

Recommendation: **BUY**Stock Code: **8567**Bloomberg: **SALC MK**Price: **MYR0.51**12-Month Target Price: **MYR0.65**Date: **May 28, 2009****Board:** Main**Sector:** Trading/Services**GICS:** Utilities/Water Utilities**Market Value - Total:** MYR236.2 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 1Q09 revenue and net profit of MYR79.8 mln (+76.1% YoY) and MYR3.2 mln (+81.1% YoY), respectively. The earnings accounted for 20.2% of our previous 2009 forecasts and we view the results to be in line, given that we expect stronger results in the following quarters. The sharp increase in net profit was mainly due to contributions from new construction projects and improved performance from its China concessions.
- Salcon's water division continues to provide stable income to the company, contributing revenue of MYR20.1 mln (+14.5% YoY) during the quarter under review. Meanwhile, the construction division reported revenue of MYR57.0 mln, an increase of 117.1% YoY, thanks to higher revenue recognition from domestic contracts such as non-revenue water (NRW) and sewage projects in Negeri Sembilan, Kelantan and Sabah. We understand from management that there will be more contributions from overseas projects (Vietnam and Sri Lanka) going forward.
- Recently, Salcon also secured a MYR94.3-mln contract to construct a sewage treatment plant for Medini Development, Iskandar Malaysia in Johor with project duration of 67 weeks. We view this development positively as it shows Salcon's ability to clinch new projects amid the current economic downturn.
- We have revised upwards our 2009 and 2010 earnings forecasts by 18.2% and 15.9%, respectively, taking into account the contributions from the new project.

Recommendation & Investment Risks

- We maintain our Buy recommendation on Salcon with a higher 12-month target price of MYR0.65 (from MYR0.60), following our earnings revisions.
- We continue to value Salcon based on a sum-of-parts method that is derived from discounted cash flow 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.
- We believe the group is poised for a strong turnaround as the investments in China concessions and new construction projects are beginning to take off and contribute meaningfully to its bottomline. Salcon's orderbook currently stands at MYR1.1 bln with the unbilled portion at about 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)	26.9	12.4
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 - 0.65	
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)	24.7	NM	26.9	12.4
P/Cash Flow (x)	10.6	NM	14.3	8.7
P/Book Value (x)	0.9	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	1Q09	1Q08	% Change
Reported Revenue	79.8	45.3	76.1
Reported Operating Profit	5.5	3.2	69.4
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	-2.1	-1.1	83.8
Reported Pre-tax Profit	4.5	2.8	61.5
Reported Net Profit	3.2	1.8	81.1
Reported Operating Margin (%)	6.9	7.2	-
Reported Pre-tax Margin (%)	5.7	6.2	-
Reported Net Margin (%)	4.1	4.0	-

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&P Equity Research

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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.

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Required Disclosures

Recommendation and Target Price History

Date	Recommendation	Target Price
New	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

