

Recommendation: **BUY**

Stock Code: 8567

Bloomberg: SALC MK

Price: MYR0.47

12-Month Target Price: MYR0.60

Date: August 29, 2008

Board: Main

Sector: Trading/Services

GICS: Utilities/Water Utilities

Market Value - Total: MYR217.5 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.

Analyst: Chok Wai Lee, CFA



Results Review & Earnings Outlook

- Salcon posted 1H08 revenue and net profit of MYR107.2 mln (+92.5% YoY) and MYR5.5 mln (from MYR188,000 in 1H07), respectively. The earnings accounted for 28.2% of our original 2008 forecasts and were below our expectations.
- The variance was mainly due to lower-than-expected contribution from the construction business. Construction progress for the MYR183 mln Kota Kinabalu Sewage System project remained slow due to the rainy season in Sabah. Management indicated that construction is expected to pick up in 2H08. Furthermore, margins for construction business have been squeezed due to escalating raw material prices.
- On a positive note, Salcon's water concessions in China have improved significantly, contributing pre-tax profit of MYR5.8 mln, well within our expectations. We believe this is mainly due to the contribution from the expanded capacity in the Linyi and Haining water supply concessions.
- We have reduced our net profit forecasts for 2008 and 2009 by 33.2% and 17.5% to MYR13.1 mln and MYR20.9 mln, respectively, taking into account the delay in construction projects and lower margins from construction. Salcon's order book as at end-August 2008 stood at MYR1.1 bln (up from MYR800 mln as at end-May 2008). Salcon is actively bidding for new projects in the region and we believe prospects for the group remain bright going forward.

Key Stock Statistics

FY Dec.	2007	2008E
Reported EPS (sen)	-1.8	2.8
PER (x)	NM	16.7
Dividend/Share (sen)	0.0	0.0
NTA/Share (MYR)	0.50	0.53
Book Value/Share (MYR)	0.52	0.55
No. of Outstanding Shares (mln)	467.7	
52-week Share Price Range (MYR)	0.44 - 1.27	
Major Shareholders:	%	
Naga Muhibbah Sdn. Bhd.	15.7	
EPF Board	3.6	

*Stock deemed Shariah compliant by the Securities Commission.

Recommendation & Investment Risks

- We maintain our Buy recommendation on Salcon with a lower 12-month target price of MYR0.60 (from MYR0.77) 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 order book-related activities.
- Salcon has ambitious plans to raise its water and wastewater treatment concessions in China to 1,000 mln litres/day (mld) from the current 400 mld through a combination of organic expansion and new concessions.
- We believe the group is poised for a strong turnaround going forward and the investments in China are beginning to take off and contribute meaningfully to its bottom line. Share price catalysts could also include, in our view, positive news flow on potential concessions and construction related contracts in Malaysia and overseas.
- Risks to our recommendation and target price include slower-than-expected replenishment of its order book and commencement of new construction projects, higher-than-expected costs, collection issues and regulatory issues for the China concessions that could lead to lower water tariffs. With the recent political changes domestically, water projects in the country could also be much slower in taking off.

Per Share Data

FY Dec.	2005	2006	2007	2008E
Book Value (MYR)	0.51	0.53	0.52	0.55
Cash Flow (sen)	-5.0	4.8	-0.4	4.1
Reported Earnings (sen)	-14.2	2.0	-1.8	2.8
Dividend (sen)	0.0	0.0	0.0	0.0
Payout Ratio (%)	0.0	0.0	0.0	0.0
PER (x)	NM	22.8	NM	16.7
P/Cash Flow (x)	NM	9.8	NM	11.2
P/Book Value (x)	0.9	0.9	0.9	0.8
Dividend Yield (%)	0.0	0.0	0.0	0.0
ROE (%)	-12.5	3.9	-4.5	5.7
Net Gearing (%)	28.6	74.6	12.6	0.0

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

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 © 2008 The McGraw-Hill Companies, Inc.

Page 1 of 4

Recommendation: **BUY**

Stock Code: 8567

Bloomberg: SALC MK

Price: MYR0.47

12-Month Target Price: MYR0.60

Date: August 29, 2008

Quarterly Performance

FY Dec. / MYR mln	2Q08	2Q07	% Change
Reported Revenue	61.9	28.3	>100
Reported Operating Profit	5.4	0.1	>100
Depreciation & Amortization	NA	NA	NA
Net Interest Income / (Expense)	-1.0	-1.2	-17.5
Reported Pre-tax Profit	4.9	0.9	>100
Reported Net Profit	3.7	0.0	>100
Reported Operating Margin (%)	8.7	0.3	-
Reported Pre-tax Margin (%)	8.0	3.3	-
Reported Net Margin (%)	5.9	0.1	-

Source: Company data

Profit & Loss

FY Dec. / MYR mln	2006	2007	2008E	2009E
Reported Revenue	121.3	134.6	250.8	338.2
Reported Operating Profit	-1.6	-6.9	25.0	35.9
Depreciation & Amortization	-5.8	-6.0	-6.3	-6.6
Net Interest Income / (Expense)	-4.2	-3.1	-4.2	-4.6
Reported Pre-tax Profit	0.5	-4.8	24.7	35.2
Effective Tax Rate (%)	NM	NM	26.0	25.0
Reported Net Profit	4.3	-7.5	13.1	20.9
Reported Operating Margin (%)	-1.3	-5.1	10.0	10.6
Reported Pre-tax Margin (%)	0.5	-3.6	9.9	10.4
Reported Net Margin (%)	3.6	-5.6	5.2	6.2

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.

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 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	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

