

Recommendation: **BUY**Stock Code: **8567**Bloomberg: **SALC MK**Price: **MYR0.36**12-Month Target Price: **MYR0.60**Date: **March 2, 2009****Board:** Main**Sector:** Trading/Services**GICS:** Utilities/Water Utilities**Market Value - Total:** MYR168.4 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 2008 revenue and net profit of MYR252.8 mln (+87.8% YoY) and MYR8.8 mln (from net loss of MYR7.8 mln in 2007), respectively. The strong earnings were mainly contributed by new construction projects as well as concession income from China. However, the results were below expectations, accounting for only 74.5% of our 2008 forecasts.
- The variance was mainly due to an impairment loss of MYR2.2 mln and a MYR0.5-mln write-down on collateralized loan obligation investment. Stripping out the one-off items, Salcon's 2008 results were within our expectations. Salcon's concessions business has however improved significantly, contributing operating profit of MYR14.9 mln in 2008. We believe this is mainly due to the contribution from the expanded capacity in the Linyi and Haining water supply concessions in China.
- Salcon has withdrawn from the proposed acquisition of 74% of Oriental Capital Assurance Berhad (OAC) in February 2009. We have not factored in any earnings contribution from OAC into our earnings model. We are positive on this as the group can now move on and focus instead on its water and wastewater business.
- We have reduced our net profit forecasts for 2009 by 17.4% to MYR16.1 mln, taking into account the delay in construction projects amid the slower domestic economic growth. We also introduce our 2010 earnings estimate of MYR17.2 mln.

Recommendation & Investment Risks

- We maintain our Buy recommendation on Salcon with an unchanged 12-month target price of MYR0.60.
- 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 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 MYR750 mln. About 30% of the orderbook is contributed by overseas projects. Salcon is actively bidding for new projects in the region and we believe prospects for the group remain bright 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.

Key Stock Statistics

FY Dec.	2008	2009E
Reported EPS (sen)	1.9	3.4
PER (x)	19.2	10.5
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)	0.34 - 0.92	
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.

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	5.2
Reported Earnings (sen)	2.0	-1.8	1.9	3.4
Dividend (sen)	0.0	0.0	0.0	0.0
Payout Ratio (%)	0.0	0.0	0.0	0.0
PER (x)	17.6	NM	19.2	10.5
P/Cash Flow (x)	7.6	NM	10.2	7.0
P/Book Value (x)	0.7	0.7	0.6	0.5
Dividend Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	3.9	-4.7	3.4	5.4
Net Gearing (%)	74.6	12.6	0.0	0.0

FY04: July YE, FY05: 17 months to Dec. 2005

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FY Dec. / MYR mln	4Q08	4Q07	% Change
Reported Revenue	81.0	53.6	51.1
Reported Operating Profit	5.2	-5.7	NM
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	-1.4	-0.6	>100
Reported Pre-tax Profit	4.7	-6.2	NM
Reported Net Profit	1.5	-7.5	NM
Reported Operating Margin (%)	6.4	-10.7	-
Reported Pre-tax Margin (%)	5.7	-11.5	-
Reported Net Margin (%)	1.8	-14.0	-

Source: Company data

Profit & Loss

FY Dec. / MYR mln	2007	2008	2009E	2010E
Reported Revenue	134.6	252.8	280.7	311.7
Reported Operating Profit	-7.2	18.3	28.5	32.6
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	26.0	29.6
Effective Tax Rate (%)	NM	25.9	25.0	25.0
Reported Net Profit	-7.8	8.8	16.1	17.2
Reported Operating Margin (%)	-5.3	7.2	10.1	10.5
Reported Pre-tax Margin (%)	-3.8	6.3	9.3	9.5
Reported Net Margin (%)	-5.8	3.5	5.7	5.5

Source: Company data, S&P Equity Research

Required Disclosures

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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.

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Recommendation and Target Price History

Date	Recommendation	Target Price
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
24-May-06	Strong Buy	0.47
30-Mar-06	Buy	0.50

