

UPDATE REPORT

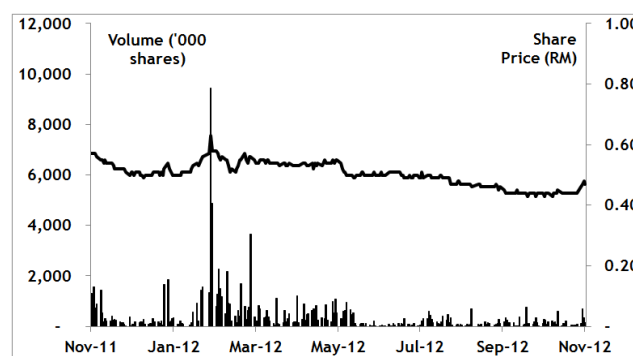
13 August 2012

Name of PLC: <i>Salcon Berhad (Salcon)</i>	Target Price:	RM 0.78
Business Summary : <i>Investment holding company involved in water and wastewater treatment, raw water transfer via concession and O&M contract, as well as water construction</i>		
Major Shareholders :	<i>Dato' Seri (Dr.) Goh Eng Toon</i>	12.8%
	<i>Tan Sri Dato' Tee Tiam Lee</i>	10.8%
<i>(as at 25 April 2012)</i>		
PLC Website : www.salcon.com.my	Recommendation:	BUY
IR Contact : <i>Ms Chern Meng Gaik</i> mgchern@salcon.com.my	Market Capitalisation:	RM245.2m
<ul style="list-style-type: none"> - <i>FBM Small Cap</i> - <i>FBM Emas Shariah</i> 	Current Price :	RM 0.47
	Market / Sector:	Trading/Services
	Stock Code:	8567
Analyst : Lim Boon Ngee <i>Tel : +603 2163 3200; Email : bnlim@nra.com.my</i>		

Key Stock Statistics	2010	2011	2012F	2013F
EPS (sen)	5.7	3.1	1.8	3.1
P/E (x)	8.3	15.2	26.4	14.9
Dividend/Share (sen)	1.5	1.5	1.5	1.5
NTA/Share (RM)	0.65	0.79	0.77	0.78
Book Value/Share (RM)	0.68	0.82	0.79	0.81
Issued Capital (mil shares)	473.5	474.3	521.7	521.7
52-weeks Share Price Range (RM)			0.43 - 0.67	

Per Share Data	2010	2011	2012F	2013F
Year-end 31 Dec				
Book Value (RM)	0.68	0.82	0.79	0.81
Operating Cash Flow (sen) (20.1)	(11.9)	(2.1)	8.6	
Earnings (sen)	5.7	3.1	1.8	3.1
Dividend (sen)	1.5	1.5	1.5	1.5
Payout Ratio (%)	26.6	48.6	84.4	47.7
PER (x)	8.3	15.2	26.4	14.9
P/Cash Flow (x)	(2.3)	(4.0)	(22.3)	5.5
P/Book Value (x)	0.7	0.6	0.6	0.6
Dividend Yield (%)	3.2	3.2	3.2	3.2
ROE (%)	8.4	4.1	2.3	3.9
Net Gearing (%)	28.2	22.8	23.9	20.1

P&L Analysis (RM mil)	2010	2011	2012F	2013F
Revenue	549.9	472.5	318.7	406.0
Operating Profit	37.4	38.8	40.4	55.4
Depreciation	(11.7)	(14.0)	(16.8)	(17.7)
Finance, net	(1.1)	(12.6)	(14.1)	(13.9)
Associate	3.6	2.9	4.0	4.0
EI	5.5	-	-	-
Pre-tax Profit	44.1	29.1	30.3	45.5
Effective Tax Rate (%)	(19.5)	(12.7)	(20.0)	(20.0)
Net Profit	26.8	14.6	9.3	16.4
Operating Margin (%)	6.8	8.2	12.7	13.6
Pre-tax Margin (%)	8.0	6.1	9.5	11.2
Net-Margin (%)	4.9	3.1	2.9	4.0

Share Price Chart

1. Recent developments

- Salcon has announced to terminate the wastewater concession agreement of a TOT project in Changzhou, Jiangsu Province, China.
- To recap, Salcon signed a concession agreement with Changzhou City Tian Ning District Diao Zhuang Street Office in Mar-2011 to acquire, upgrade, operate and maintain the Changzhou Southeast Industrial Wastewater Treatment Plant (Changzhou Southeast Industrial WWTP) for RMB60.0m (RM27.7m).
- This is a 30 year TOT project with a capacity of 30 MLD upon completion of the upgrading works.
- The reason for the termination is due to government buyback for redevelopment of the industrial zone into a new city.

2. Earnings Outlook

- Upon completion of the upgrading work, which was completed in Mar-12, this project was supposed to potentially add RMB 21.6m (RM10.0m) to its turnover based on the minimum water volume of 17.8MLD (based on 320 days for first 5 years) and the agreed treatment fee of RMB3.8/m³. As the project is still at its initial stage of operation and coupled with its much smaller capacity, the impact to Salcon is negligible.
- Salcon's cumulative investment amounts to RMB62.5m (RM30.6m). With the expected net compensation of RMB63.3m (RM31.0m), the termination is expected to result in an investment gain of RMB0.8m (RM0.4m).
- Beginning FY12, Salcon's larger-capacity concessions such as Changle new WTP (100 MLD) and Changle Raw Water (100 MLD) will start to contribute more significantly to the group. The commissioning of Nan An Raw Water (175 MLD) and completion of the acquisition of Wukang and Qian Yua WTPs will drive earnings in FY13.

Production Capacity of China Concessions (MLD as at end-FY)

	FY09	FY10	FY11	FY12	FY13	
Changle sewage treatment plant	40	40	40	40	40	
Linyi water treatment plant	150	150	150	150	150	
Haining water treatment plant	150	300	300	300	300	
Changle water treatment plant (existing/new)	40	WIP	WIP	100	100	operational in 1QFY12
Changle raw water transfer project	WIP	WIP	WIP	100	100	operational in 1QFY12
Yizheng water supply project	-	-	WIP	50	50	operational in 1QFY12
Yizheng sewage treatment plant	-	-	WIP	50	50	operational in 1QFY12
Nan An raw water supply project	WIP	WIP	WIP	175	350	operational in 3QFY12
Wukang water treatment plants	-	-	-	60	60	JV with Darco
Qian Yua water treatment plants	-	-	-	100	100	JV with Darco
Total	380	490	490	1,125	1,300	

3. Valuation and Recommendation

- The stock is currently trading at a 41% discount to its book value of RM0.80/share, which does not reflect the promising long-term prospects of its growing concession-based business in China. We are maintaining our Buy recommendation on Salcon.

Disclosures/Disclaimer

Investment ratings:

Buy (generally >10% upside over the next 12 months)

Hold (generally negative 10% downside to positive 10% upside over the next 12 months)

Sell (generally >10% downside over the next 12 months)

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