

## Comtec Solar

### Margin expansion to continue

to summarize...

- Excellent Q3 results due to wider-than-expected margin expansion
- Anticipate a temporal margin peak at Q4 2010 – margin trend
- 770MW contracts secured for 2011, exceeding planned capacity
- Our expansion hypothesis remains – additional 500MW beyond 2011
- Reiterate BUY and revised target price at HK\$3.21

**Q3 FY12/10 results.** Though we did not include specifically breakdown quarterly profit estimates, we had emphasized a strong 3Q due to strong wafer ASP. That being said, the results came in ahead of our expectations. For 3Q FY12/10A, revenue was RMB280.4m with 33.8% gross margin, which is attributable to unexpected ASP rise to US\$0.9 per W. Our channel checks suggest further gains to US\$1.0 in 4Q cannot be ruled out. While there was a one-off gain of RMB6-7m due to RMB appreciation in 3Q, net profit was RMB80.8m. Due to a further delay in capacity ramp-up, we downward revise 4Q shipment to 65MW but upward revise 4Q ASP to US\$0.975 per W. Table 1 shows the revenue and profit estimates.

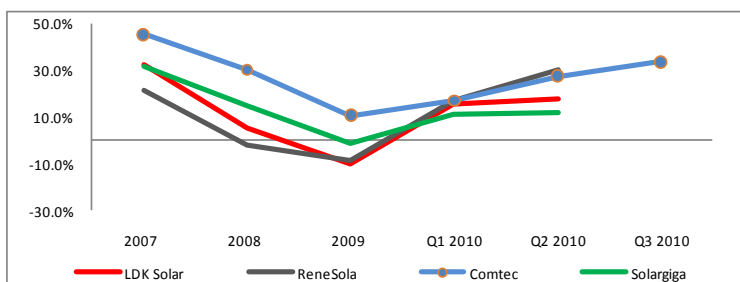
**Table 1. Profit and Loss for Q3 FY12/10A**

RMB m	Q1 FY12/10A	Q2 FY12/10A	Q3 FY12/10A	Q4 FY12/10F
Revenue	198.3	230.8	280.4	417.4
Gross profit	34.0	64.0	94.8	159.1
Profit for the year	20.3	48.2	80.8	110.9

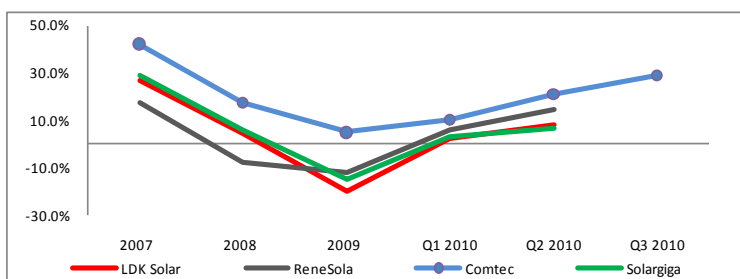
Source: SBI E2-Capital

**Anticipate a temporal margin peak for Q4 2010.** Solar sector recovered on renewed demand driven by government incentive and falling ASP since Q1 2010. However, we believe gross margin / net margin for wafer producers may seasonally peak at 4Q due to a lag in capacity expansion of wafer peers in 2010 and major ramp-up of polysilicon supply since 2009.

**Figure 1. Gross profit margin of Comtec Solar is consistently higher**



**Figure 2. Net profit margin of Comtec Solar is also consistently higher**



Source: SBI E2-Capital

Please refer to important disclosures at the end of this report

Ticker	0712 HK
Rating	BUY
Price (HK\$)	2.77
Target Price (HK\$)	3.21 (+16%)
12m Price Range (HK\$)	1.22-2.95
Market cap. (US\$m)	401.9
Daily t/o (US\$m)	2.2
Free float (%)	35.0

#### Financial summary

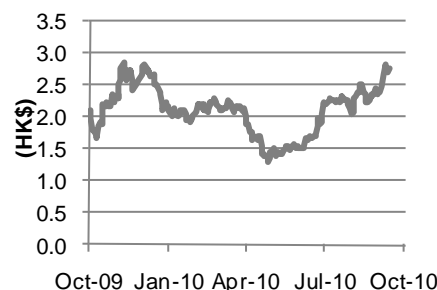
Year to Dec	08A	09A	10F	11F	12F
Turnover (RMBm)	762	507	1,127	3,370	4,774
Net Profit (RMBm)	130	25	260	517	663
EPS (RMB)	-	0.032	0.230	0.457	0.585
P/E (x)	-	83.3	10.6	5.3	4.2
P/B (x)	-	2.0	1.8	1.4	1.1
EV/EBITDA (x)	-	29.9	6.4	3.6	2.7
Yield (%)	-	0	0.9	1.9	2.4
ROE (%)	-	2.7	19.4	29.5	29.1
ROCE (%)	-	2.7	19.4	29.5	29.1
N. Gear. (%)	Cash	Cash	Cash	1%	1%

Source: SBI/Bloomberg

	10F	11F	12F
Consensus EPS (RMB)	0.180	0.333	0.443
Previous earnings (RMBm)	204.9	337.3	451.5
Previous EPS (RMB)	0.199	0.327	0.438

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	0.7	44.2	n.a.
Actual price changes (%)	9.5	62.9	n.a.



Source: Bloomberg

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**Shipment in 2010 revised downwards.** Due to coordination with local government, there is further delay in 2010 ramp-up. By the end of Oct, Comtec would have installed planned 400MW and may complete installation and reach 600MW by end of Nov. Since fine adjustment to equipment is still needed, we expect the new capacity of 33.3MW per month (400MW / 12) would only utilized at 60% to produce 20MW wafers. With 90% utilization rate of existing 50MW quarterly effective capacity, new shipment forecast for 4Q will be 65MW, down from 100MW in our previous report. See Table 2 for revised key operational data.

**770MW contracts secured for 2011, exceeding planned capacity.** For 2011, the company announced to raise capacity to 1,000MW, yet this is inconsistent with its 2011 contracts. The company has secured 770MW wafer orders for 2011 from leading module producers such as JA Solar (JASO US), Suntech Power (STP US), Dongfang Electric (1072 HK) and Sunergy (CSUN US). According to the announced expansion plan, and assuming the company could ramp up additional 400MW by the end of 3Q 2011, effective capacity for 2011 would be 700MW and potential output would be 630MW, falling short of 770MW. According to management, there is no penalty or compensation liable even if its actual shipment is below 770MW in 2011. However, as the company has raised HK\$230m by issuing 100m new shares in Sep 2010, we believe the company may put ~HK\$200m to boost additional 200MW capacity in 2011, which brings total capacity to 1,200MW possibly by the end of 3Q 2011. As such, an effective capacity would increase to 750MW with shipment of 675MW. Also see Table 2 for revised shipment for 2011.

**Our expansion hypothesis remains.** Comtec raised HK\$230m by issuing 100m new shares in Sep 2010. With this extra money, we assume Comtec would boost its 2011 expansion plan while keep remain its net cash position for the coming years according to our model. As such, the company could expand at 500MW per year afterwards under our hypothesis. Even with 500MW capacity addition per year, the company is still holding a net cash position for the coming years, which is a low gearing compared to peers. Upon new capital coming to the company or clearer market, a faster capacity expansion plan could be made.

**Table 2. Selected key operational data**

	FY12/08A	FY12/09A	FY12/10F	FY12/11F	FY12/12F
Ingot and Wafer Capacity at year end (MW)	55	200	600	1,200	1,500
Sales volume (MW)	44	82	187	675	1,050
Overall ASP (RMB per W)	17.32	6.18	6.03	4.99	4.55
Gross Margin (%)	30.4%	10.9%	31.2%	23.2%	21.6%

Source: Company data, SBI E2-Capital

**Revising up our numbers.** We originally agree with management expected range of gross margin between 15% and 20% and expect a gross margin peak below 30%. However, data shows that the sector has been much stronger than expected for at least 2H 2010. We revised our profit forecast by taking account into 1) lowered discount rate to 12.5% due to net cash position for coming years, representing a gearing too low; 2) the greater increase in ASP and profit margin in short-term; 3) effective capacity and thus sales volume increase due to new ramp-up assumptions. Table 3 shows the revised pro-forma profit and loss for 2010 to 2012.

**Table 3. Revised pro-forma profit and loss**

RMB m	FY12/08A	FY12/09A	FY12/10F	FY12/11F	FY12/12F
Revenue	762.10	506.88	1,126.87	3,370.37	4,774.22
Cost of sales	(530.80)	(451.76)	(774.99)	(2,589.85)	(3,744.14)
Gross profit / loss	231.30	55.12	351.88	780.52	1,030.07
Other income	47.13	6.70	0.00	0.00	0.00
Other expenses	(80.29)	(3.41)	(0)	(0)	(0)
Selling and distribution expenses	(1.40)	(2.22)	(2.88)	(8.63)	(12.22)
Administrative expenses	(23.89)	(18.19)	(36.25)	(117.96)	(167.10)
EBIT	172.86	38.00	312.75	653.93	850.76
Finance Costs	(6.30)	(6.67)	(6.59)	(7.64)	(22.54)
EBT	166.57	31.33	306.16	646.29	828.21
Income tax expenses	(36.09)	(6.39)	(45.92)	(129.26)	(165.64)
Profit for the year	130.48	24.94	260.23	517.03	662.57

**Valuation.** We continued to use discount cash flow to value Comtec Solar. We revised TP at HK\$3.21 considering short-term sentiment and longer-term trend. Table 4 shows our target price of HK\$3.21 applying 12.5% discount rate. Based on our target price of HK\$3.21 per share and estimated net profit of RMB260.2m and RMB517.0m for FY12/10F and FY12/11F, forward P/E represents 12.3x and 6.2x for FY12/10F and FY12/11F. With respective estimated net equity, P/B for the said target price would be 2.1x and 1.6x for FY12/10F and FY12/11F. Reiterate BUY.

**Table 4. Our target price**

Discount Rate	10.0%	12.5%	15.0%
Market cap (RMB)	4,556m	3,197m	2,399m
CNY / HKD	1.1374	1.1374	1.1374
Market cap (HK\$)	5,182m	3,637m	2,729m
number of shares	1,131.7m	1,131.7m	1,131.7m
Target price	HK\$4.58	HK\$3.21	HK\$2.41

Source: SBI E2-Capital

**Table 5. Implied multiples of our target price HK\$3.21**

	FY12/10F	FY12/11F	FY12/12F
Implied P/B (x)	2.1	1.6	1.2
Implied P/E (x)	12.3	6.2	4.8
Implied EV/EBITDA (x)	7.6	4.2	3.1

Source: SBI E2-Capital

**Peers comparison.** Since our initial report, stock price of Comtec Solar had risen 92.4% from HK\$1.44 to HK\$2.77. Despite the sharp rise within 3Q, compared to its peers Comtec is trading only an average P/B of 2.1x for FY12/10F and below average P/E at 13.2x and 7.2x for FY12/10F and FY12/11F based on market consensus.

**Table 6. Peers comparison based on market consensus**

Company	Ticker	Fiscal Year End	Mkt Cap (US\$m)	P/E (x)			
				P/B (x)	ROE (%)	FY12/10F	FY12/11F
SINO-AMERICAN	5483 TT	12/2009	3,706.5	2.9	5.5	13.5	10.8
GREEN ENERGY TEC	3519 TT	12/2009	2,386.2	1.9	1.8	13.1	11.6
WAFER WORKS CORP	6182 TT	12/2009	1,587.9	1.7	(3.6)	15.6	10.2
SOLARGIGA ENERGY	757 HK	12/2009	408.0	1.9	(7.4)	19.9	11.3
<b>COMTEC SOLAR</b>	<b>712 HK</b>	<b>12/2009</b>	<b>402.2</b>	<b>2.2</b>	<b>3.1</b>	<b>13.2</b>	<b>7.2</b>
LDK SOLAR CO-ADR	LDK US	12/2009	190.9	1.5	(28.8)	11.6	13.3
RENESOLA LTD	SOLA LN	12/2009	93.1	2.6	(16.3)	11.1	8.3
PV CRYSTALOX SOL	PVCS LN	12/2009	27.5	0.9	11.7	12.1	10.0
			Average	1.9	--	13.8	10.3

Source: Bloomberg

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Disclosure of interests: SBI E2-Capital Securities Limited was 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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