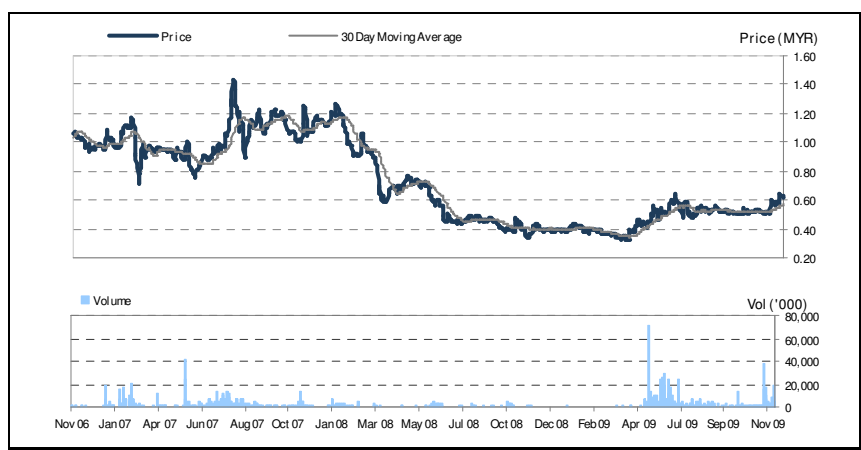


Recommendation: **BUY**Stock Code: **8567**Bloomberg: **SALC MK**Price: **MYR0.63**12-Month Target Price: **MYR0.70**Date: **November 26, 2009****Board:** Main**Sector:** Trading/Services**GICS:** Utilities/Water Utilities**Market Value - Total:** MYR292.3 mln

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 posted 9M09 revenue and net profit of MYR301.0 mln (+75.2% YoY) and MYR16.8 mln (+129.3% YoY), respectively. The earnings were above our expectations and accounted for 88.2% of our previous 2009 forecast. The sharp increase in net profit was mainly due to higher construction activities and improved performance from its China concessions.
- Salcon's concessions business remains resilient, contributing revenue of MYR65.7 mln (+12.5% YoY) in 9M09, on the back of growing water consumption in China. Meanwhile, the construction division reported revenue of MYR229.1 mln (+110.9% YoY), mainly attributable to higher revenue recognition from domestic contracts and overseas projects in Vietnam and Sri Lanka.
- Salcon is ambitious about securing more construction projects in India, Indonesia and Vietnam. It also intends to source for attractive water and wastewater assets in the region. The group also plans to venture into environmentally friendly projects with high growth potential in Malaysia, which complements its existing business (such as solid waste management).
- We increase our net profit forecasts for 2009 and 2010 by 18.6% and 25.6% respectively, taking into account the stronger earnings growth achieved.

Recommendation & Investment Risks

- We maintain our Buy recommendation on Salcon with a higher 12-month target price of MYR0.70 (from MYR0.65), following our earnings revisions.
- 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. At our target price, Salcon would trade at 13.2x 2010 P/E, comfortably at the low end of its historical trading range. We continue to like Salcon for its strong orderbook and growing concessions business in China, which provide a long-term recurring income base.
- Salcon 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. Its current treatment capacity in China stands at around 400 mln mld. In addition, its orderbook is now at MYR1.1 bln, with the unbilled portion at around MYR600 mln. About 30% of the orderbook is contributed by overseas projects.
- 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.

Key Stock Statistics

| FY Dec. | 2008 | 2009E |
|---------------------------------|-------------|-------|
| Reported EPS (sen) | 1.9 | 4.8 |
| PER (x) | 33.3 | 12.9 |
| Dividend/Share (sen) | 0.0 | 0.0 |
| NTA/Share (MYR) | 0.59 | 0.64 |
| Book Value/Share (MYR) | 0.62 | 0.67 |
| No. of Outstanding Shares (mln) | 467.7 | |
| 52-week Share Price Range (MYR) | 0.33 - 0.64 | |
| Major Shareholders: | % | |
| Naga Muhibbah Sdn. Bhd. | 14.3 | |
| Leong Lai Shen | 4.1 | |
| Teng Li Ling | 3.6 | |

Per Share Data

| FY Dec. | 2006 | 2007 | 2008 | 2009E |
|-------------------------|------|------|------|-------|
| Book Value (MYR) | 0.53 | 0.52 | 0.62 | 0.67 |
| Cash Flow (sen) | 4.8 | 1.8 | 4.1 | 6.5 |
| Reported Earnings (sen) | 2.0 | -1.8 | 1.9 | 4.8 |
| Dividend (sen) | 0.0 | 0.0 | 0.0 | 0.0 |
| Payout Ratio (%) | 0.0 | 0.0 | 0.0 | 0.0 |
| PER (x) | 30.6 | NM | 33.3 | 12.9 |
| P/Cash Flow (x) | 13.1 | 35.3 | 15.4 | 9.5 |
| P/Book Value (x) | 1.2 | 1.2 | 1.0 | 0.9 |
| Dividend Yield (%) | 0.0 | 0.0 | 0.0 | 0.0 |
| ROE (%) | 3.9 | 0.1 | 4.4 | 7.5 |
| Net Gearing (%) | 74.6 | 12.6 | 0.0 | 0.0 |

*Stock deemed Shariah compliant by the Securities Commission.

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Recommendation: **BUY**Stock Code: **8567**Bloomberg: **SALC MK**Price: **MYR0.63**12-Month Target Price: **MYR0.70**Date: **November 26, 2009****Quarterly Performance**

| FY Dec. / MYR mln | 3Q09 | 3Q08 | % Change |
|---------------------------------|-------|------|----------|
| Reported Revenue | 109.5 | 45.3 | >100 |
| Reported Operating Profit | 10.8 | 3.2 | >100 |
| Depreciation & Amortization | NA | NA | NA |
| Net Interest Income / (Expense) | -0.8 | -1.1 | -28.9 |
| Reported Pre-tax Profit | 11.0 | 2.8 | >100 |
| Reported Net Profit | 7.1 | 1.8 | >100 |
| Reported Operating Margin (%) | 9.9 | 7.2 | - |
| Reported Pre-tax Margin (%) | 10.0 | 6.2 | - |
| Reported Net Margin (%) | 6.5 | 4.0 | - |

Source: Company data

Profit & Loss

| FY Dec. / MYR mln | 2007 | 2008 | 2009E | 2010E |
|---------------------------------|-------|-------|-------|-------|
| Reported Revenue | 134.6 | 252.8 | 390.8 | 438.7 |
| Reported Operating Profit | 0.8 | 20.8 | 37.1 | 43.1 |
| Depreciation & Amortization | -7.4 | -7.7 | -8.0 | -8.4 |
| Net Interest Income / (Expense) | -3.1 | -5.1 | -5.6 | -6.1 |
| Reported Pre-tax Profit | -5.1 | 16.0 | 34.6 | 40.0 |
| Effective Tax Rate (%) | NM | 25.9 | 25.0 | 25.0 |
| Reported Net Profit | -7.8 | 8.8 | 22.6 | 25.0 |
| Reported Operating Margin (%) | 0.6 | 8.2 | 9.5 | 9.8 |
| Reported Pre-tax Margin (%) | -3.8 | 6.3 | 8.9 | 9.1 |
| Reported Net Margin (%) | -5.8 | 3.5 | 5.8 | 5.7 |

Source: Company data, S&P Equity Research

Standard & Poor's Equity Research Services

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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

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Required Disclosures

Recommendation and Target Price History

| Date | Recommendation | Target Price |
|-----------|----------------|--------------|
| New | 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 |
| 4-Dec-06 | Hold | 1.08 |

