

INDEPTH UPDATE REPORT

Date: 3-March 2011

Name of PLC: Taliworks Corporation Berhad	Target Price:	RM 1.36
Business Summary : Investment holding company involved in water treatment and supply, waste management via O&M contract and concession, construction and toll concession		
Major Shareholders :	Dato' Lim Chee Meng (direct and indirect stakes)	55.5%
	Kumpulan Perangsang Selangor Berhad	16.9%
PLC Website : www.taliworks.com.my	Recommendation:	Buy
IR Contact : Mr. Ronnie Lim, Executive Director ronnie@taliworks.com.my Mr. Victor Wong, General Manager, Finance victorwong@taliworks.com.my	Market Capitalisation:	RM 497.6m
- FBM Small Cap	Current Price :	RM 1.14
- FBM Emas Shariah	Market / Sector:	Trading/Services
	Stock Code:	8524
Analyst : Lim Boon Ngee Tel : +603 2163 3200; Email : bnlim@nra.com.my		

Key Stock Statistics	2009	2010	2011F	2012F
EPS (sen)	10.2	6.5	11.3	11.5
P/E (x)	11.1	17.7	10.1	9.9
Dividend/Share (sen)	4.5	1.1	1.1	1.1
NTA/Share (RM)	0.99	1.09	1.19	1.29
Book Value/Share (RM)	0.95	1.05	1.16	1.27
Issued Capital (mil shares)	376.7	436.5	436.5	436.5
52-weeks Share Price Range (RM)			1.12 - 2.12	

Per Share Data	2009	2010	2011F	2012F
Book Value (RM)	0.95	1.05	1.16	1.27
Operating Cash Flow (sen)	4.7	5.1	9.3	5.9
Earnings (sen)	10.2	6.5	11.3	11.5
Dividend (sen)	4.5	1.1	1.1	1.1
Payout Ratio (%)	44.0	17.4	10.0	9.7
PER (x)	11.1	17.7	10.1	9.9
P/Cash Flow (x)	24.2	22.3	12.3	19.4
P/Book Value (x)	1.2	1.1	1.0	0.9
Dividend Yield (%)	3.9	1.0	1.0	1.0
ROE (%)	10.6	6.6	9.9	9.3
Net Gearing (%)	n.c.	n.c.	14.2	17.7

n.c. - net cash

P&L Analysis (RM mil)	2009	2010	2011F	2012F
Revenue	158.9	173.1	187.6	206.8
Operating Profit	59.6	54.5	59.6	68.4
Depreciation	(3.7)	(3.9)	(17.2)	(32.6)
Finance	(16.1)	(15.3)	(6.2)	(12.2)
Jointly-controlled & Associates	7.5	12.9	10.7	11.7
EI	-	(9.2)	-	-
Pre-tax Profit	51.0	42.9	64.1	67.9
Effective Tax Rate (%)	(23.6)	(33.6)	(22.0)	(22.0)
Net Profit	38.6	28.2	49.3	50.4
Operating Margin (%)	37.5	31.5	31.8	33.1
Pre-tax Margin (%)	32.1	24.8	34.2	32.8
Net-Margin (%)	24.3	16.3	26.3	24.4

1. Investment Highlights/Summary

- Taliworks Corporation Berhad (Taliworks) is an investment holding company involved in water treatment and supply, waste management via O&M contract and concession, construction and toll concession.
- Its O&M of SSP1 and Langkawi concession provide steady and recurring earnings stream. Additionally, it is currently in various stages of implementing its wastewater projects in China. Upon full commissioning by FY12, these wastewater projects will have a sizeable combined design capacity of 500 MLD.
- We are upgrading Taliworks to a Buy due to the strong earnings turn-around in FY11 arising from the increased earnings contribution from Water Division, absence of exceptional charges and reduced finance costs.
- The stock is currently trading at slightly above its NTA of RM1.09/share. While we acknowledge the uncertainty surrounding the consolidation of water concessionaires in Selangor, we believe much of the uncertainties have been discounted in its share price.
- The stock is currently trading at a P/E of 10.1x for FY11 based on our EPS forecast of 11.3 sen. We have arrived at a target price of RM1.36, based on a target P/E of 12x for FY11, which is at a discount of close to 15% to market P/E of 14x.

2. Company Background/Overview

- Key areas of operation

The principal activities of Taliworks are in water and waste-related businesses, which can be divided into the following categories:

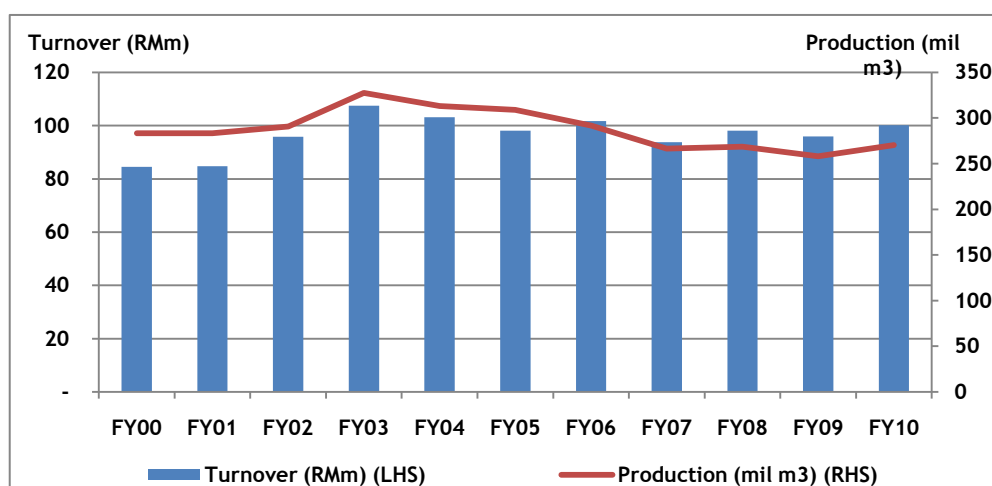
- Water treatment and supply;
- Waste Management; and
- Construction

A. Water Treatment and Supply

- **Operations and maintenance (O&M) of Sungai Selangor Water Treatment Works Phase 1 (SSP1)**

This 30-year O&M contract, which will be expiring in Jan-2030, is held by 100%-owned Sungai Harmoni Sdn Bhd (SHSB). The water treatment plant (WTP) has a design capacity of 950 MLD and is currently supplying treated water to a large part of Selangor and Kuala Lumpur. The O&M of SSP1 represents the largest turnover contributor, accounting for 57.9% of group turnover in FY10.

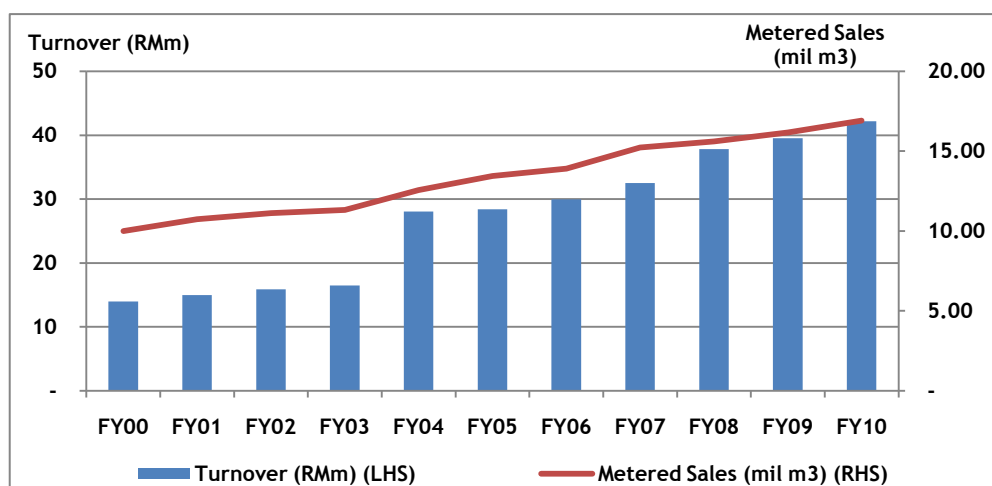
Historical Turnover and Production



- **Water concession in Langkawi**

The concession includes the O&M of WTPs and water distribution systems in Langkawi, Kedah for 25 years, expiring in Oct-2020. Its 100%-owned Taliworks (Langkawi) Sdn Bhd (TLSB) owns the concession. It manages in total 5 WTPs with a combined design capacity of 90 MLD. In FY10, TLSB accounted for 24.4% of Group turnover.

Historical Turnover and Production



- Water division as a whole accounted for 82.2% and of Group turnover in FY10.

B. Waste Management

- **Concession of the Tianjin Panlou Domestic Waste Transfer Station**
90%-owned, Tianjin-SWM (M) Environment Co., Ltd, (Tianjin-SWM) holds a 21-year concession rights (expiring in Oct-2025) to manage, operate and maintain the Tianjin Panlou Domestic Waste Transfer Station and its related assets in the Tianjin, China. This concession entails the transport of household waste deposited at transfer station to the municipal landfills. It commenced operations in FY05 and is currently operating at close to the design capacity of 1,000 tonnes/day.
- **Concession of the Guanghan San Xin Dui Wastewater Treatment Plant (WWTP)**
Puresino (Guanghan) Water Co. Ltd. has been granted an exclusive 30-year concession (expiring in 2033) to undertake the construction, management and operation of the 50 MLD Guanghan San Xin Dui Wastewater Treatment Plant in Sichuan, China. It commenced commercial operations in Sep-2007. Taliworks has an indirect stake of 56% in Puresino (Guanghan) Water Co. Ltd.
- Waste management division is currently a much smaller division, contributing 8.0% to group turnover for FY10.

C. Construction

- Taliworks is also in the construction of water supply works. It is currently in the final stage of completing its sole construction project, Padang Terap Water Supply Scheme in Kedah.

D. Jointly Controlled and Associated Companies

- In FY07, Taliworks acquired a 55% stake in a jointly controlled entity, Cerah Sama Sdn Bhd (CSSB), which is the holding company of Grand Saga Sdn Bhd that owns and operates the Cheras-Kajang Expressway until 2027. In FY10, CSSB contributed 23.4% to Group PBT before exceptional charges.
- Its 40%-owned associate, Hydrovest Sdn Bhd is in the provision of water management and project services. It recorded a small net profit of RM0.7m in FY10.

- **Revenue Breakdown**

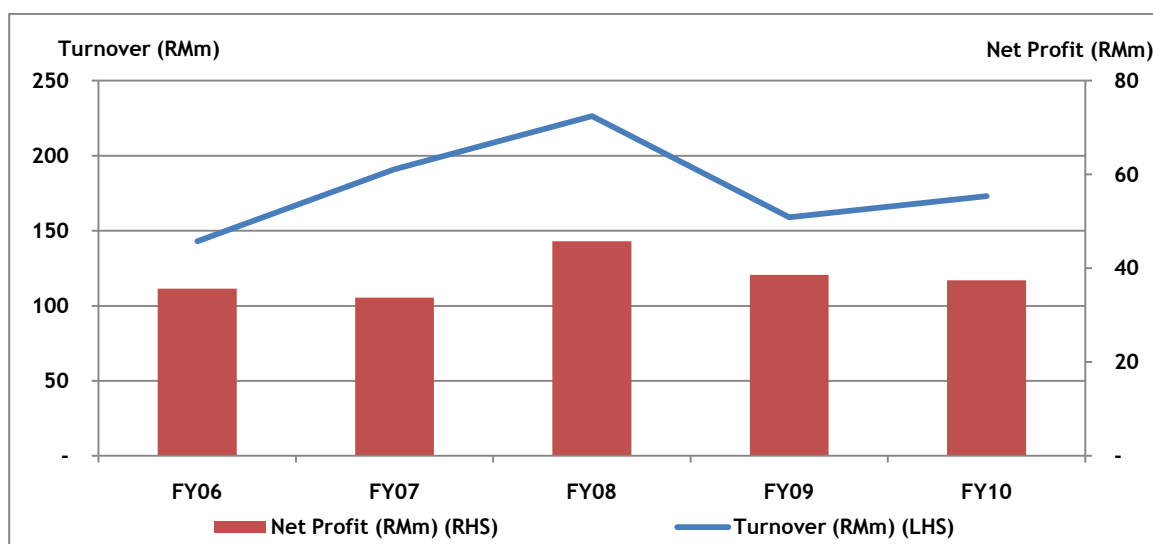
<u>RMm</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>
Water	131.61	126.32	135.89	135.51	142.35
Waste Management	6.66	8.09	13.53	15.56	13.79
Construction	4.63	56.55	76.96	7.81	16.81
Investment Holding + Elimination	-	-	0.02	0.04	0.16
Group Turnover	142.90	190.97	226.41	158.92	173.11

- **Profit Breakdown**

<u>RMm</u>	<u>FY06</u>	<u>FY07</u>	<u>FY08</u>	<u>FY09</u>	<u>FY10</u>
Water	49.80	47.16	50.88	54.08	56.43
Waste Management	0.10	(0.34)	3.98	2.66	0.66
Construction	1.28	7.50	11.65	3.51	1.68
Investment Holding + Elimination	(1.21)	(7.06)	1.08	(0.64)	(4.24)
Segment profit	49.98	47.27	67.59	59.61	54.52
Finance	(0.60)	(1.55)	(14.48)	(16.11)	(15.28)
Jointly-Controlled	-	0.30	5.69	6.92	12.17
Associate	0.87	0.64	0.57	0.63	0.70
El	-	-	-	-	(9.25)
Group PBT	50.25	46.66	59.36	51.05	42.87

3. **Financial Review**

Historical Turnover and Net Profit Performance



- Taliworks reported a 15.7% decline in net profit to RM38.6m in FY09 mainly due to lower contribution from construction as its projects were nearing the tail end with no replenishment from new projects. Meanwhile, its water division enjoyed steady profit contribution due to steady water consumption growth.

- Excluding exceptional charges of RM9.3m due to the early redemption of convertible bonds, net profit for FY10 came in marginally lower by 2.9% at RM37.4m. It was driven by steady profit contribution from its Water Division and higher net profit contribution from jointly-controlled CSSB despite lower profit contribution from Waste Management and Construction Division.

4. Recent Developments

- **Linhe Project**

The acquisition of a 70% stake in Eco3 Technology and Engineering Pte Ltd (ECO3) was completed on 3 Mar 2010. Subsequently in Jun 2010, ECO3 established a wholly-owned subsidiary, Ningxia ECO Wastewater Treatment Co., Ltd to undertake the construction and management of the wastewater and recycled WTP of the Linhe Integrated Industrial Park in Yinchuan, China (Linhe Project). This is a 30-year build-operate-transfer (BOT) project with a design capacity of 50 MLD. The total project cost is estimated at RMB70m. The WTP is current being constructed and is expected to commence operations in 2HFY11.

- In Jun-2010, the Group incorporated a 70%-owned TILGEA Consortium Sdn. Bhd (TILGEA) for participation in tenders and engineering construction projects in Vietnam. Australia-based Green Equity Australia Pty Ltd is the JV partner that owns the remaining 30% stake in TILGEA.

- **Yinchuan Project**

In Aug-2010, Taliworks and Beijing Puresino-Boda Environmental Engineering Co. Ltd. (BODA) jointly signed a concession agreement with Yinchuan Municipal Construction Bureau, a government agency to take-over 4 existing municipal waste water treatment plants with recycled water facilities (WWTPs) in Yinchuan City, China on a takeover-operate-transfer (TOT) basis for RMB810m. Taliworks and BODA has a 70% and 30% stake in the JV company. The concession is for 30 years. The WWTPs have a combined treatment capacity of 300 MLD and 52 MLD for municipal wastewater treatment and recycled water processing. The proposed take-over is expected to be completed by 1HFY11.

However, in Jan-2011, as both companies have yet to formalise the JV Company following a default by BODA to fulfil its obligation, Taliworks is obligated to assume responsibility and has taken over the entire Yinchuan Project. It is currently looking for another partner to jointly participate in the Yinchuan Project.

- **Meihua Project**

Through its 70% indirectly owned ECO3, Taliworks entered into a 30-year concession agreement in Sep-2010 with the Ningdong Energy Chemical Base Management Committee to design, construct, operate and maintain the industrial waste water treatment and recycled water plant and recycled water piping in the Ningdong Energy Chemical Base Meihua Industrial Park, Ningxia, China (Meihua Project). This Meihua Project that will have a treatment capacity of 50 MLD, is estimated to cost RMB145m. The construction of its facility is expected to commence in 4QFY11.

- **Serial bonds**

Taliworks via a special purpose vehicle, Destinasi Teguh Sdn Bhd has proposed the issuance of RM395m serial bonds, which is pending implementation.

- **Convertible bonds (CBs)**

On 6 Dec 2010, holders of the CBs exercised their option to early redeem the outstanding RM113m nominal value of CBs at the early redemption amount of RM125.7m. This resulted in an exceptional charge of RM25.0m in 4QFY10 due to the de-recognition and redemption of CBs. In FY10, the net exceptional charge attributable to the CBs amounted to RM9.3m, after deducting a fair value gain on the embedded derivatives contained within the CB of RM15.7m.

- **Warrants**

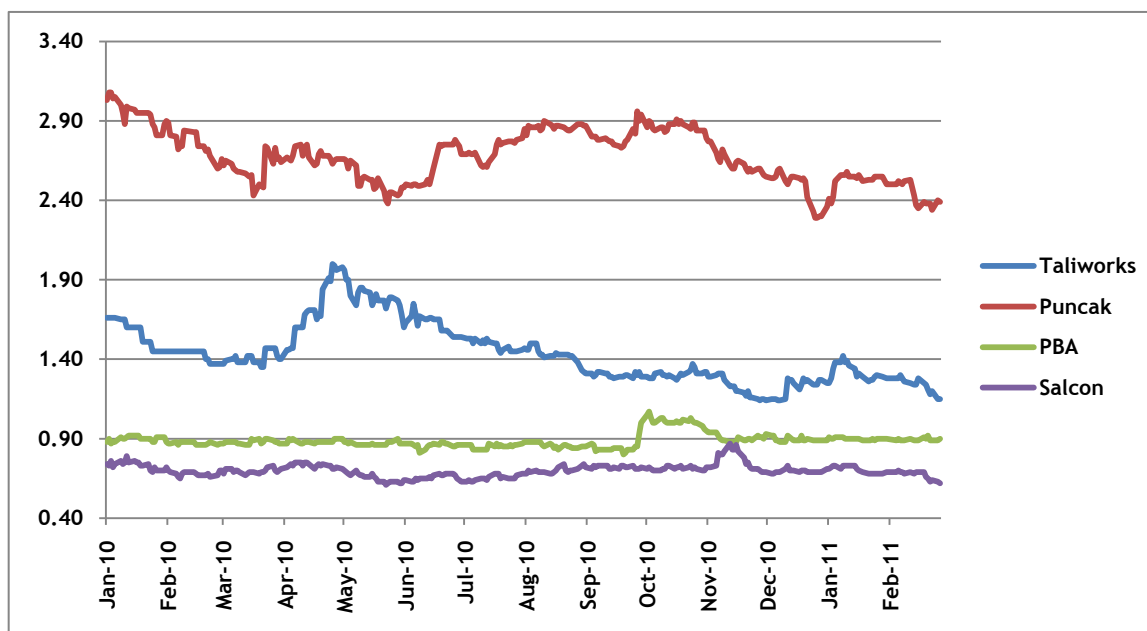
A total of 59.6m warrants were exercised in FY10, increasing its share capital from 376.7m shares in FY09 to 436.5m shares in FY10. The remaining outstanding warrants unexercised on 21 Sep 2010 have expired.

5. Competitive Analysis

<u>Comparative Valuation</u>	<u>Taliworks *</u>	<u>Puncak</u>	<u>PBA</u>	<u>Salcon</u>
Share Price (RM) @ 2-Mar-11	1.15	2.39	0.90	0.60
Mkt. Cap (RM mil)	502.0	977.8	296.5	280.6
P/E FY09 (x)	11.2	6.9	20.0	12.7
P/E FY10 (x)	13.4	8.2	11.3	13.2
Latest P/NTA (x)	1.1	0.7	0.5	1.0
Yield (%)	1.0	-	3.4	2.5

* FY10 EPS excludes EI

Share Price Chart of Taliworks, Puncak, PBA and Salcon



6. Earnings Outlook

- The production of SSP1 has been on a declining trend since peaking in FY03 at 327.6m m³ due to the rationalisation of water supply and distribution system in Selangor. As such, following the commissioning of SSP3 in FY05 and the completion of downstream pipes connection in FY06, SHSB had been experiencing lower production and hit a lowest production of 258.2m m³ in FY09. However, due to improved consumption demand and the gradual utilisation of all water resources, SHSB's production recorded its first profound positive growth of 4.7% to 270.3m m³ in FY10. We expect this positive growth trend to continue due to steady consumption demand.
- TLSB has continued to enjoy consistent metered sales growth due to increase in the consumer accounts base and vibrant tourism activities. In FY11, it is expected to enjoy a spike in profit due to the contractual bulk sale rate (BSR) hike from RM1.92/m³ to RM2.11/ m³.
- Due to the expected completion of its sole construction project by 2QFY11, its Construction Division is expected to see a dip in earnings. However, the impact is marginal due to the small EBIT contribution of RM1.7m in FY10 (3.1% of Group EBIT).

- Given the full redemption of CBs, Taliworks' total borrowings declined to RM2.8m (FY10) from RM122.4m (FY09). This would translate into some savings in finance costs in FY11 as compared with RM15m for FY10. In addition, Taliworks also incurred an exceptional charge of RM9.3m in relation to the CBs, which will not recur going forward.
- Although the EBIT from its Waste Management Division is relatively small as compared with Water Division, it offers promising long-term prospects once its current Projects starts its commercial operations and are operating at optimum capacity.

Currently, only the Panlou and Guanhan Projects are operational. While Linhe will start its commercial operation towards 2HFY11, the bigger Yinchuan Project and Meihua will only contribute more significantly in FY12.

Design Capacity of Waste Management's Projects (before any planned upgrading)

<u>Projects</u>	<u>Design Capacity (tonne/day)</u>
Panlou	1,000
	(MLD)
Guanghan	50
Linhe	50
Yinchuan	352
<u>Meihua</u>	<u>50</u>
Total	502

- Due to the redemption of the CB and the capex requirement for the above projects, Taliworks has lowered its gross dividend payout to 1.5 sen/share in FY10 from 6 sen/share in FY09.

7. Key Investment Risks

- Although Taliworks' Water Division provides steady and recurring income stream, it's adversely affected by the deadlock in the takeover of all water concessionaires in Selangor. This continued delay will continue to dampen market sentiment on water stocks.

8. Balance Sheet

Taliworks has a healthy balance sheet with a net cash position of RM174.1m as at end-FY10. We estimate that the Linhe, Yinchuan and Meihua Projects would require funding of around RM330m for FY11 and FY12. This would turn its balance sheet into net debt position, albeit at a still healthy net gearing ratio of 0.2x.

<u>Balance Sheet and Other Financial Data (RM mil)</u>	<u>2009</u>	<u>2010</u>	<u>2011F</u>	<u>2012F</u>
Total Assets	560.4	540.2	784.2	831.6
Fixed Assets	25.7	24.2	290.5	305.0
Current Asset	385.2	270.1	234.7	253.3
LT Assets	149.5	245.9	259.0	273.4
Current Liabilities	179.1	58.2	254.6	252.8
LT Liabilities	0.0	0.0	0.0	0.0
Share Capital	188.3	218.2	218.2	218.2
Shareholders Funds	375.5	476.2	522.6	569.1

9. Valuation and Recommendation

We are upgrading Taliworks to a Buy recommendation for the following reasons:

- Strong earnings turn-around for FY11 due to the increased earnings contribution from Water Division due to growing consumption and BSR hike, absence of exceptional charges and reduced finance costs;
- While the existing Water Division provides steady and recurring earnings stream, its Waste Management Division offers promising long-term growth prospects once its current Projects that are in various stages of implementation, commences its commercial operations.
- The stock is currently trading at slightly above its NTA of RM1.09/share. While we acknowledge the uncertainty surrounding the consolidation of water concessionaires in Selangor, we believe much of the uncertainties have been factored in its share price.
- The stock is currently trading at a P/E of 10.1x for FY11 based on our EPS forecast of 11.3 sen. We have arrived at a target price of RM1.40, based on a target P/E of 12x for FY11, which is at a discount to market P/E of 14x.

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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