

Comtec Solar

It takes patience to aim high

to summarize...

- Q1 gross margin was 30.5%; net profit was RMB83.5m, up 311% YoY
- Utilization of newly added 400MW capacity lower-than-expected in Q1
- TPG CB plus warrants investment on 20.7% of Comtec boosts confidence
- TPG investment and TDR issue accelerate Comtec expansion plan to 1,500MW while raising concern on shipment and dilution effect in 2011
- Maintain BUY with target price at HK\$4.93, representing 11.1x (before dilution) or 15.0x (after CB, warrants and TDR dilution) FY12/11F P/E

Q1 FY12/11A results. Comtec Solar posted its Q1 results of 2011. The following compares the actual figure and our previous estimates. Actual results were below our expectation mainly on deviation on shipment volume.

Table 1. Profit and Loss for Q1 FY12/11A

RMB m	Q1 FY12/11A	Our estimates	Deviation (%)
Revenue	317.9	426.8	-25.5
Gross profit / loss	96.9	130.4	-25.7
Profit for the year	83.5	89.7	-6.9

Source: SBI E2-Capital

Where we got wrong? Low utilization rate of new capacity. Revenue was up 60.3% YoY to RMB317.9m. It was largely lower than our expectation since utilization of additional 400MW capacity was actually 10% in the quarter instead of 30% in our previous forecast. Gross margin was the same as forecast at 30.5%. Net profit was high at RMB83.5m for the period with apparently low tax rate. We are reviewing utilization assumptions on new capacity and would downward revise shipment assumptions for 2011 and 2012. Nevertheless, we slightly adjust profit margin upward on current market condition. Table 2 shows our revised forecast on quarterly performance.

Table 2. Revised FY12/11F quarterly forecast

RMB m	Q1 FY12/11F	Q2 FY12/11F	Q3 FY12/11F	Q4 FY12/11F
Revenue	426.8	639.7	913.3	1,201.4
Gross profit	130.4	167.7	208.2	258.9
Profit for the period	89.7	113.2	137.4	169.3

Source: SBI E2-Capital

Several rounds of fund raising leading to dilution. Texas Pacific Group (TPG) agreed to invest RMB654.5m zero-coupon 5-year CB at HK\$3.90 conversion price convertible to 200m common shares and 95.1m warrants at HK\$4.10 per share subscription price. TPG would also put representative on the board. Upon full conversion of both CB and warrants, TPG would hold 20.7% enlarged shares. TPG is familiar with solar sector and it rescued wafer maker MEMC (WFR US) in the past. Its investment in Comtec could be viewed as a vote of confidence, and we expect Comtec to leverage on extra capital and TPG expertise for better development.

Expansion plan accelerates. The management indicated most of the proceeds in the first stage, which is RMB645.5m, would be invested for new capacity. At RMB1.25 per W CAPEX, the company is expected to raise its capacity more aggressively than our forecast to 1,500MW in one single step by Q2 2012 from current capacity of 600MW. The company also expect to complete 100m TDR issue by Q3. While terms are good for the company and thus positive on longer-term outlook, there is short-term pressure due to potentially further delay in capacity ramp-up as well as dilution concern.

Please refer to important disclosures at the end of this report

Ticker	0712 HK
Rating	BUY
Price (HK\$)	4.46
Target Price (HK\$)	4.93 (+10.5%)
12m Price Range (HK\$)	1.22-4.48
Market cap. (US\$m)	648.3
Daily t/o (US\$m)	3.7
Free float (%)	35.9

Financial summary

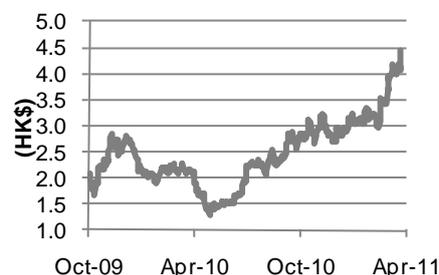
Year to Dec	09A	10A	11F	12F	13F
Turnover (RMBm)	507	1,021	2,399	4,474	6,460
Net Profit (RMBm)	25	223	423	676	1,039
EPS (RMB)	0.032	0.197	0.295	0.472	0.725
P/E (x)	121.8	13.6	10.1	6.3	4.1
P/B (x)	2.9	2.0	1.4	1.2	0.9
EV/EBITDA (x)	45.7	9.4	4.7	3.6	2.3
Yield (%)	0	0.7	0.8	1.3	1.9
ROE (%)	2.8	17.5	16.9	22.3	27.2
ROCE (%)	2.8	17.5	16.9	22.3	27.2
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI

	11F	12F	13F
Consensus EPS (RMB)	0.454	0.599	0.835
Previous earnings (RMBm)	510	719	--
Previous EPS (RMB)	0.450	0.635	--

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	19.9	23.7	86.8
Actual price changes (%)	28.5	44.3	106.5



Source: Bloomberg

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Assumptions on operational performance revised. Since Comtec is planning to raise capacity to 1,500MW in one single step by Q2 2012 from 600MW, we expect contribution from the extra 900MW in 2011 is limited. Therefore, for the coming 3 quarters, shipment largely depends on the 600MW capacity. While we believe shipment for Q1 was 50MW to 60MW, chances of getting 500MW or even 600MW shipment this year are reduced. We conservatively revise our shipment target this year to 454MW, while putting target at higher levels as 1,575MW for 2013. Nevertheless, profit margins are revised up partly to reflect post-earthquake demand.

Table 3. Revised selected key operational data

	FY12/09A	FY12/10A	FY12/11F	FY12/12F	FY12/13F
Ingot and Wafer Capacity at year end (MW)	200	600	1,000	2,000	2,700
Sales volume (MW)	82	165	454	990	1,575
Overall ASP (RMB per W)	6.18	6.17	5.29	4.52	4.10
Gross Margin (%)	10.9	32.4	26.2	22.6	23.9

Source: SBI E2-Capital

Profit and loss forecasts. The following tables show our estimates net profit forecast are RMB177.2m and RMB246.1m for 1H FY12/11F and 2H FY12/11F respectively. On a full-year basis, net profits are estimated at RMB423.4m, RMB676.2m and RMB1,039.2m 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	2,399.5	4,474.0	6,460.2
Cost of sales	(451.8)	(690.8)	(1,771.4)	(3,461.0)	(4,919.0)
Gross profit / loss	55.1	330.6	628.1	1,013.0	1,541.2
Other income	6.7	26.6	0.0	0.0	0.0
Other expenses	(3.4)	(9.1)	(0)	(0)	(0)
Selling and distribution expenses	(2.2)	(1.8)	(6.0)	(11.2)	(16.2)
Administrative expenses	(18.2)	(75.8)	(84.0)	(156.6)	(226.1)
EBIT	38.0	270.5	538.1	845.2	1,299.0
Finance Costs	(6.7)	(7.4)	(8.9)	0.0	0.0
EBT	31.3	263.1	529.2	845.2	1,299.0
Income tax expenses	(6.4)	(40.2)	(105.8)	(169.0)	(259.8)
Profit for the year	24.9	222.9	423.4	676.2	1,039.2

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	900.7	1,498.8
Cost of sales	(331.1)	(359.7)	(640.9)	(1,130.4)
Gross profit / loss	98.0	232.6	259.8	368.3
Other income	7.9	18.7	0.0	0.0
Other expenses	(1.7)	(7.4)	(0)	(0)
Selling and distribution expenses	(0.8)	(1.0)	(2.3)	(3.7)
Administrative expenses	(18.8)	(57.0)	(31.5)	(52.5)
EBIT	84.6	185.9	226.0	312.1
Finance Costs	(3.8)	(3.6)	(4.5)	(4.5)
EBT	80.8	182.3	221.5	307.7
Income tax expenses	(12.2)	(27.9)	(44.3)	(61.5)
Profit for the year	68.6	154.4	177.2	246.1

Source: SBI E2-Capital

Valuation. We continued to use discount cash flow model with 15% discount rate to value Comtec Solar. TP was HK\$4.93 due to positive effect of new substantial shareholder and acceleration in capacity expansion. Table 6 shows our target price of HK\$4.93, which represents 11.1x (before dilution), 14.1x (upon CB conversion and TDR issue) and 15.0x (Upon CB conversion, warrants conversion and TDR issue) P/E FY12/11F. On this fully diluted basis, P/E will be 15.0x, 9.4x and 6.1x for FY12/11F, FY12/12F and FY12/13F respectively.

Table 6. Implied multiples of our target price HK\$4.93 for FY12/11F

FY12/11F	With existing common shares	Upon CB conversion and TDR issuance	Further diluted by warrants conversion
Implied P/E (x)	11.1	14.1	15.0
Dilution effect	0	20.9	25.8

Source: SBI E2-Capital

Peers comparison. Since our initial report, stock price of Comtec Solar had risen 210% from HK\$1.44 to HK\$4.46. Compared to its peers, Comtec is trading at an above average P/B at 2.8x. Considering FY12/11F P/E, valuation is 10.1x (before dilution) and 13.6x (fully diluted), which is higher than sector average. Yet, we believe our target valuation is justified because 1) the company deserves a premium due to its technology, efficiency and growth prospects; 2) there is potential sector re-rating especially when government policies stay positive after Japan incident. Maintain BUY.

Table 7. Peers comparison based on market consensus (base on

Company	Ticker	Fiscal Year End	Mkt Cap (US\$m)	P/B (x)	ROE (%)	P/E (x)	
						1-year fwd	2-year fwd
GCL-POLY ENERGY	3800 HK	12/2010	9,691.4	4.6	29.0	<u>10.6</u>	8.8
GREEN ENERGY TEC	3519 TT	12/2010	868.5	2.0	16.5	<u>8.2</u>	7.8
COMTEC SOLAR	712 HK	12/2010	647.3	2.8	17.3	<u>8.2</u>	6.3
SOLARGIGA ENERGY	757 HK	12/2010	528.6	2.4	14.3	<u>10.0</u>	8.1
SINO-AMERICAN	5483 TT	12/2009	1,470.8	2.3	25.2	11.5	<u>9.3</u>
WAFER WORKS CORP	6182 TT	12/2009	441.8	1.8	(3.6)	19.5	<u>12.6</u>
					average	9.8	(FY12/11F)
LDK SOLAR CO-ADR	LDK US	12/2010	1,564.1	1.4	27.8	4.5	4.4
RENESOLA LTD-ADR	SOL US	12/2010	800.7	1.4	34.4	4.4	4.4

Source: Bloomberg

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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