

Recommendation: **HOLD**

Stock Code: 8567

Bloomberg: SALC MK

Price: MYR0.66

12-Month Target Price: MYR0.70

Date: February 26, 2010

Board: Main

Sector: Trading/Services

GICS: Utilities/Water Utilities

Market Value - Total: MYR308.7 mln

Summary: Salcon is a water-engineering specialist that designs, constructs and operates water and wastewater treatment systems and plants. Its projects are located in Malaysia, ASEAN and China. It also owns concessions to treat water and wastewater in China and Vietnam. The stock is a component of the FBM EMAS.

Analyst: Chok Wai Lee, CFA



Results Review & Earnings Outlook

- Salcon's 2009 net profit of MYR22.1 mln (+149.9% YoY) was in line with our expectations. The sharp increase in net profit was mainly due to higher construction activities and improved performance from its China concessions.
- Salcon's concessions continue to provide stable income to the group, contributing revenue of MYR88.9 mln (+6.7% YoY) in 2009. More positively, operating margin for the segment improved to 33.4% (from 17.9% in 2008) due to better cost management. Meanwhile, the construction division registered revenue of MYR274.0 mln (+66.7% YoY), on the back of higher revenue recognition from domestic contracts, as well as overseas projects.
- Salcon's 67%-owned subsidiary, Jiangsu Salcon Water & Environmental Development has been granted a 30-year concession to operate a water transfer project in the central region of the Yizheng City, China. The project encompasses the takeover of an existing 8km pipeline of 600mm diameter and the laying of 21km pipeline of 600mm diameter.
- We leave our 2010 earnings forecast largely unchanged. We also introduce our 2011 net profit estimate of MYR18.2 mln. The lower profit is mainly due to the depletion of Salcon's construction orderbook, mitigated by higher contribution from its China concessions.

Key Stock Statistics

FY Dec.	2009	2010E
Reported EPS (sen)	4.7	5.4
PER (x)	14.0	12.2
Dividend/Share (sen)	1.5	1.5
NTA/Share (MYR)	0.63	0.68
Book Value/Share (MYR)	0.66	0.71
No. of Outstanding Shares (mln)	467.7	
52-week Share Price Range (MYR)	0.33 - 0.79	
Major Shareholders:	%	
Naga Muhibbah Sdn. Bhd.	14.3	
Leong Lai Shen	4.1	
Teng Li Ling	3.6	

*Stock deemed Shariah compliant by the Securities Commission.

Recommendation & Investment Risks

- We downgrade our recommendation to Hold (from Buy) with an unchanged 12-month target price of MYR0.70.
- We value Salcon based on a sum-of-parts method that is derived from discounted cash flow (WACC: 11.2%-12.7%, terminal growth: 0%) estimates of Salcon's concessions in China and Vietnam, and orderbook-related activities. Although we continue to like Salcon's growing concessions business in China, we believe that it needs to show its ability to replenish its construction orderbook, before a re-rating of the stock. Its current unbilled orderbook is at around MYR500 mln (from about MYR750 mln end 2008).
- Salcon's current treatment plant capacity in China stands at around 400 mln mld. It plans to raise its water and wastewater treatment concessions in China by 200 mln-300 mln liters/day (mld) every year through a combination of organic expansion and new concessions. We believe that this segment will be the major earnings driver for the group going forward.
- Risks to our recommendation and target price include: (i) slower-than-expected replenishment of its orderbook and commencement of new construction projects, (ii) higher-than-expected costs and (iii) collection issues and regulatory issues for the China concessions that could lead to lower water tariffs.

Per Share Data

FY Dec.	2007	2008	2009	2010E
Book Value (MYR)	0.52	0.62	0.66	0.71
Cash Flow (sen)	1.8	4.1	6.4	7.2
Reported Earnings (sen)	-1.8	1.9	4.7	5.4
Dividend (sen)	0.0	1.0	1.5	1.5
Payout Ratio (%)	0.0	38.0	31.8	27.7
PER (x)	NM	35.0	14.0	12.2
P/Cash Flow (x)	37.3	16.2	10.3	9.2
P/Book Value (x)	1.3	1.1	1.0	0.9
Dividend Yield (%)	0.0	1.5	2.3	2.3
ROE (%)	0.1	4.4	7.4	7.9
Net Gearing (%)	12.6	0.0	0.0	0.0

All required disclosures and analyst certification appear on the last two pages of this report. Additional information is available upon request.

Redistribution or reproduction is prohibited without written permission. Copyright © 2010 The McGraw-Hill Companies, Inc.

Page 1 of 4

Quarterly Performance

FY Dec. / MYR mln	4Q09	4Q08	% Change
Reported Revenue	68.9	81.0	-15.0
Reported Operating Profit	7.1	5.2	37.4
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	0.3	-1.4	NM
Reported Pre-tax Profit	8.2	4.7	76.6
Reported Net Profit	5.3	1.5	>100
Reported Operating Margin (%)	10.3	6.4	-
Reported Pre-tax Margin (%)	11.9	5.7	-
Reported Net Margin (%)	7.6	1.8	-

Source: Company data

Profit & Loss

FY Dec. / MYR mln	2008	2009	2010E	2011E
Reported Revenue	252.5	369.8	434.3	402.2
Reported Operating Profit	20.8	33.5	39.2	34.5
Depreciation & Amortization	-7.7	-8.0	-8.4	-8.8
Net Interest Income / (Expense)	-5.1	-4.0	-4.2	-4.4
Reported Pre-tax Profit	16.0	33.3	38.9	34.0
Effective Tax Rate (%)	25.8	21.8	22.0	23.0
Reported Net Profit	8.8	22.1	25.3	18.2
Reported Operating Margin (%)	8.2	9.1	9.0	8.6
Reported Pre-tax Margin (%)	6.3	9.0	8.9	8.4
Reported Net Margin (%)	3.5	6.0	5.8	4.5

Source: Company data, S&P Equity Research

Standard & Poor's Equity Research Services

Standard & Poor's Equity Research Services U.S. includes Standard & Poor's Investment Advisory Services LLC; Standard & Poor's Equity Research Services Europe includes Standard & Poor's LLC- London; Standard & Poor's Equity Research Services Asia includes Standard & Poor's LLC's offices in Hong Kong and Singapore, Standard & Poor's Malaysia Sdn Bhd, and Standard & Poor's Information Services (Australia) Pty Ltd.

Glossary

Strong Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, by a wide margin over the coming 12 months, with shares rising in price on an absolute basis.

Buy: Total return is expected to outperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months, with shares rising in price on an absolute basis.

Hold: Total return is expected to closely approximate the total return of the KLCI or KL Emas Index respectively, over the coming 12 months with shares generally rising in price on an absolute basis.

Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months and share price is not anticipated to show a gain.

Strong Sell: Total return is expected to underperform the total return of the KLCI or KL Emas Index respectively, over the coming 12 months by a wide margin, with shares falling in price on an absolute basis.

S&P 12 Month Target Price – The S&P equity analyst's projection of the market price a given security will command 12 months hence, based on a combination of intrinsic, relative, and private market valuation metrics.

Shariah-compliant stock - As defined by the Shariah Advisory Council of Malaysia's Securities Commission

Required Disclosures

All of the views expressed in this research report accurately reflect the research analyst's personal views regarding any and all of the subject securities or issuers. No part of analyst compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Additional information is available upon request.

Other Disclosures

This report has been prepared and issued by Standard & Poor's and/or one of its affiliates. In the United States, research reports are prepared by Standard & Poor's Investment Advisory Services LLC ("SPIAS"). In the United States, research reports are issued by Standard & Poor's ("S&P"); in the United Kingdom by Standard & Poor's LLC ("S&P LLC"), which is authorized and regulated by the Financial Services Authority; in Hong Kong by Standard & Poor's LLC, which is regulated by the Hong Kong Securities Futures Commission; in Singapore by Standard & Poor's LLC, which is regulated by the Monetary Authority of Singapore; in Malaysia by Standard & Poor's Malaysia Sdn Bhd ("S&PM"), which is regulated by the Securities Commission; in Australia by Standard & Poor's Information Services (Australia) Pty Ltd ("SPIS"), which is regulated by the Australian Securities & Investments Commission; and in Korea by SPIAS, which is also registered in Korea as a cross-border investment advisory company.

The research and analytical services performed by SPIAS, S&P LLC, S&PM, and SPIS are each conducted separately from any other analytical activity of Standard & Poor's.

A reference to a particular investment or security by Standard & Poor's and/or one of its affiliates is not a recommendation to buy, sell, or hold such investment or security, nor is it considered to be investment advice.

Indexes are unmanaged, statistical composites and their returns do not include payment of any sales charges or fees an investor would pay to purchase the securities they represent. Such costs would lower performance. It is not possible to invest directly in an index.

Standard & Poor's and its affiliates provide a wide range of services to, or relating to, many organizations, including issuers of securities, investment advisers, broker-dealers, investment banks, other financial institutions and financial intermediaries, and accordingly may receive fees or other economic benefits from those organizations, including organizations whose securities or services they may recommend, rate, include in model portfolios, evaluate or otherwise address.

CMDF-Bursa Research Scheme ("CBRS")

This report has been prepared by S&PM for purposes of CBRS administered by Bursa Malaysia Berhad, independent from any influence from CBRS or the subject company. S&P will receive total compensation of RM15,000 each year for each company covered by it under CBRS. For more information about CBRS, please visit Bursa Malaysia's website at: <http://www.bursamalaysia.com/website/bm/>

Disclaimers

This material is based upon information that we consider to be reliable, but neither S&P nor its affiliates warrant its completeness, accuracy or adequacy and it should not be relied upon as such. With respect to reports issued to clients in Japan and in the case of inconsistencies between the English and Japanese version of a report, the English version prevails. Neither S&P nor its affiliates guarantee the accuracy of the translation. Assumptions, opinions and estimates constitute our judgment as of the date of this material and are subject to change without notice. Neither S&P nor its affiliates are responsible for any errors or omissions or for results obtained from the use of this information. Past performance is not necessarily indicative of future results.

This material is not intended as an offer or solicitation for the purchase or sale of any security or other financial instrument. Securities, financial instruments or strategies mentioned herein may not be suitable for all investors. Any opinions expressed herein are given in good faith, are subject to change without notice, and are only correct as of the stated date of their issue. Prices, values, or income from any securities or investments mentioned in this report may fall against the interests of the investor and the investor may get back less than the amount invested. Where an investment is described as being likely to yield income, please note that the amount of income that the investor will receive from such an investment may fluctuate. Where an investment or security is denominated in a different currency to the investor's currency of reference, changes in rates of exchange may have an adverse effect on the value, price or income of or from that investment to the investor. The information contained in this report does not constitute advice on the tax consequences of making any particular investment decision. This material is not intended for any specific investor and does not take into account your particular investment objectives, financial situations or needs and is not intended as a recommendation of particular securities, financial instruments or strategies to you. Before acting on any recommendation in this material, you should consider whether it is suitable for your particular circumstances and, if necessary, seek professional advice.

For residents of the U.K. This report is only directed at and should only be relied on by persons outside of the United Kingdom or persons who are inside the United Kingdom and who have professional experience in matters relating to investments or who are high net worth persons, as defined in Article 19(5) or Article 49(2) (a) to (d) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, respectively.

For residents of Singapore - Anything herein that may be construed as a recommendation is intended for general circulation and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. Advice should be sought from a financial adviser regarding the suitability of an investment, taking into account the specific investment objectives, financial situation or particular needs of any person in receipt of the recommendation, before the person makes a commitment to purchase the investment product.

For residents of Malaysia. All queries in relation to this report should be referred to Alexander Chia, Desmond Ch'ng or Ching Wah Tam.

Recommendation and Target Price History

Date	Recommendation	Target Price
New	Hold	0.70
26-Nov-09	Buy	0.70
28-May-09	Buy	0.65
29-Aug-08	Buy	0.60
30-May-08	Buy	0.77
22-Apr-08	Buy	0.85
6-Sep-07	Hold	1.17
26-Jun-07	Buy	0.99

