

Comtec Solar

Prolonged industry consolidation

to summarize...

- Reported increase in global shipment in Dec 2011 while price stayed weak
- Thin margin and impairment may lead to gross loss in 2H; potential warning
- Comtec repurchase part of TPG CB and warrants with new warrants issue
- Staying with net cash; expects suspended expansion to resume in 2013
- Downward revise TP to HK\$2.66 from HK\$3.47. Maintain BUY.

Reported increase in global shipment in Dec 2011 while price stayed weak. In the middle of market consolidation, competitions among manufacturers of modules, cells, wafers and even polysilicon are intense in their own fields. Since Q2, there was continuous pressure on pricing as well as shipment volume. ASP of wafers was as low as US\$0.30+ per W during 2H last year. Nevertheless, we continue to believe premium products were sold at premium price in favourable market condition and were able to secure sales in challenging market conditions. As such, the temporal shipment increase in Q4, for instance, having 3,000MW installation in Germany in Dec alone, is some of the relief for the tough solar market.

Thin margin and impairment may lead to gross loss in Q4; potential warning. While shipment went up for some of the major solar product players, gross margin was as thin as single digit in 2H last year. Considering potential impairment of inventories due to sharp fall in wafer price, we expect Comtec and its peers to incur certain degree of inventory impairment on polysilicon, which leads to potential gross loss in 2H last year. While we previously expect gradual recovery since 2H, the market is currently in Q1 stabilized at US\$0.95 per W, US\$0.60 per W and US\$0.40 per W for module, cell and wafer respectively. Mid single digit gross margin is seen in Jan this year. See Table 1 for industry cost structure according to our checks.

Table 1. Typical cost structure various parts within solar value chain

Jan 2012	Quotation per kg	Quotation per W
Efficient poly production cost	US\$22.5 per kg	US\$0.135 per W
Typical poly margin	US\$7.5 per kg	US\$0.045 per W (~27%)
Typical poly ASP	US\$30.0 per kg	US\$0.165 per W
Efficient wafer production cost		US\$0.210 per W
Typical wafer margin		US\$0.025 per W (~6%)
Typical wafer ASP		US\$0.400 per W
Efficient cell production cost		US\$0.175 per W
Typical cell margin		US\$0.025 per W (~4%)
Typical cell ASP		US\$0.60 per W
Efficient module production cost		US\$0.30 per W
Typical module margin		US\$0.05 per W (~5%)

Source: SBI E2-Capital

TPG CB partial repurchase and new warrant issue. Comtec Solar confirmed to repurchase 75% of RMB654.5m 5-year CB with conversion price at HK\$3.90 from TPG at HK\$490.875m and at the same time cancel 75% of 95.1m original warrants with conversion price at HK\$4.10. As a precedent condition, Comtec have to issue 94.35m new warrants with HK\$1.24 conversion price to TPG. While repayment should have limited liquidity pressure on Comtec as it is in net cash position, it is expected to slow its expansion progress and stays at 600MW for some time. We lowered the target price to HK\$2.66 largely on unexpected pause in expansion.

Ticker	0712 HK
Rating	BUY
Price (HK\$)	1.62
Target Price (HK\$)	2.66 (+64.2%)
12m Price Range (HK\$)	0.94 - 4.80
Market cap. (US\$m)	235.5
Daily t/o (US\$m)	1.0
Free float (%)	36.6

Financial summary

Year to Dec	09A	10A	11F	12F	13F
Turnover (RMBm)	507	1,021	1,022	1,078	1,191
Net Profit (RMBm)	25	223	34	104	218
EPS (RMB)	0.032	0.197	0.030	0.091	0.193
P/E (x)	121.8	13.6	44.7	14.6	6.9
P/B (x)	2.9	2.0	1.0	0.9	0.8
EV/EBITDA (x)	45.7	9.4	3.8	3.8	2.8
Yield (%)	0	0.7	0.2	0.7	1.4
ROE (%)	2.8	17.5	2.2	6.5	12.6
ROCE (%)	2.8	17.5	6.4	12.3	17.5
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI E2

	11F	12F	13F
Consensus EPS (RMB)	0.105	0.082	0.120
Previous earnings (RMBm)	232	424	712
Previous EPS (RMB)	0.205	0.374	0.638

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	4.9	13.7	(46.9)
Actual price changes (%)	11.7	31.7	(51.8)



Source: Bloomberg

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Downward revision of nameplate capacity as well as shipment. According to the management, during market consolidation, while there is potential demand, some of the potential customers place orders on condition of especially long credit terms. As such, Comtec Solar may not take such orders. For 2011, with full capacity of 600MW by the end of the year, we expect Comtec to achieve 253MW shipment at overall gross margin of 15.0%, which combined the effect of 109.4MW shipment at 24% margin in 1H and 144MW at 4% in 2H in 2011. Under our revised assumptions, Comtec is to resume expansion to 1,100MW only in 2013 and to gradually release the additional 500MW capacity in Q4 2013. The expansion assumption would be in line with our expectation that solar market is to gradually resume reasonable profitability in 2H 2012 and brings 416MW and 480MW shipments in 2012F and 2013F respectively. Table 2 shows selected key data on yearly count while Table 3 shows certain key data on half-year basis. For 2H FY12/11F, we expect a low gross margin of 4% and a net loss of RMB75.7m, which included an impairment loss of RMB58.95m on inventory write-down and RMB11m non-cash charges on CB. The impairment estimate is equivalent to 20% of inventory by end of Jun 2011, largely in line with price fall of ~20% in the last 2 months of 2011.

Table 2. Revised selected key operational data on yearly basis

	FY12/09A	FY12/10A	FY12/11F	FY12/12F	FY12/13F
Nameplate capacity in progress (MW)	200	600	600	600	1,100
Sales volume (MW)	82	165	253	416	480
Overall ASP (RMB per W)	6.18	6.17	4.03	2.59	2.48
Gross Margin (%)	10.9%	32.4%	15.0%	15.6%	26.2%

Table 3. Revised selected key operational data on half-yearly basis

	1H FY12/11A	2H FY12/11F	1H FY12/12F	2H 12/12F
Nameplate capacity MW	600	600	600	600
Wafer shipment MW	109	144	191	225
Revenue (RMBm)	575	447	478	600
Overall gross margin	24%	4%	9%	21%
Overall net margin	18%	-17%	4%	14%
Net profit (RMBm)	101.6	(75.7)	18.6	85.5
EPS (RMB)	0.090	(0.067)	0.016	0.075

Source: SBI E2-Capital

Profit and loss forecasts. Table 4 shows profit and loss forecast on half-yearly basis for 2H FY12/11F. As we have mentioned, with potential impairment loss and a low gross margin of 4% for 2H FY12/12F, net loss is expected to be seen at RMB75.7m. Nevertheless, on full-year basis, Comtec should still maintain profitable in 2011F. On the next page, Table 5 shows profit and loss forecast for FY12/12F as well as FY12/13F. With our new shipment and margin assumptions, net profit for FY12/11F and FY12/12F would be revised down to RMB33.9m and RMB103.6m respectively. That said, with the revised assumptions, Comtec is expected to return to 2010A profit level only in 2013F. In 2012F, while recovery would be seen in 2H this year, an overall improvement may be limited partly on relative strong 1H 2011 results. From 2013 onwards, with the new 500MW additional fully in operation, Comtec should resume strong growth in line with global demand recovery especially in light of grid-parity.

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

RMB m	1H FY12/10A	2H FY12/10A	1H FY12/11A	2H FY12/11F
Revenue	429.1	592.3	574.7	447.0
Cost of sales	(331.1)	(359.7)	(439.3)	(429.4)
Gross profit / loss	98.0	232.6	135.4	17.7
Other income	7.9	18.7	15.5	0.0
Other expenses	(1.7)	(7.4)	14.1	(70.0)
Selling and distribution expenses	(0.8)	(1.0)	(0.8)	(0.9)
Administrative expenses	(18.8)	(57.0)	(18.8)	(14.5)
EBIT	84.6	185.9	145.5	(67.7)
Finance Costs	(3.8)	(3.6)	(8.0)	(8.0)
EBT	80.8	182.3	137.5	(75.7)
Income tax expenses	(12.2)	(27.9)	(35.9)	0.0
Profit for the year	68.6	154.4	101.6	(75.7)

Source: SBI E2-Capital

Table 5. 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	1,021.7	1,077.6	1,190.8
Cost of sales	(451.8)	(690.8)	(868.6)	(909.5)	(879.2)
Gross profit / loss	55.1	330.6	153.1	168.1	311.6
Other income	6.7	26.6	15.5	0.0	0.0
Other expenses	(3.4)	(9.1)	(55.8)	0.0	0.0
Selling and distribution expenses	(2.2)	(1.8)	(1.7)	(2.2)	(2.4)
Administrative expenses	(18.2)	(75.8)	(33.3)	(35.6)	(39.3)
EBIT	38.0	270.5	77.8	130.4	269.9
Finance Costs	(6.7)	(7.4)	(7.9)	(4.9)	(5.1)
EBT	31.3	263.1	69.8	125.5	264.8
Income tax expenses	(6.4)	(40.2)	(35.9)	(22.0)	(46.3)
Profit for the year	24.9	222.9	33.9	103.6	218.5
Reported EPS (RMB)	0.032	0.210	0.030	0.091	0.193

Source: SBI E2-Capital

Staying net cash upon CB partial repurchase. Comtec is expected to repay HK\$490.875m CB and it is reflected in increment in 2011F and reduction in 2012F. By end of 2011F, cash and cash equivalent may reached RMB1,160m, which is largely sufficient to support the repayment. After the repayment, Comtec is to maintain a net cash position. Due to current defensive tone expressed by the management, we revise our expansion assumption to maintain an ongoing net cash position until at least 2013F.

Table 6. Selected balance sheet items

RMB m	FY12/09A	FY12/10A	FY12/11F	FY12/12F	FY12/13F
Non-current assets	668	1,136	869	727	1,189
Property, plant and equipment	428	716	655	581	1,105
Other non-current assets	240	420	214	147	84
Current assets	743	777	1,690	1,373	1,108
Inventories	108	248	184	182	176
Trade and other receivables	166	155	173	180	204
Cash and cash equivalent	399	294	1,160	842	557
Other current assets	69	80	172	169	171
Non-current liability	4	4	657	168	173
CB	0	0	655	164	164
Other non-current liabilities	4	4	2	4	9
Current liabilities	345	397	350	289	285
Trade and other payables	199	194	178	187	181
Short-term bank loans	146	170	170	100	100
Other current liabilities	1	33	1	2	5
Total Equity	1,062	1,511	1,552	1,643	1,839

Source: SBI E2-Capital

Our view and revised target price to HK\$2.66 from HK\$3.47. Using 15% discount rate, we revise our target price at HK\$2.66. Maintain BUY. We would issue an update report upon results release by the end of March. Current price represents valuation at 44.7x, 14.6x and 6.9x P/E for FY12/11F, FY12/12F and FY12/13F. While short-term outlook in 2012 may not be especially positive, we believe gradual up-pick of demand in China, US and Japan would improve volume as well as margin for survivors within the sector.

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