

# Solargiga

*Have only just begun*

**Not Rated**

China Industrial 1

## Financial summary

Year to Dec	06A	07A	08A	09F	10F
Turnover (RMBm)	413.31	015.51	492.91	958.72	831.7
Net Profit (RMBm)	109.7	292.2	83.4	338.9	496.7
EPS (RMB)	0.219	0.203	0.051	0.229	0.302
EPS Δ%	165.5	165.5	(91.2)	339.0	31.9
P/E (x)	4.9	1.9	21.1		
P/B (x)	2.86	2.45	1.44		
EV/EBITDA (x)	11.2	4.6	12.7		
Yield (%)	-	4.3	1.2		
ROE (%)	72.5	71.1	8.8		
ROCE (%)	60.3	64.6	10.4		
N. Gear. (%)	Cash	Cash	Cash		

Source: Bloomberg

Ticker:	0757.HK	12 mth range:	HK\$1.05-7.10
Price:	HK\$1.22	Market cap:	US\$264.5m
Target:	n.a.	Daily t/o, 3 mth:	US\$1.1m
		Free float %:	30.5%

## Key points:

- \* Solar market hit by the financial crisis.
- \* Expects pickup in 2H thanks to favorable policies.
- \* Tough 2009 due to market transition.
- \* Growth to resume in 2010.
- \* Strength from quality.
- \* Seeking long-term sales contracts to reduce uncertainties.

## Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-6.1	-31.3	n.a.
Actual price changes (%)	-1.6	-34.1	n.a.

  

	09F	10F	11F
Consensus EPS (RMB)	0.229	0.302	n.a.
Previous forecasts (RMBm)	n.a.	n.a.	n.a.
Previous EPS (RMB)	n.a.	n.a.	n.a.

## Price Chart



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expect polysilicon price to correct further until associated gross margin reaches a sustainable level (est. production cost of polysilicon: ~US\$30/kg for leading overseas producers and US\$70~80 for domestic Chinese producers). This will result in a continuous cost down for crystalline silicon-based solar products and favor their long-term outlook when competing with other technologies.

**Motivation behind expansion.** Based on present US\$85/kg polysilicon price, we roughly calculate that wafer production cost is ~US\$1.2/watt, which is still far below its selling price (over US\$2.0/watt). This, on one hand, suggests wafer price might go down significantly this year. On the other hand, it encourages further capacity expansion (our sensitivity test shows a single wafer project could yield 23.8% ROE based on US\$1.5/watt selling price and 15% gross margin). In fact, most companies maintain their expansion plans, despite the gloomy economy. Under this continuous capacity expansion trend, we expect wafer producers' gross margin to stay under pressure.

**Market contraction since 4Q.** Global solar photovoltaic (PV) industry suffered at the end of last year due to a soft demand exacerbated by credit crunch (solar power projects require financing support from banks). Price of polysilicon, the major raw material, plunged from peak ~US\$400/kg in mid-2008 to ~US\$130/kg in 4Q. Solar PV wafer price dropped, accordingly, from US\$2.87/watt in 3Q to US\$2.45/watt (Solargiga's effective selling price). The market remains silent so far this year with polysilicon price down further to ~US\$85/kg.

**Will recovery come in 2H?** As a policy-oriented industry, market recovery relies on governments' efforts, in our view. Though outlook is still uncertain, some positive developments have been spotted recently, including:

- China – approved 3 pilot solar power stations located in Chongming Island (1MW), Ordos (255KW) and Dunhuang (10MW), respectively.
- US – feed-in tariff launched in Gainesville, Florida, in Mar, as the first US city to adopt this incentive scheme for installation of solar systems.
- Japan – to offer subsidies for installing household solar power systems (JPY70,000/KW with total budget of JPY9b)

Though these policy announcements are not earth shattering, we regard the movements as warm-up signals and expect them to scale up gradually. Together with worldwide governments' effort to loosen credit, we reckon it is possible to observe some recovery in 2H.

## Cost down to favor crystalline silicon-based solar technology.

Global polysilicon capacity is anticipated to improve 28.9% in 2009 to 75,400 tonne, followed by a 44.8% jump in 2010 to 109,200 tonnes. With this improving supply, another severe shortage is unlikely. We

**Table 1: Capacity expansion**

Year to Dec (MW)	08A	09F
Solargiga	200	400
ReneSola	645	825
JA Solar	600	875
LDK Solar	1,400	2,300

Source: Companies data

**Competitive edges of Solargiga.** We think solar wafer industry has stepped into a relatively mature stage and competition, similar to other traditional manufacturing industries, will concentrate on production efficiency, cost control and quality. Regarding the only HK-listed solar wafer producer, Solargiga, we think the company's major strength comes from its superior product quality, which allows it to charge a premium price, according to the management. Meanwhile, as an expert of monocrystalline technology, which consumes more polysilicon during production, Solargiga might benefit more from the sharp decline in polysilicon price than peers in multicrystalline area.

**Table 2: Wafer selling price**

Year to Dec (US\$/watt)	1Q 08A	2Q 08A	3Q 08A	4Q 08A
Solargiga	2.52	2.75	2.87	2.45
ReneSola	n.a.	n.a.	2.73	2.16
JA Solar	n.a.	n.a.	n.a.	n.a.
LDK Solar	2.22	2.44	2.48	n.a.

Source: Companies data

**FY12/08A results hit by market turnaround in 4Q.** Turnover increased 47.0% in FY12/08A to RMB1,492.9m thanks mainly to capacity expansion. However, ASP in 4Q dropped considerably from US\$2.71/watt on average in 1-3Q to US\$2.45/watt in 4Q. Thus gross profit margin narrowed 16.7pcp to 15.1% (after excluding RMB220.2m write-down of inventories, mainly polysilicon, gross margin declined mildly by 1.9pcp to 29.9%). Net profit plunged 71.5% to RMB83.4m, implying a net loss of RMB234.7m in single 4Q.

**FY12/09F driver at cost side.** The company maintains its expansion plan to double capacity to 400MW by end-2009. Solargiga used to sell products at spot market. Lacking of long-term sales contracts in hand, the company's sales in FY12/09F carries more uncertainties than other peers. This could be critical amid a weak market condition. The company has been trying to make improvement in this area. We think major progress in negotiating and securing long-term contracts could be a potential catalyst for the share price. Comparably a foreseeable driver for FY12/09F could come from its cost side. The company signed several long-term polysilicon supply contracts in 2008, two of which will be enforced this year. According to the management, one contract contains a 10% discount to the market price while another at market level.

**Short-term profitability under pressure but worth to be eyed on for long-term prospect.** 2009 should be a difficult year for solar PV industry, in our view, due to market transition from supplier-led to buyer-led. Thereafter, we expect the market to return to its upside track with increasing adoption of solar technology back by each country's intention to develop renewable energy as well as the declining manufacturing cost. Our strategy at the moment is to keep eyes on participators to identify the potential winners. We will likely turn positive towards Solargiga in the events of:

- Confirmation of sizeable long-term sales contracts;
- Encouraging operating results in IH FY12/09F;
- Faster-than-expected market recovery

**Table 3: P & L**

Year to Dec (RMBm)	06A	07A	08A
Turnover	413.3	1,015.5	1,492.9
Cost of sales	(244.2)	(692.4)	(1,267.4)
Gross profit	169.1	323.1	225.5
Other revenue	5.5	81.6	11.1
Other net loss	(1.2)	(8.4)	(7.6)
Selling and distribution expenses	(2.1)	(4.4)	(6.8)
Administrative expenses	(15.2)	(47.2)	(101.5)
Profit from operation	156.0	344.7	120.7
Finance costs	(3.9)	(7.6)	(3.3)
Profit before taxation	152.2	337.1	117.4
Income tax	(4.0)	(20.6)	(34.0)
Profit for the period	148.1	316.5	83.4
Attributable to:			
Equity holders of the Company	109.7	292.2	83.4
Minority interests	38.4	24.2	
EPS - Basic (RMB)	0.219	0.203	0.051
Proposed DPS (RMB)		0.052	0.015

Source: Company data

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