works out to be RM358m and should yield at least 10% pretax margin, by our estimates. While RM300m-500m worth of a single job may barely move the needle for other larger comparable players, the Langat 2 WTP project translates into substantial order book growth of over 125% to RM696m for Salcon. In perspective, Salcon’s RM285m outstanding order book before Langat 2 WTP would have lasted for only two years, given its construction average run-rate of RM150m-200m p.a. Currently, 95% of its total order book comprises domestic jobs, while the balance is overseas, mainly sewerage and water related.

Figure 4: Details of Langat 2 WTP

Total development cost	:	RM1.2-2bn (as previously reported)
Value of phase 1	:	RM994m
Total processing capacity - phase 1	:	1,130 MLD
Overall processing capacity	:	2,500 MLD (as previously reported)
No. of interested companies	:	65
No. of tender documents distributed	:	15
Project duration - phase 1	:	2-3 years
Completion	:	2016/17
Earlier target award of contracts	:	July 2013
Land parcels to be acquired	:	300 (entire facility)
Parcels acquired as at 2013	:	100
Land required for treatment plant	:	86 lots

SOURCES: CIMB, PRESS REPORTS

CONSTRUCTION OUTLOOK

Potentially more from Langat 2 WTP

Post-restructuring, there may be limited operations and maintenance (O&M) opportunities in the state of Selangor but we do not discount the possibility of more infra opportunities, as the backlog of capex for water works begins implementation. The Langat 2 WTP represents just phase 1 of the project, as the 1,330 MLD constitutes only 45-57% of the total planned capacity of 2,000-2,500 MLD. Extrapolating the RM879k/MLD construction cost, we estimate that the remaining 800 MLD to 1,370 MLD capacity for phase 2 could cost RM700m to RM1.2bn. We believe that Salcon has a fairly good chance of securing the remaining package. Assuming the same JV share, Salcon could be in the running to secure RM276m-434m worth of additional contracts.

Tender book is comparable to those of the bigger players

Salcon's fortunes are not limited to Langat 2. Order book growth and recovery in profitability are also anchored by new sewerage-type/wastewater contracts. In addition, Salcon's full-range water and sewerage expertise suggests that there could be other opportunities to leverage the entire supply chain, including non-revenue water (NRW) services. The group currently sits on a total tender book of RM2.2bn (also at all-time high), with domestic and overseas jobs combined. This is comparable to, if not on par with, the bigger contractors' average tender book of RM2bn-4bn over the next two years.

20-30% success rate, above-industry average margins

We believe that management's target of 20-30% success rate (RM400m-600m worth of new wins - domestic and overseas combined) is not a tall order. We also believe that the next series of order replenishment is likely to come from the domestic side, which is consistent with our expectations of a pick-up in job awards in the sector in 2H. These jobs are likely to yield 9-10% pretax margin (vs. 5-6% for open tender civil works), given the more specialised work scope. We believe that the focus for Salcon would be the implementation of water/wastewater-related projects and infra works under the:

1) 11th Malaysia Plan (11MP).

2) Nationwide water capex by the federal government to build new water facilities and to upgrade existing ones.

3) Wastewater and sewerage systems in key industrial growth areas in Peninsula Malaysia.

Figure 5: Domestic construction projects in tender: worth over RM1bn in total

	Value (RM m)
	CIMB estimate
- Desalination plant for a petroleum related complex in Kertih	400-500
- Various water treatment plants (WTPs) in Perak, Selangor	100-300
- Other packages for Langat 2 WTP	50-200
- Various WTP packages for PAAB (federal government)	50-100
- Various sewerage treatment plants (STPs) in Selangor	200-500

SOURCES: CIMB, COMPANY

REVIVING ITS PROPERTY DIVISION

RM1.5bn incoming property GDV

Salcon's plans to expand its property development business are likely to materialise in 2016, driven by its RM1.5bn (effective share) incoming gross development value (GDV). The bulk of the figure comes from the RM1.2bn GDV mixed development project in Johor. This is a potential 50:50 JV with Eco World Development (ECW MK). The 12.5-acre project is located near the Johor city centre and consists mainly of residential products, which are selling better than those in the high-rise segment. We are fairly confident about this project's success, given Eco World's rising track record as a reputable developer.

Belfield Crest: Land cost and location advantages

Salcon's other venture (not with Eco World) is the 70%-owned Belfield Crest, located in the vacinity of the development of the RM3-5bn KL118 tower (118-story Menara Warisan Merdeka). Salcon is among the three biggest land owners along Jalan Belfield, Jalan Hose and Jalan Talalla. Once completed in 2019, the KL118 (see figure 6) will not only emerge as the next tallest building overtaking Petronas's Twin Towers (KLCC), but also become the new growth area, similar, if not greater than the spillover effects of the KLCC. Salcon's land which is located on Jalan Belfield is therefore a prime location. The RM1.3bn GDV comprises a hotel, service apartments and service suites. Salcon acquired the land at an attractive cost of c.RM400 per sq ft, compared to the current market price that is at least 2x higher.

Figure 6: Artist impression of KL118

SOURCES: www.skyscrapercenter.com

Transformation to earnings stream

Overall, the new property development earnings stream over the next 2-3 years will be positive for Salcon, as it would offset the typically lumpy construction and infra earnings. Based on a conservative pretax margin assumption of 15%, we expect the RM1.5bn balance GDV to contribute RM15m-20m to pretax profit over a conservative six years, based on Salcon's JV stake. This would result in a huge transformation in Salcon's future earnings.

Figure 7: Eco Mid Town (Johor)

- **Project name**: Eco Mid Town
- **Type**: leasehold land
- **Equity stake**: Salcon Berhad's 50.01% owned subsidiary Nusantara Megajuta S/B
- **Total size of lands**: 51,476 sqm (12.5 acres)

- **Proposed development**: Mixed development comprise retail outlets, serviced residences and strata shop-cum-apartments
- **GDV**: RM 1.2 bil

SOURCE: COMPANY

Figure 8: Eco Mid Town - development breakdown

Type	Net Floor Area (m2)	Percentage
Residential	83,007	51.7%
Retail	46,141	25.7%
Commercial	23,668	13.2%
Hotel	16,932	9.4%
Total	169,748	100.0%

SOURCE: COMPANY

VBT: EXPOSURE TO GROWTH IN RAIL PUBLIC TRANSPORT

New recurring income asset

Over the past 10-15 years, Salcon has ventured into several build-operate-transfer (BOT) projects, both locally and overseas. Its first few ventures were: 1) an Ipoh water supply concession (330 MLD), the group's maiden domestic water concession, which was sold to Intan Utilities several years ago, 2) a BOT project in Vietnam, and 3) a Changle water supply project in China. The China BOT expanded into eight other similar water supply/water treatment-type ventures. In Sep 2013, Salcon signed a RM518.3m deal to sell all of its China water concessions to Beijing Water Enterprise (BEW).

With over RM300m in net cash proceeds, Salcon then signed an agreement to acquire a 50.1% stake in Volksbahn Technologies Sdn Bhd(VBT) for RM23.5m. A major milestone this year was the MOU signed between VBT and Celcom on 20 April, which, could translate to the signing of the group's first revenue stream. Broadband access and the utilisation of broadband-related services on rail is the first of its kind in Malaysia. We do not discount the buy-ins of other medium/major telco operators as VBT provides an additional means for telco operators to expand its network and services.

50.1% stake in VBT to lay fibre optic cables on rail network

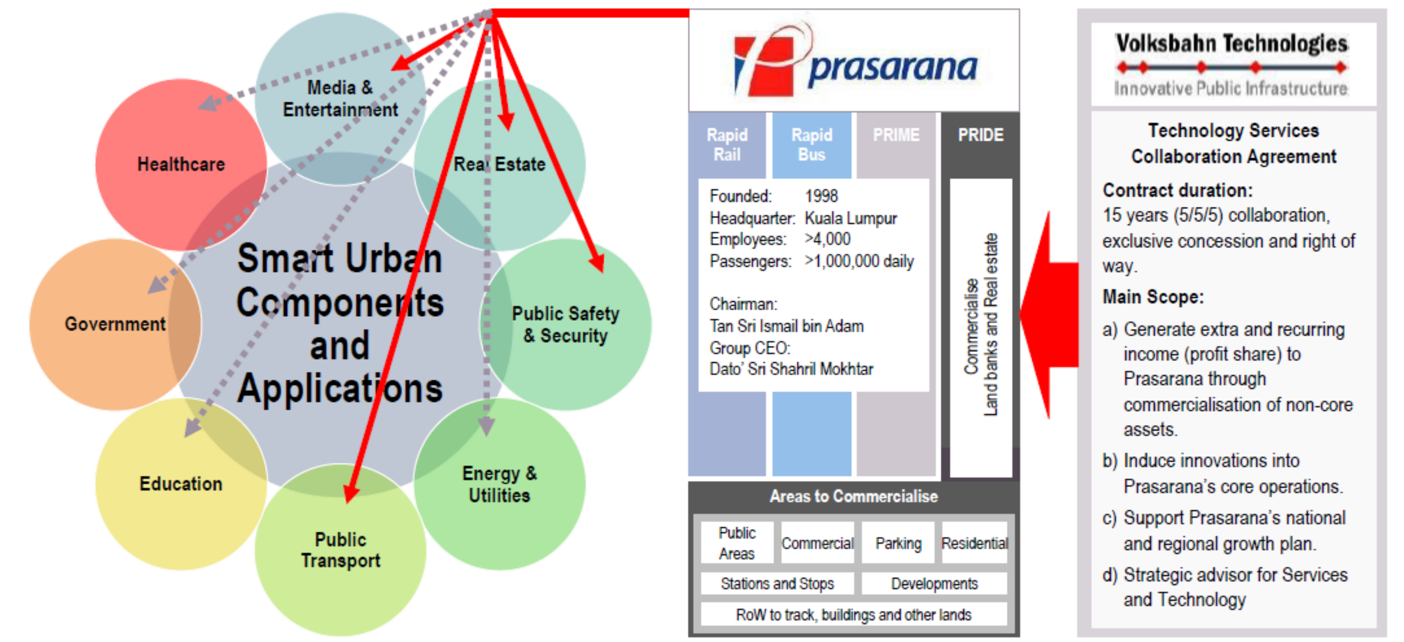
In our view, VBT is the crown jewel. It provides integrated technology services to the Prasarana group of companies, the owner of major LRT and monorail network assets in the Klang Valley. VBT has been granted exclusive rights to lay 108km of fibre optic cables on Prasarana's rail network and premises for up to 15 years (5+5+5). Based on our industry checks, we understand that the lucrative part of the deal (after the laying of fibre optic cables on the existing and expanded LRT and monorail lines) is the monetisation of the fibre optic network via either (or a combination) of the generic components below:

1) direct lease agreements with telco operators on a per km basis, or

2) a broadband wholesale model, as widely applied in the rights-of-way model used in European countries, and/or

3) rental income on the cellular sites.

Figure 9: How VBT fits into Prasarana's agenda

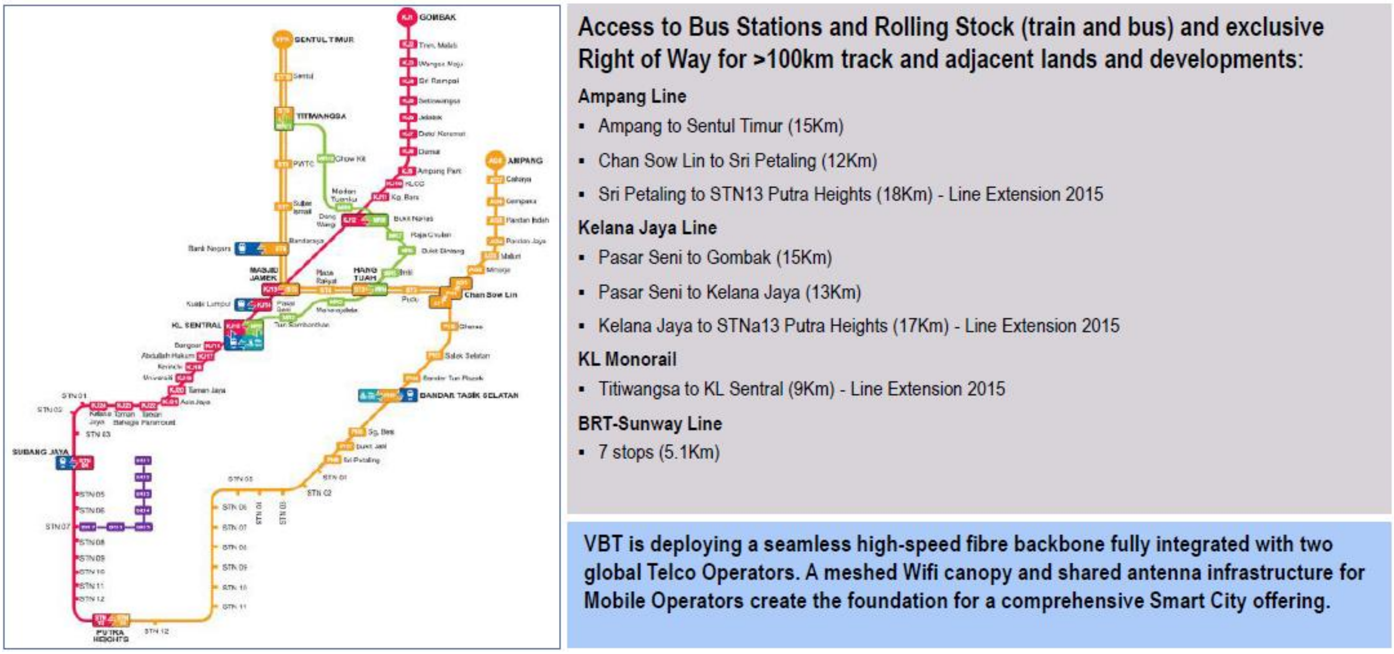


SOURCE: COMPANY

Arguably more lucrative than winning an LRT building contract

Monetisation of this asset will kick off once VBT begins inking agreements with other telco players. For telco operators, the appeal would lie in the c.400k-500k ridership/day on the LRT. This figure is expected to rise to over 1m ridership/day once all LRT extensions are fully operational. Theoretically, there should be upside to VBT's profit potential, considering that any potential new contracts with telco operators only applies to the existing 70km of LRT and Monorail, and have not included the extension of the LRT (44km). In perspective, we view the 15-year concession that leverages on the growing rail usage as more lucrative than a typical lower-margin rail construction project, given the wide scope of revenue generation and lucrative net margin; much higher than the single-digit margin for a typical open tender rail job.

Figure 10: Relevant rail/public transport infrastructure under VBT



SOURCE: COMPANY

RISKS & SWOT ANALYSIS

Execution and delays

Project execution and delay risks are typical challenges for contractors/infra companies, as demonstrated by the rollout of sizeable domestic contracts in the past, such as MRT and the long-overdue award of the Langat 2 WTP., we believe that the local water/wastewater scene could be exciting in the next few years in view of the rollout of the government's budget to restructure water assets and more initiatives to integrate or build new sewerage treatment plants nationwide.

Further delays to the water industry restructuring in Selangor

Risk to the water infra story in relation to Salcon are the persistent delays in the resolution to the water restructuring initiatives in Selangor. This may give rise to payment issues for the Langat 2 WTP and Langat STP as both of these jobs are located in the state of Selangor. Delay risks could translate to lower revenue p.a. due to payment issues as the project could stretch beyond the 3-4 year period. Our earnings forecasts based on the RM696m outstanding order could fall below the average run rate of RM190m p.a. Based on our sensitivity calculation, a 6-12 months delay beyond the average 3-4 years construction time line would cut EPS by 5-6%.

Job flow outlook

The outlook for job flows in this segment is positive in 2H15 onwards, given the pending awards for other water/wastewater jobs in the state of Selangor and those related to other statewide growth areas. Also, we view the high likelihood of Salcon securing new overseas jobs as a plus. We have assumed RM300-600m of new jobs p.a.

Partnership with Eco World

We believe that the execution risk for the group's new property development ventures could be mitigated by its JV with Eco World Development. We do not discount the possibility of other new ventures, although details are limited at this point.

Figure 11: SWOT analysis

Strenghts	Opportunities
- A leading water infra contractor	- M&A's and new recurring income assets
- All-time high order book	- Backlog of government-led water infra spending
- Net cash position	- Overseas jobs
- Prime land bank	- Upside to VBT's rights-of-way coverage
- Owns rail rights-of-way via VBT	- Property JV with Eco World
Weaknesses	**Threats**
- Lumpy earnings due to construction	- Slower-than-expected success rate for VBT
- Slow monetisation of land bank	- Political risks on government jobs
- Weak market perception on the VBT deal	- Execution and delays on current jobs
	- More delays to Selangor water restructuring

SOURCES: CIMB, COMPANY REPORTS

FINANCIALS

Transitioning away from volatile earnings

Excluding the remaining potential net gain from the monetisation of its China water assets, we expect Salcon's net profit to slowly turn around in FY15 and continue improving in FY16 onwards, due to the transitioning from a volatile earnings trend in the past (see Figure 12), to a more stable and predictable one. As at end-FY14, the group reported a minor net profit (excluding discontinued operations in China) due to the recognition timing of the Langat 2 project and existing jobs. Based on our assumptions, Salcon's overall earnings outlook is as follows:

We expect the turnaround in earnings to be driven by several stages:

1) The group's outstanding RM696m order book that is good for the next 3 years, in view of its burn rate of RM180m p.a.

2) Maiden contribution from 50.1%-owned VBT, based on our assumption of initial contracts from two Telco operators.

3) Monetisation of land bank from 2H16 - Belfield Crest and Eco Mid Town should contribute an effective GDV share of RM1.5bn over the next 5-6 years.

We expect FY15 to be a non-event, but forecast an improvement in net profit margin from FY16 due to:

1) The above average construction pretax margin of 9-10% that makes up more than 50% of the group's outstanding order book. The two big water contracts should contribute strong numbers from 2H15.

2) The more lucrative margins from 50.1%-owned VBT. We forecast pretax margins of 30-40% in the initial 2 years. There is upside due to the operating leverage effect and additional revenue streams.

3) The 15-20% pretax margin from property development which is achievable due to Salcon's land cost advantage.

Figure 12: Salcon's historical 4-year segmental breakdown

	FY11	FY12	FY13	FY14
Revenue				
Construction	240.2	141.9	155.3	185.0
Concessions (only Vietnam from FY13)	218.6	189.0	1.2	1.2
Others	14.0	13.0	13.3	15.7
Property development	0.0	0.0	0.0	0.0
Discontinuing ops	0.0	0.0	202.9	70.7
Total	**472.8**	**343.9**	**372.6**	**272.6**
EBIT				
Construction	14.0	-11.0	-19.2	0.7
Concessions (only Vietnam from FY13)	32.3	59.7	1.7	4.5
Others	2.1	4.0	0.7	-8.4
Property development	0.0	0.0	0.0	-1.2
Discontinuing ops	0.0	0.0	95.7	39.6
Total	**48.4**	**52.7**	**78.8**	**35.3**
% of revenue				
Revenue				
Construction	51%	41%	42%	68%
Concessions (only Vietnam from FY13)	46%	55%	0%	0%
Others	3%	4%	4%	6%
Property development	0%	0%	0%	0%
Discontinuing ops	0%	0%	54%	26%
Total	**100%**	**100%**	**100%**	**100%**
% of EBIT				
Construction	29%	-21%	-24%	2%
Concessions (only Vietnam from FY13)	67%	113%	2%	13%
Others	4%	8%	1%	-24%
Property development	0%	0%	0%	-3%
Discontinuing ops	0%	0%	121%	112%
Total	**100%**	**100%**	**100%**	**100%**
EBIT margin				
Construction	6%	-8%	-12%	0%
Concessions (only Vietnam from FY13)	15%	32%	145%	378%
Others	15%	31%	5%	-53%
Property development	nm	nm	nm	nm
Discontinuing ops	nm	nm	47%	56%
Total	**10%**	**15%**	**21%**	**13%**

SOURCES: CIMB, COMPANY REPORTS

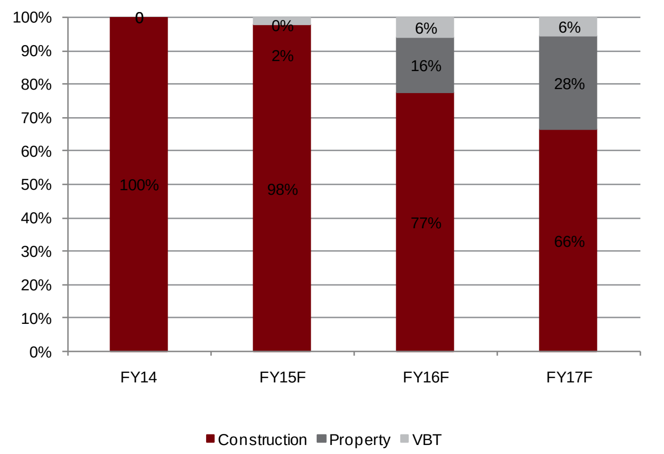
We forecast Salcon's revenue break down to include new businesses from FY15.

1) Contribution from the construction division to fall from 100% of revenue in FY14 to 98% in FY15, 77% in FY16 and 66% in FY17.

2) 50.1%-owned VBT to begin chipping in 2% of revenue from FY15, but rising to 6% in FY16 and FY17 - these assumptions are conservative and arguably have upside.

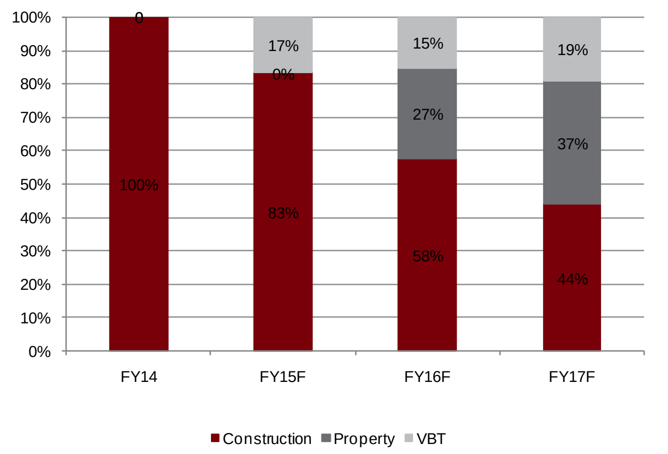
3) New property development revenue from FY16 based on Salcon's target launch of 2H16. We forecast property development to contribute 0% in FY15, 16% in FY16, and 28% in FY17.

Figure 13: New revenue streams from FY15



SOURCE: CIMB

Figure 14: EBIT profile changes with VBT and property



SOURCE: CIMB

We forecast Salcon's break down of EBIT to feature higher-margin ventures.

1) The proportion of construction EBIT from the RM696m of outstanding order book (9-10% margin) to decline from 100% in FY14, to 83% in FY15, 58% in FY16, and 44% in FY17.

2) Despite a low base-case revenue for VBT, recurring earnings contribution is forecasted to make up 15-19% of EBIT in FY15-17, based on 30-40% margins.

3) Property development to bring in new earnings only from FY16, at 27-37% of EBIT.

Figure 15: EBIT assumptions by division (RM m)

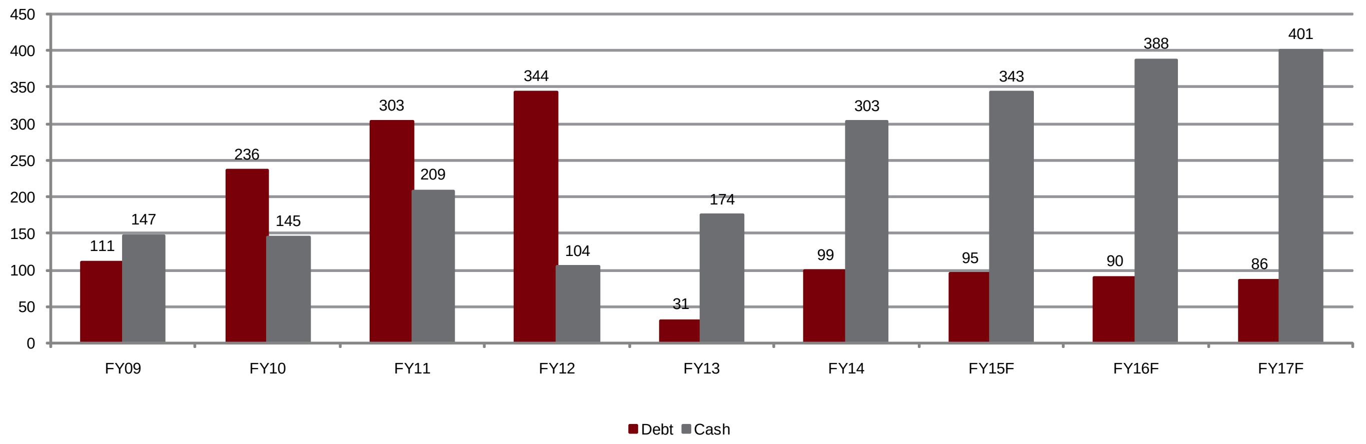
	FY15	FY16	FY17	Notes
Construction	4.0	17.8	19.8	FY15 reflects slow progress billings. Progress billings from FY16 to accelerate based on 9-10% margin
Property	0.0	6.3	16.7	Launches from 2H16 based on 15-20% margin and RM1.5bn effective share of incoming GDV
VBT	2.0	4.8	8.8	30-40% margin assumption has upside due to operating leverage and new revenue streams
Total	**6.0**	**28.8**	**45.2**	
% of EBIT				
Construction	66%	62%	44%	Driven mainly by RM696m outstanding order book
Property	0%	22%	37%	Land bank location and land cost advantage
VBT	34%	17%	19%	VBT has more upside over the longer-term
Total	**100%**	**100%**	**100%**	

SOURCES: CIMB, COMPANY REPORTS

Net cash comprises 30% of market value

Salcon's balance sheet is healthy, with a net cash position as at 1QFY15. The net cash level could grow to over RM400m by end-FY16, driven by the completion of the China asset divestments and new cash flows from VBT. The group's total debt has declined from over RM300m over three years ago to RM99m at end-FY14 as most of the borrowings were tied to the eight water concessions in China.

Figure 16: Around RM40m additional tail-end cash upon completion of China water assets sale in 2015



SOURCES: CIMB, COMPANY REPORTS

VALUATION AND RECOMMENDATION

Stock trades at a steep 34% discount to RNAV

In our view, the RNAV valuation method is the best way of reflecting Salcon's asset base, apart from the recovery in net profit for the construction segment. Key components of our RNAV are: 1) the estimated FY16 construction net profit of RM13.5m (mainly from the Langat 2 WTP, new sewerage plant jobs) pegged to 15x target P/E, in line with our construction coverage, 2) the estimated DCF value of 50.1%-owned VBT, based on RM10m-15m revenue p.a. for up to 15 years at 7% WACC, 3) BV of the remaining water concessions in Vietnam, 4) the 12.5-acre landbank for Eco Mid Town at RM350 per sq ft, 5) the 0.9-acre Selayang land at RM250 per sq ft, and 3) the 5.4-acre prime land for Belfield Crest at RM1,100 per sq ft. After accounting for other main balance sheet items, we arrive at an RNAV/share of RM1.62. The stock trades at a steep 34% discount to RNAV.

RM1.30 target price at 20% RNAV discount

We initiate coverage with an Add and a RM1.30 target price, which is based on a 20% discount to RNAV. The discount is at the lower end of the 10-50% range that we apply to the construction stocks under our coverage. In spite of its relatively small market cap and lower ROE's, we believe that Salcon deserves to be valued at a narrower RNAV discount versus its water infra peers, as in our view, Salcon business model is shaping up to be comparable to most of the bigger and more mature construction conglomerates. Net cash constitutes 30% of its market cap (1QFY15 NCPS: 25.2 sen). We forecast 3-year EPS CAGR of 76% driven by a turnaround in net profit, including that of property development.

Figure 17: RNAV

	FY16	P/E		Stake	Value
	RM m	(x)		(%)	(RM m)
Construction net proft	13.5	15		100%	202.7
	DCF value	WACC		Stake	
	(RM m)	(%)		(%)	
15-year concession (VBT, RM10-15m base-case revenue p.a.)	100.1	7%		50.1%	50.2
Water concession in Vietnam (110 MLD) at BV	75.0			36%	27.0
Land bank	**Acres**	**m sq ft**	**RM psf**	**Stake**	
Eco Mid Town - Johor	12.5	0.54	350	50%	95.3
Res 280 - Selayang	0.98	0.04	250	50%	5.4
Belfield Crest	5.35	0.23	1100	70%	179.4
Cash (1Q15)					269.4
Remaining proceeds from China water assets monetisation					40.0
Borrowings (1Q15)					(96.6)
Property investments					8.4
Investment in associate & JVs					53.0
Net current asset less property dev. cost					272.5
RNAV					**1,106.8**
No. of shares (m)					683.5
RNAV/share (RM)					**1.62**
RNAV discount (%)					20%
Target price (RM)					**1.30**

SOURCES: CIMB, COMPANY REPORTS

The stock is ripe for a re-rating

Likely catalysts in the next 6-12 months:

1) Investors sustained interest in selected undervalued small cap companies which offer recovering fundamentals.

2) Salcon securing more domestic projects backed by water infrastructure plans under the 11th Malaysia Plan (11MP), and the backlog of water and sewerage projects.

3) VBT securing its maiden contracts with telco operators.

4) VBT scaling up its fiber optic asset concession on rail to include other variations of revenue generation, and the likely extension of the concession to cover MRT lines.

5) Securing more land banks as it leverages on its partnership with Eco World.

6) Securing overseas water infra jobs.

7) Management realising its commitment to higher dividends.

RNAV sensitivity to VBT concession value and discount

We estimate more upside to RNAV, as our base-case DCF value for VBT contributes 5% (7.3 sen/share) of Salcon's RNAV, assuming earnings contribution from two telcos. Working on a doubling of the DCF value, which should reflect additional contracts, more scope of revenue streams, and the effect of operating leverage, we estimate Salcon RNAV to be RM1.69/share, or an indicative target price of RM1.35/share (unchanged 20% discount). This implies an almost 60% upside. Separately, in terms of earnings impact, we estimate a 15-20% upside to FY16-17 EPS if EBIT contributions from VBT doubles from the RM4-9m p.a. to RM10-18m p.a.

Figure 18: Sensitivity of base-case RNAV of RM1.62/share based on VBT DCF value of RM50.2m (Salcon's share) on various RNAV discounts

RNAV discount	Target price (RM)	Upside
50%	0.81	-5%
40%	0.97	14%
30%	1.13	33%
20%	1.30	52%
10%	1.46	72%
0%	1.62	91%

SOURCES: CIMB, COMPANY REPORTS

Figure 19: Sensitivity of higher RNAV of RM1.69/share based on a doubling of VBT DCF value to RM100.3m (Salcon's share) on various RNAV discounts

RNAV discount	Target price (RM)	Upside
50%	0.85	-1%
40%	1.01	19%
30%	1.18	39%
20%	1.35	59%
10%	1.52	79%
0%	1.69	99%

SOURCES: CIMB, COMPANY REPORTS

Likely in the big league in the longer term

1) Over the longer term, we view Salcon as one of the major beneficiaries of the ongoing water/wastewater-related expenditure under the 11th Malaysia Plan (11MP), while new growth areas have spurred new tenders over the past 12-18 months. We view these as major opportunities for Salcon's construction business and one of the major potential re-rating catalysts in 2H15.

2) Salcon has indirect exposure to the growth of rail public transport through its new recurring income venture. The group has already secured first-mover advantage through VBT, which could shape up to be a big player domestically, given its ownership of rail rights-of-way.

3) Overall, this translates into: 1) transformation of Salcon's earnings profile from volatile but still above-industry average construction margins to stable high-double-digit margins, and 2) more predictable cash flows, with potentially higher dividends of over 3 sen/share p.a. If Salcon raises its DPS to 5 sen, potential dividend yield is 5.8%.

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Score Range:	90 - 100	80 - 89	70 - 79	Below 70 or	No Survey Result
Description:	Excellent	Very Good	Good	N/A	

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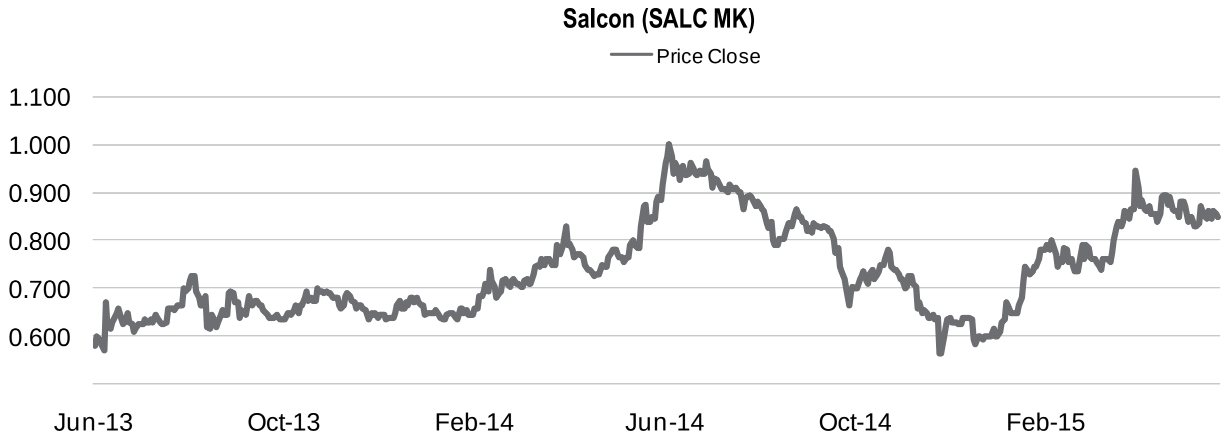
Distribution of stock ratings and investment banking clients for quarter ended on 31 March 2015 1420 companies under coverage for quarter ended on 31 March 2015		
	Rating Distribution (%)	Investment Banking clients (%)
Add	55.4%	6.6%
Hold	31.3%	3.8%
Reduce	13.2%	1.3%

Spitzer Chart for stock being researched (2 year data)



Corporate Governance Report of Thai Listed Companies (CGR). CG Rating by the Thai Institute of Directors Association (Thai IOD) in 2014.
AAV – Very Good, **ADVANC** – Very Good, **AEONTS** – not available, **AMATA** - Good, **ANAN** – Very Good, **AOT** – Very Good, **AP** - Good, **ASK** – Very Good, **ASP** – Very Good, **BANPU** – Very Good , **BAY** – Very Good , **BBL** – Very Good, **BCH** – not available, **BCP** - Excellent, **BEAUTY** – Good, **BEC** - Good, **BECL** – Very Good, **BGH** - not available, **BH** - Good, **BIGC** - Very Good, **BJC** – Good, **BLA** – Very Good, **BMCL** - Very Good, **BTS** - Excellent, **CCET** – Good, **CENTEL** – Very Good, **CHG** – not available, **CK** – Very Good, **CPALL** – not available, **CPF** – Very Good, **CPN** - Excellent, **DELTA** - Very Good, **DEMCO** – Good, **DTAC** – Very Good, **EA** - Good, **ECL** – not available, **EGCO** - Excellent, **GFPT** - Very Good, **GLOBAL** - Good, **GLOW** - Good, **GRAMMY** - Excellent, **HANA** - Excellent, **HEMRAJ** – Very Good, **HMPRO** - Very Good, **ICHI** - not available, **INTUCH** - Excellent, **ITD** – Good, **IVL** - Excellent, **JAS** – not available, **JUBILE** – not available, **KAMART** – not available, **KBANK** - Excellent, **KCE** - Very Good, **KGI** – Good, **KKP** – Excellent, **KTB** - Excellent, **KTC** – Good, **LH** - Very Good, **LPN** – Very Good, **M** - not available, **MAJOR** - Good, **MAKRO** – Good, **MBKET** – Good, **MC** – Very Good, **MCOT** – Very Good, **MEGA –** Good, **MINT** - Excellent, **OFM** – Very Good, **OISHI** – Good, **PS** – Very Good, **PSL** - Excellent, **PTT** - Excellent, **PTTEP** - Excellent, **PTTGC** - Excellent, **QH** – Very Good, **RATCH** – Very Good, **ROBINS** – Very Good, **RS** – Very Good, **SAMART** - Excellent, **SAPPE** - not available, **SAT** – Excellent, **SAWAD** – not available, **SC** – Excellent, **SCB** - Excellent, **SCBLIF** – Good, **SCC** – Very Good, **SCCC** - Good, **SIM** - Excellent, **SIRI** - Good, **SPALI** - Excellent, **STA** – Very Good, **STEC** - Good, **SVI** – Very Good, **TASCO** – Good, **TCAP** – Very Good, **THAI** – Very Good, **THANI** – Very Good, **THCOM** – Very Good, **THRE** – not available, **THREL** – Good, **TICON** – Good, **TISCO** - Excellent, **TK** – Very Good, **TMB** - Excellent, **TOP** - Excellent, **TRUE** – Very Good, **TTW** – Very Good, **TUF** - Good, **VGI** – Very Good, **WORK** – not available.

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Stock Ratings	Definition:
Add	The stock's total return is expected to exceed 10% over the next 12 months.
Hold	The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
Reduce	The stock's total return is expected to fall below 0% or more over the next 12 months.

The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.

Sector Ratings	Definition:
Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

Country Ratings	Definition:
Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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