

Recommendation: **BUY**Stock Code: **8567**Bloomberg: **SALC MK**Price: **MYR0.52**12-Month Target Price: **MYR0.65**Date: **August 27, 2009****Board:** Main**Sector:** Trading/Services**GICS:** Utilities/Water Utilities**Market Value - Total:** MYR243.2 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 FBMEMAS.

**Analyst:** Chok Wai Lee, CFA

## Results Review & Earnings Outlook

- Salcon posted 1H09 revenue and net profit of MYR191.4 mln (+78.5% YoY) and MYR9.7 mln (+76.5% YoY), respectively. The earnings accounted for 50.7% of our full-year forecasts and were in line with our expectations. The sharp increase in net profit was mainly due to improved performance from its China concessions and construction division.
- Salcon's concessions continue to provide stable income to the group, contributing revenue of MYR20.8 mln (+3.3% QoQ) in 2Q09. Meanwhile, the construction division reported revenue of MYR89.7 mln (+57.3% QoQ), thanks to higher revenue recognition from domestic contracts, as well as overseas projects in countries such as Vietnam and Sri Lanka.
- Going forward, we believe Salcon's earnings will remain solid, given its strong orderbook and enhanced profit contributions from its China concessions. The group has continued to expand its core business overseas by setting up offices in Vietnam and India, to tap into the vast water and wastewater construction projects in these high-growth countries.
- We leave our 2009 and 2010 earnings forecasts unchanged.

## Recommendation & Investment Risks

- We maintain our Buy recommendation on Salcon with an unchanged 12-month target price of MYR0.65.
- We continue to 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.
- Salcon has ambitious 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 380 mln mld. The existing and new concessions in China will enable Salcon to secure sustainable and recurring income going forward, in our view.
- Salcon's orderbook is now at MYR1.2 bln, with the unbilled portion at around MYR800 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	4.1
PER (x)	27.7	12.8
Dividend/Share (sen)	0.0	0.0
NTA/Share (MYR)	0.59	0.63
Book Value/Share (MYR)	0.62	0.66
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	0.66
Cash Flow (sen)	4.8	-0.1	3.5	5.8
Reported Earnings (sen)	2.0	-1.8	1.9	4.1
Dividend (sen)	0.0	0.0	0.0	0.0
Payout Ratio (%)	0.0	0.0	0.0	0.0
PER (x)	25.5	NM	27.7	12.8
P/Cash Flow (x)	10.9	NM	14.7	9.0
P/Book Value (x)	1.0	1.0	0.8	0.8
Dividend Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	3.9	-4.7	3.4	6.4
Net Gearing (%)	74.6	12.6	0.0	0.0

\*Stock deemed Shariah compliant by the Securities Commission.

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FY Dec. / MYR mln	2Q09	2Q08	% Change
Reported Revenue	111.6	61.9	80.3
Reported Operating Profit	10.1	5.4	87.0
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	-1.4	-1.0	38.7
Reported Pre-tax Profit	9.6	4.9	94.9
Reported Net Profit	6.4	3.7	74.2
Reported Operating Margin (%)	9.1	8.7	-
Reported Pre-tax Margin (%)	8.6	8.0	-
Reported Net Margin (%)	5.7	5.9	-

Source: Company data

**Profit & Loss**

FY Dec. / MYR mln	2007	2008	2009E	2010E
Reported Revenue	134.6	252.8	338.4	367.2
Reported Operating Profit	-7.2	18.3	32.4	36.3
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	29.9	33.2
Effective Tax Rate (%)	NM	25.9	25.0	25.0
Reported Net Profit	-7.8	8.8	19.0	19.9
Reported Operating Margin (%)	-5.3	7.2	9.6	9.9
Reported Pre-tax Margin (%)	-3.8	6.3	8.8	9.1
Reported Net Margin (%)	-5.8	3.5	5.6	5.4

Source: Company data, S&amp;P Equity Research

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**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.

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**Recommendation and Target Price History**

Date	Recommendation	Target Price
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
30-Aug-06	Hold	0.44

