

## Comtec Solar

### Short-term earning risk reflected

to summarize...

- Downward revise shipment and margin forecast for 2011
- May and Jun expected to realize margin at the lower range of 15%-25%
- We expect recovery since Jul and Q3 margin to slightly improve over Q2
- China regulatory policy gradually rolls out. Tariff set at RMB1.00 per kWh
- TP lowers to HK\$4.07 from HK\$4.93 on revised earnings and sentiment
- Treating TPG CB as debt, our TP represents 13.5x FY12/11F and 7.1x FY12/12F P/E before dilution at HK\$3.90 conversion price

**Update on Q2.** Market prices of solar products fell faster-than-expected in 2011. While ASP of modules and cells continue to fall sharply in Q1 and Q2, the impact is partly transferred to wafers and polysilicon in Q2. As we have discussed in our previous sector update, we expect a margin squeeze this year, yet a low should be seen in Q2 for wafer manufacturers. While there is a longer-term gross margin range between 15% and 25% for wafers, gross margin for Q2 may be as low as 10% to 15%, according to our channel checks. We would downward revise sales, shipment and profit forecast for the coming years. Nevertheless, we remain positive towards wafers and polysilicon producers. For instance, GCL-Poly (3800 HK) issued a profit alert, indicating 300%+ YoY increase in net profit for 1H FY12/11F.

**Table 1. Revised forecasts and assumptions for 1H and 2H 2011 and 2012**

	1H FY12/11F	2H FY12/11F	1H FY12/12F	2H FY12/12F
Nameplate capacity MW	600	1,000	1,400	1,400
Wafer shipment MW	116	290	370	570
Revenue (RMBm)	612	1,207	1,446	2,062
Overall gross margin	25%	22%	23%	23%
Overall net margin	17%	15%	15%	15%
Net profit (RMBm)	105.4	176.7	218.0	319.2
EPS before dilution (RMB)	0.093	0.156	0.192	0.282

Source: SBI E2-Capital

**Government regulatory policy gradually rolls out in China.** It is expected that Chinese government target to reach 5,000MW cumulative on-grid PV capacity by 2015. Besides, NDRC announced a nationwide solar PV on-grid tariff last month. For projects approved prior to 1 Jul 2011, applicable on-grid tariff (including tax) would be RMB1.15 per kWh. While for projects approved after 1 Jul 2011, applicable on-grid tariff would be RMB1.00 per kWh. Base on simple conservative estimation with RMB0.85 ex-tax tariff for 1,320 sun hours (4 hours x 330 days) for 20 years at RMB22.5 per W all-in CAPEX, on-grid PV projects could break-even without additional subsidy even though all-in CAPEX stay at the assumed high level. System integrator may receive a higher IRR if solar site is carefully chosen.

**Table 2. Conservative IRR estimation of RMB1.00 per kWh tariff**

On-grid tariff including tax (RMB)	1.00		
Ex-tax tariff (RMB)	0.85		
Life of PV project (years)	20		
Number of sun hours a year (hours)	1,320		
System cost (RMB per W)	15	IRR 1	4.7%
Outsourcing system cost (RMB per W)	22.5	IRR 2	0.0%

Source: SBI E2-Capital

Ticker	0712 HK
Rating	BUY
Price (HK\$)	2.74
Target Price (HK\$)	4.07 (+49%)
12m Price Range (HK\$)	2.00-4.80
Market cap. (US\$m)	398.3
Daily t/o (US\$m)	3.8
Free float (%)	36.6

#### Financial summary

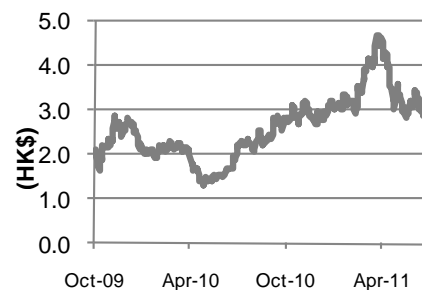
Year to Dec	09A	10A	11F	12F	13F
Turnover (RMBm)	507	1,021	1,819	3,508	4,927
Net Profit (RMBm)	25	223	282	537	774
EPS (RMB)	0.032	0.197	0.249	0.474	0.682
P/E (x)	121.8	13.6	9.1	4.8	3.3
P/B (x)	2.9	2.0	1.5	1.1	0.9
EV/EBITDA (x)	45.7	9.4	4.6	3.3	2.3
Yield (%)	0	0.7	1.1	2.1	3.0
ROE (%)	2.8	17.5	17.2	26.8	29.8
ROCE (%)	2.8	17.5	19.1	21.4	24.7
N. Gear. (%)	Cash	Cash	3.8	40.3	33.3

Source: SBI E2

	11F	12F	13F
Consensus EPS (RMB)	0.280	0.440	0.600
Previous earnings (RMBm)	423	676	1,039
Previous EPS (RMB)	0.295	0.472	0.725

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(10.6)	(35.3)	17.8
Actual price changes (%)	(12.2)	(39.8)	20.7



Source: Bloomberg

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**Continuous concern on utilization of new capacity.** In Q1, the management indicated that 400MW new capacity out of the 600MW would gradually contribute to shipment over the year. While we believe equipment were installed and adjusted, in our last report we have already lowered our shipment forecast to below guidance then. With power restriction arising from infrastructure issues in connection with the new facilities, we would further lower shipment forecast for the year from 454MW to 406MW, where each of Q1 and Q2 sold 50-60MW. Nevertheless, the company would continue to expand its capacity to 1,400MW to 1,500MW by 2H 2012. Under our estimation, the company should be working on expansion all the time and achieve increasing shipment volume. Table 3 shows our revised key operational data. Gross margin for 2011F was lowered faster-than-expected to 22.7% from our previous forecast at 26.2%.

**Table 3. Revised selected key operational data**

	FY12/09A	FY12/10A	FY12/11F	FY12/12F	FY12/13F
Nameplate capacity in progress (MW)	200	600	1,000	2,000	2,700
Sales volume (MW)	82	165	406	940	1,530
Overall ASP (RMB per W)	6.18	6.17	4.48	3.73	3.22
Gross Margin (%)	10.9	32.4	22.7	22.7	23.1

Source: SBI E2-Capital

**Profit and loss forecasts.** The following tables show that our net profit forecast are RMB105.4m and RMB176.7m for 1H FY12/11F and 2H FY12/11F respectively, down from RMB177.2m and RMB246.1m for the 2 periods. On a full-year basis, net profits are estimated at RMB282m, RMB537.2m and RMB773.8m for FY12/11F, FY12/12F and FY12/13F respectively.

**Table 4. Revised profit and loss forecast (Full-year)**

RMB m	FY12/09A	FY12/10A	FY12/11F	FY12/12F	FY12/13F
Revenue	506.9	1,021.4	1,819.2	3,508.0	4,926.9
Cost of sales	(451.8)	(690.8)	(1,406.6)	(2,711.5)	(3,788.4)
Gross profit / loss	55.1	330.6	412.6	796.6	1,138.6
Other income	6.7	26.6	0.0	0.0	0.0
Other expenses	(3.4)	(9.1)	0.0	0.0	0.0
Selling and distribution expenses	(2.2)	(1.8)	(3.6)	(7.0)	(9.9)
Administrative expenses	(18.2)	(75.8)	(59.1)	(114.0)	(160.1)
EBIT	38.0	270.5	349.8	675.5	968.6
Finance Costs	(6.7)	(7.4)	(7.9)	(24.4)	(30.6)
EBT	31.3	263.1	341.9	651.1	938.0
Income tax expenses	(6.4)	(40.2)	(59.8)	(113.9)	(164.1)
Profit for the year	24.9	222.9	282.0	537.2	773.8
Reported EPS (RMB)	0.032	0.210	0.249	0.474	0.682

**Table 5. Revised profit and loss forecast (Half-year)**

RMB m	1H FY12/10A	2H FY12/10A	1H FY12/11F	2H FY12/11F
Revenue	429.1	592.3	611.8	1,207.4
Cost of sales	(331.1)	(359.7)	(459.0)	(947.6)
Gross profit / loss	98.0	232.6	152.8	259.8
Other income	7.9	18.7	0.0	0.0
Other expenses	(1.7)	(7.4)	0.0	0.0
Selling and distribution expenses	(0.8)	(1.0)	(1.2)	(2.4)
Administrative expenses	(18.8)	(57.0)	(19.9)	(39.2)
EBIT	84.6	185.9	131.7	218.1
Finance Costs	(3.8)	(3.6)	(4.0)	(4.0)
EBT	80.8	182.3	127.7	214.1
Income tax expenses	(12.2)	(27.9)	(22.4)	(37.5)
Profit for the year	68.6	154.4	105.4	176.7

Source: SBI E2-Capital

**Our view and valuation.** Consolidation in the last cycle merely lasted for around 6 months back in 2008 and 2009 before ASP of solar products rose sharply in 2H 2010. A good number of less competitive peers restored probability and hence total market supply. This round of consolidation began in Q2 this year due to a pause in demand increment. It hit the sector the most in Q2 and would continue to affect the industry in 2H, in our view. While we revise our profit forecast down especially for the 2011, we believe current stock price retreat from HK\$4.80 to as low as HK\$2.69 largely contains the downside. Comtec is in healthy financial position and longer-term outlook remains positive. Apparently TPG has no intention to ask for lower conversion price for its RMB654.5m 0% interest CB and warrants at HK\$3.90 and HK\$4.10 respectively, we treat CB as debt for now. Taking account into the CB, we expect Comtec to stay below 5% net-debt-to-equity by end of 2011. We continued to use discount cash flow model with 15% discount rate to value Comtec Solar. TP was lowered from HK\$4.93.HK to HK\$4.07, which represents 13.5x and 7.1x P/E for FY12/11F and FY12/12F before CB and warrants dilution. We retain our BUY rating on the counter.

**Table 6. Selected balance sheet items**

RMB m	FY12/09A	FY12/10A	FY12/11F	FY12/12F	FY12/13F
Non-current assets	668	1,136	1,261	2,318	2,899
Property, plant and equipment	428	716	1,136	2,219	2,826
Other non-current assets	240	420	125	99	73
Current assets	743	777	1,616	1,602	1,999
Inventories	108	248	299	514	675
Trade and other receivables	166	155	399	673	877
Cash and cash equivalent	399	294	758	248	275
Other current assets	69	80	161	167	172
Non-current liability	4	4	666	677	687
CB	0	0	655	655	655
Other non-current liabilities	4	4	12	23	33
Current liabilities	345	397	446	994	1,265
Trade and other payables	199	194	270	483	649
Short-term bank loans	146	170	170	500	600
Other current liabilities	1	33	6	11	16
Total Equity	1,062	1,511	1,765	2,249	2,945

Source: SBI E2-Capital

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Disclosure of interests: SBI E2-Capital Securities Limited, a parent company of SBI E2-Capital Financial Services Limited, acted as sub-placing agent for Comtec Solar Systems Group Limited (stock code: 712) in September 2010.

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**BUY** : absolute upside of >10% over the next six months

**HOLD** : absolute return of -10% to +10% over the next six months

**SELL** : absolute downside of >10% over the next six months

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