

Salcon

SALC MK / SLCN.KL

NOT RATED

➤ **Market Cap**
US\$162.4m
 RM524.2m

➤ **Avg Daily Turnover**
US\$2.13m
 RM6.93m

➤ **Free Float**
79.0%
 648.3 m shares

Current	RM0.79
Target	N/A
Prev. Target	N/A
Up/Downside	N/A

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Share price info

Share price perf. (%)	1M	3M	12M
Relative	7.1	9.7	15.4
Absolute	6.8	11.3	20.8

Major shareholders	% held
Naga Muhibbah Sdn Bhd	11.0
Tan Sri Tee Tiam Lee	5.0
Infra Tropika Sdn Bhd	5.0

More than just a huge war chest

Salcon, an under-researched small-cap water and sewerage contractor, has recently won the contract for the Langat 2 water treatment plant, the largest in Southeast Asia. This has boosted its profile and drawn investors' interest. The stock still offers value given catalysts in 2H.

Order book is likely to surge to another all-time high. A 20-30% hit rate on its sizeable RM2.2bn tender book is achievable, in our view. Salcon sits on a net cash hoard that is 76% of its market value, implying ex-cash FY15-16 P/E of just 3-4x. The stock could be worth RM1.12/share (20% discount to our FD RNAV), implying 43% upside.

Under-researched

We believe Salcon's story remains relatively underappreciated. What will drive profitability and a new stream of recurring income over the coming years are its domestic prospects. The group's core focus over the next few years will be on the spillovers of the restructuring of water and sewerage assets in Peninsular Malaysia – a key driver for order book growth. Both its outstanding order book of RM642m and RM2.2bn tender book are at all-time highs and have upside. Key projects that could reach the award stage in the coming months are 1) Rapid raw water supply - 260 MLD - worth RM170m, 2) Rapid water treatment plant (WTP) package 16B -

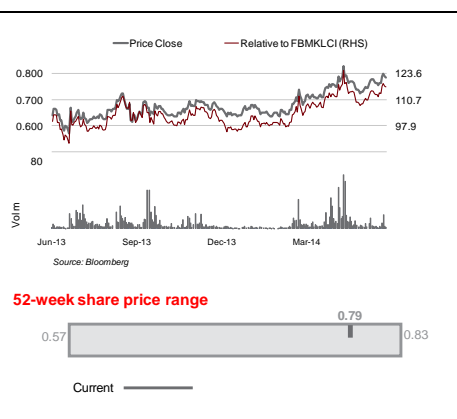
250 MLD - worth RM240m, and 3) the Langat sewerage treatment plant (STP) worth RM200m.

Property and new M&A

The impact of the RM1.2bn GDV new property development via its potential JV with Eco World (ECW MK) has yet to flow through and we do not discount the possibility of more M&A opportunities for longer-term recurring income given its huge war chest post the divestment of water assets in China. The recently-acquired 50% stake in VBT locks in strong new recurring income potential.

3-4x P/E, ex-cash

Despite its relatively small market cap, we believe Salcon deserves to be valued at a narrower 20% RNAV discount vs. its peers as its enlarged estimated net cash of over RM400m makes up 76% of its market cap (NCPS: 57 sen). Using the EV/net profit method and an estimated FY15-16 net profit of RM33m-38m, it is still cheap at 3-4x EV/net profit.



Financial Summary

FYE Dec	Dec-09A	Dec-10A	Dec-11A	Dec-12A	Dec-13A
Revenue (RMm)	369.8	549.9	472.5	182.1	169.8
Operating EBITDA (RMm)	72.6	77.5	79.5	22.5	31.2
Net Profit (RMm)	22.1	26.8	14.6	11.3	24.6
Core EPS (RM)	0.05	0.06	0.03	0.02	0.04
Core EPS Growth	na	21.4%	-50.3%	-25.4%	74.1%
FD Core P/E (x)	16.7	13.7	27.6	37.0	21.3
DPS (RM)	0.02	0.02	0.02	0.01	0.03
Dividend Yield	1.9%	1.9%	1.9%	1.3%	3.8%
EV/EBITDA (x)	7.0	8.2	8.0	34.8	12.9
P/FCFE (x)	7.5	7.0	6.9	24.2	17.5
Net gearing (x) / (NCPS) (RM)	(0.05)	0.13	0.14	0.34	(0.21)
P/BV (x)	1.44	1.32	0.99	0.85	0.75
Recurring ROE	5.8%	6.5%	2.7%	1.8%	3.4%
% Change in Core EPS Estimates					
CIMB/consensus EPS (x)					

SOURCE: CIMB, COMPANY REPORTS

The CIMB Stock Selection Tools (SST) are designed to complement and enhance the investment decision making process. The SST incorporate a range of analytical tools, providing ready access to key company and market data, valuation tools and charts. If you are interested in subscribing for the 'Stock Selection Tools', please contact your CIMB account manager.

1. BACKGROUND

1.1 Domestic growth story ▶

2014 marks Salcon's 40th anniversary as a water and sewerage infra contractor. Even as a relatively small player, the group has in the past made successful inroads into foreign markets, especially Sri Lanka and China. Salcon's story, however, and what will drive profitability and a new stream of recurring income over the coming years are its domestic prospects. The group's core focus over the next few years will be on the spillovers from the restructuring of water and sewerage assets in Peninsular Malaysia – a key driver for order book growth.

Over the longer term, we view Salcon as one of the major beneficiaries of the ongoing water/wastewater-related expenditure under the 10th Malaysia Plan (MP) while new growth areas, like Petronas's Rapid project in Iskandar, have spurred new tenders over the past 12-18 months. We view these as major opportunities for Salcon and as potential rerating catalysts in 2H even after the 17% jump in its share price YTD. The impact of new property development prospects via its potential JV with Eco World (ECW MK) has yet to flow through and we do not discount the possibility of more M&A opportunities for longer-term recurring income given its huge war chest post the divestment of water assets in China.

Salcon's expertise goes beyond engineering capabilities within the raw water treatment and distribution segments. The group also specialises in engineering and construction related to wastewater and sewerage. Its track record includes overseas contracts, including BOT concessions.



1.2 Recent Langat 2 win raises its profile ▶

Like a handful of other relatively smaller listed and unlisted players within the water and sewerage engineering infra segment locally, Salcon's order book growth has mainly focused on government tenders. What sets Salcon apart from other competitors, in our view, is the group's end-to-end water and wastewater management services and turnkey capabilities and its success regionally. In the past, the group has 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 and water supply projects in Sri Lanka and Vietnam on a turnkey basis. For Salcon, the recent major contract win (after several years) for the RM994m Langat 2 water treatment plant (WTP) underscores the group's competitiveness and track record. Other competitors in the water/wastewater segment include WET (subsidiary of Loh & Loh), CWM, ABC and Ranhill Construction but we believe Salcon has the more dominant market share due to its full spectrum of services.

Figure 2: Salcon's turnkey capabilities

INVESTMENT	TURNKEY CONTRACTING	ASSET MANAGEMENT
<ul style="list-style-type: none"> • Design • Finance • Construct • Public Private Partnership (PPP) <ul style="list-style-type: none"> - Concession/ BOOT - Build Operate Transfer (first in Vietnam) - Transfer Operate Transfer - Refurbish Build Operate Transfer 	<ul style="list-style-type: none"> • 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) 	<ul style="list-style-type: none"> • 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	WATER - OVERSEAS	WASTEWATER
<ul style="list-style-type: none"> • 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  <p>Aerial view of Sg. Labu Water Treatment Plant</p>	<ul style="list-style-type: none"> • 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  <p>Water Treatment Plant in Hambantota, Sri Lanka</p>	<ul style="list-style-type: none"> • 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  <p>Aerial view of Medini Iskandar Sewage Treatment Plant</p>

SOURCE: COMPANY

1.3 RM642m all-time high order book with Langat 2 WTP ▶

Salcon has emerged with the largest 36% JV share in the RM994m Langat 2 WTP contract. The group's package value works out to RM358m and should yield at least a 10% pretax margin, by our estimates. While RM300m-500m worth of a single job scope may hardly move the needle for other larger comparable players, the Langat 2 WTP project translates into substantial order book growth of over 125% to RM645m for Salcon, which is an all-time high. In perspective, the RM285m outstanding order book before Langat 2 WTP would have lasted only up to two years given its construction average run-rate of RM150m-200m p.a. Currently, 87% of its total order book comprises domestic jobs while the balance is overseas, mainly sewerage and water related.

1.4 Phase 2 could be smaller but fairly sizeable ▶

The recent award of the Langat 2 WTP represents 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 should have 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. We are also not discounting operation and maintenance (O&M) opportunities in view of Salcon's track record.

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

2. OUTLOOK - DOMESTIC

2.1 Fat tender book of RM2.2bn is comparable to the bigger boys ▶

We understand that the timeline for the rollout of phase two of Langat 2 WTP is unknown given the major delays in the implementation of phase 1. While this could be a risk to further order book growth, 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 are other available 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 all-time high), domestic and overseas jobs combined. This is comparable, if not on par, with the bigger contractors' average tender book of RM2bn-4bn over the next 2 years.

Figure 5: Breakdown of RM2.2bn tender book

Domestic jobs		RM m
Water		779
Wastewater (sewerage)		542
Subtotal		1,321
Overseas		RM m
Sri Lanka		795
Thailand		21
Vietnam		61
Subtotal		877
Total		2,198
<i>% of domestic</i>		60%
<i>% of overseas</i>		40%

SOURCES: CIMB, COMPANY REPORTS

2.2 20-30% success rate looks within reach ▶

We believe management's target of a 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 replenishments 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. We believe the focus will be on the implementation of water/wastewater-related projects and infra works for Petronas's Rapid. Salcon's domestic tender book is skewed more towards the water and sewerage/wastewater segment.

Key projects that could reach the award stage in the coming months are 1) Rapid raw water supply - 260 MLD - worth RM170m, 2) Rapid WTP package 16B - 250 MLD - worth RM240m, and 3) Langat STP worth RM200m. These jobs are likely to yield a 10-12% pretax margin (vs. 5-6% for open tender civil works) as the work scope is largely negotiated.

Figure 6: Breakdown of RM1.3bn domestic tender book

Water segment (59% of total)	RM m
Sg. Keloi WTP (20 MLD)	41
Sg. Siput mini hydro power plant (7 MW)	46
NGC Raw water intake (50 MLD)	27
Rapid raw water supply (PAMER) (260 MLD)	170
Ganchong water treatment works (80 MLD)	160
Rapid WTP package 16B (250 MLD)	240
Sg. CheroK WTP, Genting Highlands	95
Subtotal	779

Wastewater segment (41% of total)	RM m
Langat sewerage treatment plant (STP)	200
Johor Bahru STP	200
Joho Bahru STP and pumping station	55
Cyberjaya Flagship zone STP "A"	54
Batu Feringghi STP	21
Senai Airport City water & sewer reticulation works	12
Subtotal	542

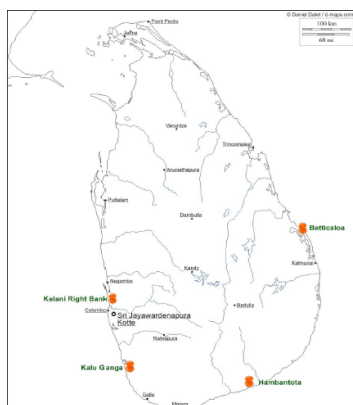
SOURCES: CIMB, COMPANY REPORTS

3. OUTLOOK - OVERSEAS

3.1 Sri Lanka offers the best overseas prospects ▶

The group is more optimistic about its tender prospects in Sri Lanka. Based on past and completed projects there, the average pretax margin is surprisingly as high as 20% given the high technical input during the tender process. The larger projects tendered are non-revenue water (NRW) types worth c.RM200m each. The group has track records in other countries, like Vietnam, Thailand and India, but it has not been actively tendering in those areas, which explains why the tender books are low. This could turn out to be a good strategy given the perceived tough political and operating environments in those countries.

Figure 7: Sri Lanka



- PROJECT: HAMBANTOTA WATER SUPPLY PROJECT**
• Design & build a water treatment plant with 15 MLD capacity & ancillary works
- PROJECT: BATTICALOA WATER SUPPLY PROJECT**
• Design & build a water treatment plant with 40 MLD capacity & ancillary works
- PROJECT: KELANI RIGHT BANK WATER TREATMENT PLANT**
• Design & build a water treatment plant with 180 MLD capacity & ancillary works
- PROJECT: KALU GANGA WATER SUPPLY PROJECT**
• Construction of Kandana Water Treatment Plant extension

SOURCE: COMPANY

Figure 8: Vietnam



- PROJECT: DONG TAM WATER TREATMENT PLANT**
• Design and construction of Dong Tam Water Treatment Plant with total capacity of 90 MLD after upgrading
- PROJECT: BINH AN WATER SUPPLY SCHEME**
• Design and construction of Binh An Water Supply Scheme, Ho Chi Minh City under BOT concept with total capacity of 100 MLD
- PROJECT: Nhon Trach Water Supply Project**
• Construction and commissioning of raw and treated water transmission pipelines with total capacity of 100 MLD

SOURCE: COMPANY

Figure 9: Thailand



PROJECT: MIN BURI WATER DISTRIBUTION PUMPING STATION

- Construction of Min Buri Water Distribution Pumping Station with total capacity of 540 MLD

PROJECT: SAM LAE RAW WATER PUMPING STATION

- Construction of Sam Lae raw water pumping station No. 4

PROJECT: PHET KASEM & RAT BURANA DISTRIBUTION PUMPING STATIONS & RELATED WORKS

- Construction of reservoirs at Phet Kasem distribution pumping station of 40,000 cu.m. and Rat Burana distribution pumping station of 10,000 cu.m & other related works

SOURCE: COMPANY

Figure 10: India



DAVANAGERE CITY PROJECT: LAYING OF RAW WATER PUMPING MAINS & RELATED ANCILLARY WORKS

- Laying of raw water pumping main from Rajanahalli Head works to Kundawada Lake
- Installation of New Vertical Turbine, Centrifugal pump sets
- Construction of 15 lakh litres (1.5 million litres) Clear Water Storage Reservoir, 20 MLD Filter House
- Supplying and installation of Bulk Flow meters for Water Supply scheme

SOURCE: COMPANY

Figure 11: Breakdown of overseas tender book

	RM m
Sri Lanka (largest tender book)	
Non-revenue water (NRW) reduction in North of Colombo City	200
NRW reduction in East of Colombo City	208
Valaichenai water supply scheme (20 MLD)	51.2
Jaffna Killinochchi water supply project	176
Greater Colombo wastewater pumping station	160
Total Sri Lanka	795.2
Thailand	20.8
Vietnam	60.6
Total	876.6

SOURCES: CIMB, COMPANY REPORTS

4. PROPERTY JV WITH ECO WORLD

4.1 RM1.2bn incoming GDV ►

Salcon's plans to further grow its property development business are likely to begin materialising this year in view of the RM1.2bn incoming GDV (88% of total outstanding GDV) from a 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 mainly consists of residential products. Other features include retail and commercial space and a hotel. Management is fairly confident about this project's success given Eco World's growing track record as a reputable developer. The new property development earnings stream over the next 2-3 years will be positive for Salcon as it typically offsets the lumpy construction and infra earnings. Based on a conservative pretax margin assumption of 20%, we expect this venture to contribute c.RM20m p.a. to pretax profit over the next five years, based on Salcon's JV stake.

Based on our checks, Dato' Eddy Leong Kok Wah (age 58), who is currently an Executive Director and a major shareholder in Salcon, spent eight years at SP Setia between September 2005 to February 2013 before he resigned. He was appointed to EcoWorld's directorship in June 2012, and is a shareholder of Eco World Holdings, which in turn, is the major shareholder of Eco World Development Group, the listed entity. We believe Dato' Eddy is also a shareholder in the RM3.8bn land bank to be injected into Eco World Development. The ongoing land banking efforts for Eco World, led by Dato' Eddy, would likely provide opportunities for Salcon to undertake niche smaller property development projects.

Figure 12: 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 13: 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

5. NEW RECURRING INCOME ASSETS

5.1 Replacing China water concessions with a telco deal ▶

Over the past 10-15 years or so, Salcon has ventured into several built-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 back, 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 the over RM300m in net cash proceeds, Salcon then signed an agreement to acquire a 50.1% stake in Volksbahn Technologies (VBT) Sdn Bhd for RM23.5m.

5.2 Up to 15 years of recurring net profit from VBT ▶

VBT provides integrated technology services for the Prasarana group of companies - the asset owner of major LRT and monorail networks in 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). We understand that the lucrative part of the deal is the laying of the fibre optic cables on the existing and expanded LRT and monorail lines. The estimated capex is c.RM15m, with an expected net profit contribution of RM10m-15m p.a., which could be conservative. Monetisation of this asset will kick off once VBT begins inking agreements with other telco players. Revenue generation will be in the form of subscription or rights, simply put, which is expandable given the last-mile nature of the fibre optic network. We sense that management is bullish about this venture as it offers strong potential in view of the expected surge in ridership once the new LRT lines come onstream from 2015/16 onwards. Salcon expects to begin signing agreements with telco operators in 2H14.

Figure 14: VBT's scope of services

- **Strategic collaboration between Prasarana and VBT include**
 - Generate additional income by leveraging on non core assets
 - Provide mobile, connected and sustainable transit oriented lifestyle to end users
- **Leverage on Prasarana's platform**
 - >1m passengers daily – pedestriains
 - Clients in direct vicinity of tracks, stations or SPNB developments
 - Exclusive access to Prasarana properties ie train stations, trains, bus stops, bus
 - Exclusive access to Prasarana property developments (40 mixed/residential/commercial)
- **Scope of work**
 - Property Development, Retail, Advertising, Technology Services, Parking Management

SOURCES: CIMB, COMPANY REPORTS

6. RISKS

6.1 Project execution and delay risks ►

Project execution and delay risks are typical challenges for contractors/infra companies, as in the case of the rollout of sizeable domestic contracts in the past, such as MRT and the long-overdue award of the Langat 2 WTP. However, we believe that the water/wastewater segment in the local 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. The outlook for job flows in this segment is positive from 2H onwards given the pending awards for other water/wastewater jobs in the state of Selangor and those related to the development of Petronas's Rapid project. We view the likelihood of Salcon securing new overseas jobs as a plus. We also believe that execution risks for the group's new property development ventures are mitigated by its JV with Eco World Development. We would not discount other new potential ventures although details are limited at this point.

7. FINANCIALS

7.1 Earnings turnaround from FY14 onwards ►

Excluding the remaining potential net gain from the monetisation of China water assets, Salcon should begin seeing an earnings turnaround from FY14 onwards. As at 1Q14, the group reported a net operating loss (excluding discontinued operations in China) due to the timing in the recognition of the Langat 2 project and existing jobs. Contribution from these two new segments should flow through from 2H14 onwards. The main driver for the earnings turnaround is the gradual recovery in the construction EBIT margin to the 6% level achieved in FY11, which was roughly the peak of its order book before it was depleted. In FY11, construction made up 29% of EBIT. We believe this will be the base case from FY14 onwards.

7.2 Net profit to potentially surge to c.RM30m in FY15, net cash of over RM400m ►

Operating profit from new ventures, including the impact of new contracts beyond Langat 2 WTP likely to be secured in 2H, will be the key contributor of the targeted c.RM30m in net profit in FY15. We understand that this target

does not include the potential new recurring profit from VBT. The RM30m targeted net profit is justifiable, in our view, based on a reasonable 8-10% pretax margin over a contract period of 3 years from 2014 onwards.

Figure 15: Salcon's 3-year segmental breakdown

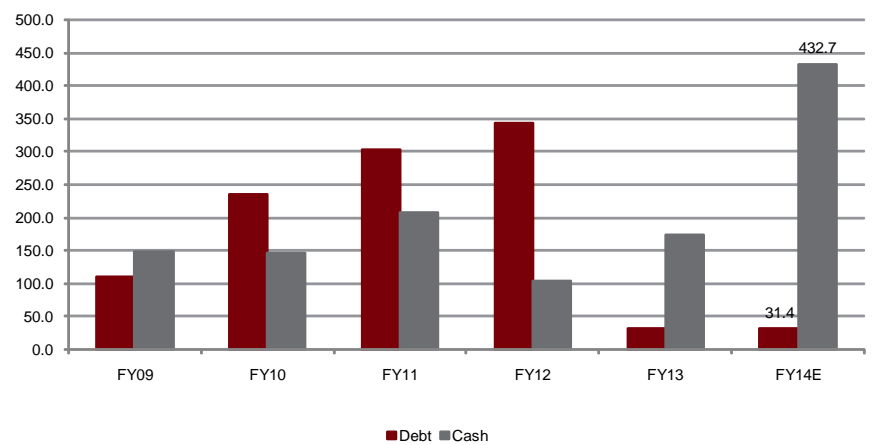
	FY11	FY12	FY13
	RM m	RM m	RM m
Revenue			
Construction	240.2	141.9	155.3
Concessions (only Vietnam BOT for FY13)	218.59	189.0	1.2
Others	13.973	13.0	13.3
China assets - discontinued ops	0	0.0	202.9
Total	472.8	343.9	372.6
EBIT			
Construction	14.0	(11.0)	(19.2)
Concessions (only Vietnam BOT for FY13)	32.3	59.7	1.7
Others	2.1	4.0	0.7
China assets - discontinued ops	0.0	0.0	95.7
Total	48.4	52.7	78.8
% of revenue			
Construction	51%	41%	42%
Concessions (only Vietnam BOT for FY13)	46%	55%	0%
Others	3%	4%	4%
China assets - discontinued ops	0%	0%	54%
Total	100%	100%	100%
% of EBIT			
Construction	29%	-21%	-24%
Concessions (only Vietnam BOT for FY13)	67%	113%	2%
Others	4%	8%	1%
China assets - discontinued ops	0%	0%	121%
Total	100%	100%	100%
% EBIT margin			
Construction	6%	-8%	-12%
Concessions (only Vietnam BOT for FY13)	15%	32%	145%
Others	15%	31%	5%
China assets - discontinued ops	na	na	47%
Total	10%	15%	21%

SOURCES: CIMB, COMPANY REPORTS

7.3 Healthy balance sheet with an expanded war chest ►

Salcon's balance sheet is healthy, with a net cash position as at FY13. Guidance was that the net cash level could surge to over RM400m by end-FY14, pending the completion of the China asset divestments. 1Q14 net cash stood at RM401m. The group's total debt has declined from over RM300m to RM31.4m presently as most of the borrowings were tied to the eight water concessions in China.

Figure 16: Cash is expected to surge to over RM400m from divestment of China water assets (RM m)



SOURCES: CIMB, COMPANY REPORTS

8. VALUATION

8.1 Steep 44% discount to RNAV/share of RM1.40 ▶

In our view, the RNAV valuation method is the best way to reflect Salcon's asset base apart from the recovery in net profit for the construction segment. Key components of our RNAV would be 1) the estimated FY15 construction net profit of RM21m (mainly from the Langat 2 WTP, new sewerage plant jobs) pegged to a 15.9x target P/E, in line with our construction coverage, 2) the estimated DCF value of 50%-owned VBT, based on RM10m-15m net profit p.a. for up to 15 years at 8% WACC, 3) BV of the remaining water concessions in Vietnam, 4) the 12.5-acre land bank for Eco Mid Town at RM300 psf, and 5) the 0.9-acre Selayang land at RM250 psf. After accounting for other main balance sheet items and the impact of the dilution of the 45.5m warrants exercised @ RM0.75, we believe its fully-diluted RNAV/share could be RM1.40. The stock is hence trading at a steep 44% discount to RNAV.

8.2 Worth RM1.12 or 43% upside; 3-4x EV/net profit ▶

We peg a 20% discount to our RNAV/share valuation for Salcon of RM1.40 and arrive at an indicative value of RM1.12/share. The discount is at the lower end of the 10-50% we apply to the construction stocks under our coverage and lower than the 40% SOP discount we apply to Puncak Niaga. In spite of its relatively small market cap, we believe Salcon deserves to be valued at a narrower RNAV discount as the enlarged estimated net cash of over RM400m makes up 76% of its market cap (NCPS: 57 sen). Using the EV/net profit method and an estimated RM33m-38m net profit for FY15-16, Salcon is cheap, trading at an attractive EV/net profit multiple of 3-4x.

8.3 Still offers value ▶

The share price has risen 17% YTD, largely due to the positives from the China asset divestment, expectations on securing the Langat 2 WTP (which is the largest in Southeast Asia) and the bottoming out of operating losses. We believe the share price has yet to factor in the positives from the potentially strong recurring income of the 50%-owned VBT and the likelihood of winning other contracts beyond Langat 2 WTP phase 1, new M&A possibilities including new land banks and the earnings turnaround in FY14. Potential rerating catalysts include 1) Rapid raw water supply - 260 MLD - worth RM170m, 2) Rapid WTP package 16B - 250 MLD - worth RM240m, and 3) the Langat STP worth RM200m.

Figure 17: RNAV

	FY15 RM m	P/E (x)	Stake (%)	Value (RM m)
Construction net profit	21	15.9	100%	333.9
	DCF value (RM m)	WACC (%)	Stake (%)	
15-year concession (VBT Telco, RM10-15m net profit p.a.)	153.4	8%	50.1%	76.8
Water concession in Vietnam (110 MLD) at BV	75.0		36%	27.0
	Land bank	Acres	m sq ft	RM psf
Eco Mid Town - Johor	12.5	0.54	300	50%
Res 280 - Selayang	0.98	0.04	250	50%
Cash (1Q14)				372.3
Remaining proceeds from China water assets monetisation				40.0
Borrowings (4Q13)				(34.4)
Property investments				8.4
Investment in associate				28.7
RNAV				939.9
Warrants proceeds (45.5m @ 75sen)				34.1
FD RNAV				974.0
No. of shares (m)				648.3
New shares from warrants				45.5
FD no. of shares (m)				693.8
FD RNAV/share (RM)				1.40
RNAV discount (%)				20%
Implied value (RM)				1.12
<i>Closing price (RM)</i>				<i>0.79</i>
<i>Upside (%)</i>				<i>43%</i>

SOURCES: CIMB, COMPANY REPORTS

Figure 18: Net cash constitutes 76% of market capitalisation

	RM m
Market cap	524.2
Cash (+ asset proceeds)	432.7
Debt	(34.4)
Net cash	398.3
Market cap ex-cash (EV)	125.9
FY15 net profit (estimated)	32.8
FY16 net profit (estimated)	37.7
FY15 P/E (x)	3.84
FY16 P/E (x)	3.34

SOURCES: CIMB, COMPANY REPORTS

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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.

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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.
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CIMB Stock Recommendation Framework #2 *

Outperform	The stock's total return is expected to exceed a relevant benchmark's total return by 5% or more over the next 12 months.
Neutral	The stock's total return is expected to be within +/-5% of a relevant benchmark's total return.
Underperform	The stock's total return is expected to be below a relevant benchmark's total return by 5% or more over the next 12 months.
Trading Buy	The stock's total return is expected to exceed a relevant benchmark's total return by 3% or more over the next 3 months.
Trading Sell	The stock's total return is expected to be below a relevant benchmark's total return by 3% or more over the next 3 months.

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Neutral	Expected total returns of between -10% and +10% over the next 12 months.
Underperform	Expected negative total returns of 10% or more over the next 12 months.
Trading Buy	Expected positive total returns of 10% or more over the next 3 months.
Trading Sell	Expected negative total returns of 10% or more over the next 3 months.

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