

2Q FYE DEC 2011 RESULTS REPORT

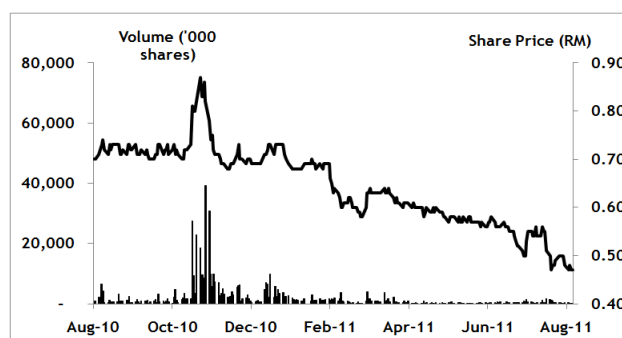
Date: 26 August 2011

Name of PLC: Salcon Berhad (Salcon)		Target Price:	RM 0.75
Business Summary : Investment holding company involved in water and wastewater treatment, raw water transfer via concession and O&M contract, as well as water construction			
Major Shareholders :			
Dato' Seri Goh Eng Toon			14.1%
Dato' Tee Tiam Lee			11.8%
(as at 29 April 2011)			
PLC Website : www.salcon.com.my		Recommendation:	Buy
IR Contact : Ms Chern Meng Gaik mgchern@salcon.com.my		Market Capitalisation:	RM 222.6m
- FBM Small Cap - FBM Emas Shariah		Current Price :	RM 0.47
		Market / Sector:	Trading/Services
		Stock Code:	8567
Analyst : Lim Boon Ngee			
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Key Stock Statistics	2009	2010	2011F	2012F
EPS (sen)	4.7	4.5	3.7	5.5
P/E (x)	10.0	10.5	12.6	8.5
Dividend/Share (sen)	1.5	1.5	1.5	1.5
NTA/Share (RM)	0.63	0.62	0.77	0.81
Book Value/Share (RM)	0.66	0.65	0.80	0.84
Issued Capital (mil shares)	467.7	473.5	473.5	473.5
52-weeks Share Price Range (RM)	0.45 - 0.89			

Per Share Data	2009	2010	2011F	2012F
Book Value (RM)	0.66	0.65	0.80	0.84
Operating Cash Flow (sen)	9.3	1.4	12.6	2.2
Earnings (sen)	4.7	4.5	3.7	5.5
Dividend (sen)	1.5	1.5	1.5	1.5
Payout Ratio (%)	31.8	33.4	40.3	27.2
PER (x)	10.0	10.5	12.6	8.5
P/Cash Flow (x)	5.1	34.6	3.7	20.9
P/Book Value (x)	0.7	0.7	0.6	0.6
Dividend Yield (%)	3.2	3.2	3.2	3.2
ROE (%)	7.4	6.9	5.1	6.7
Net Gearing (%)	n.c.	29.4	5.8	10.4

P&L Analysis (RM mil)	2009	2010	2011F	2012F
Revenue	369.9	418.2	404.0	488.9
Operating Profit	33.6	31.5	34.7	50.3
Depreciation	(10.7)	(14.9)	(20.2)	(22.8)
Finance, net	(4.0)	(3.8)	(3.5)	(2.8)
Associate	3.8	3.6	4.0	4.0
EI	-	5.9	-	-
Pre-tax Profit	33.5	37.2	35.2	51.5
Effective Tax Rate (%)	(22.1)	(22.8)	(25.0)	(25.0)
Net Profit	22.1	21.3	17.6	26.1
Operating Margin (%)	9.1	7.5	8.6	10.3
Pre-tax Margin (%)	9.0	8.9	8.7	10.5
Net-Margin (%)	6.0	5.1	4.4	5.3

Share Price Chart

1. 2QFY11 Results Highlight

	2QFY11	2QFY10	Chg
	RMm	RMm	%
Revenue	100.6	108.6	(7.4)
Operating Profit	6.1	13.5	(55.2)
Finance cost	(1.8)	(2.8)	(36.3)
Associates	0.9	0.9	(0.9)
EI	-	5.9	n.m.
Pre-tax Profit	5.2	17.5	(70.6)
Net Profit	0.4	12.9	(97.1)
Operating Margin (%)	6.0	12.5	
Pre-tax Margin (%)	5.1	16.2	
Net-Margin (%)	0.4	11.9	

- Salcon reported a disappointing 2QFY11 results that was affected by exceptional items and start-up expenses.

- In 2QFY11, while turnover only declined by 7.4% to RM100.6m, net profit plunged by 97.1% to RM5.2m. The disappointing results was due to the following reasons:
 - 2QFY10 included an exceptional gain from disposal of property amounted to RM5.5m;
 - EBIT from Construction division declined by 34.8% to RM1.0m in 2QFY11 due to lower margin of construction projects; and
 - Concession division's EBIT also dropped by 12.4% in 2QFY11 to RM5.0m due to start-up and procurement expenses of China's Changzhou concession and unrealised foreign currency translation losses. This Changzhou Southeast Industrial WWTP with a capacity of 30 MLD was recently awarded to Salcon in Mar-11. By extrapolating the increase in administrative expenses in 2QFY11, the start-up expenses and unrealised forex loss combined could amount to RM4.1m in 2QFY11.

1HFY11 Results Highlight

	1H 2011	1H 2010	Chg
	RMm	RMm	%
Revenue	211.0	221.6	(4.8)
Operating Profit	14.1	23.9	(40.8)
Finance cost	(3.7)	(3.8)	(2.0)
Associates	1.4	1.7	(14.8)
EI	-	5.9	n.m.
Pre-tax Profit	11.8	27.6	(57.2)
Net Profit	4.7	18.5	(74.8)
Operating Margin (%)	14.1	22.0	
Pre-tax Margin (%)	11.8	25.4	
Net-Margin (%)	4.6	17.0	

- For 1HFY11, while turnover was only marginally lower by 4.8% at RM211.0m, net profit declined sharply by 74.8% to RM4.7m.
- This was mainly attributed to the absence of exceptional gain of RM5.5m which was included in 2QFY10, the start-up and procurement expenses of China's Changzhou concession and unrealised foreign currency translation losses.

2. Earnings Outlook

- Annualised net profit for 1HFY11 is significantly below our earnings forecast for FY11. We are still of the view that earnings performance will be better in 2HFY11 as well as FY12 due to more meaningful contribution from its China concessions and absence of those exceptional items. Nonetheless, we have reduced our earnings forecast by 16% for FY11 to account for the lower margin of construction projects and higher administrative expenses.
- Salcon's current profit base especially its China concession has yet to reach its full potential as the larger-capacity concessions such as Changle new WTP (100MLD), Changle Raw Water (100MLD) and Nan An Raw Water (175MLD) will only be commissioned towards the later part of FY11. 2HFY11 should also see more meaningful contribution from Haining WTP (300MLD) which was commissioned in 4QFY10.

Production Capacity of China Concessions

Concessions	Production Capacity (MLD) as at end-FY		
	FY09	FY10	FY11
Changle Water Treatment Plant (existing/new)	40	WIP	100
Changle Sewage Treatment Plant	40	40	40
Linyi Water Treatment Plant	150	150	150
Haining Water Treatment Plant	150	300	300
Changle Raw Water Transfer Project	WIP	WIP	100
Nan An Raw Water Supply Project	WIP	WIP	175
Yizheng Water Supply Project	-	-	50
Yizheng Sewage Treatment Plant	-	-	50
Changzhou Southeast Industrial WWTP	-	-	30
Total	380	490	995

3. Valuation and Recommendation

- For FY11, its earnings base is depressed by exceptional items and costs associated to progressive commissioning of its larger-capacity concessions. However, we are maintaining our Buy recommendation on Salcon for the earnings growth in FY12-FY13 arising from the doubling in production capacity towards the latter part of FY11.
- The stock is currently trading at 37% discount to its book value of RM0.75/share. The slide in its share price is not warranted as it does not reflect the promising long-term prospects of its growing concession-based business in China and the doubling in design capacity of its China concession by end-FY11.

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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