

## Comtec Solar

### Eventual ramp-up restores confidence

to summarize...

- Q4 results – wrong about volume while right about margin
- Ramp-up to 600MW gradually releasing; heading to 1,000MW+ this year
- Capacity and thus volume expansion expected to continue in 2011
- Global polysilicon and wafer players to expand faster-than-expected
- Reiterate BUY and revised target price at HK\$3.91

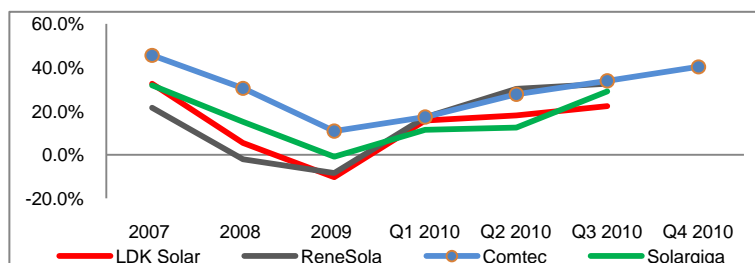
**Q4 top-line missed our estimation.** Last month, Comtec Solar posted 2 key figures with respect to its Q4 results. As we have discussed in our morning note back then, the company indicated turnover for last quarter was no less than RMB300m while gross margin was no less than 40%. It is a small disappointment to us. Our top-line estimation of RMB417m was at most 40% higher than the actual figure, essentially due to our sales volume estimation of 65MW, possibly 40%+ more than probable actual sales of ~45MW in the quarter. The 20MW overestimation was previously based on 60% utilization of newly added 33.3MW per month capacity by year end. That said, delay in ramp-up to 600MW last year affected Q4 results.

**Anticipating a temporal margin peak in the last quarter.** On the other hand, Q4 ASP and profit margin were in line with our previous estimation. In our last report we pointed out that Q4 wafer ASP might be as high as US\$1.00 per W with 38% gross margin. While we retained our view of temporal margin peak in Q4, slightly stronger-than-expected margin confirmed that wafer demand remains strong. Recently, GCL-Poly (3800 HK) received a 4,400MW order for wafer and polysilicon products from China Sunergy (CSUN US) over the next 6 years, which is another sign of strong on-going demand, in our view.

**Table 1. Q4 results based on 2 announced key figures**

RMB m	Q1 FY12/10A	Q2 FY12/10A	Q3 FY12/10A	Q4 FY12/10F
Revenue	198.3	230.8	280.4	> 300.0
Gross profit	34.0	64.0	94.8	> 120.0
Profit for the year	20.3	48.2	80.8	n.a.

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



Source: SBI E2-Capital

**Strong volume growth in 2011.** For 2011, we remain positive towards poly-silicon and wafer business. For instance, GCL-Poly, a poly-silicon producer which expands very quickly to rank top in global wafer business, outperformed the market in the quarter. For Comtec Solar, the management confirmed their ramp-up to 600MW while they are leading the way to more than 1,000MW capacity. Sales up to 600MW+ in 2011 would be at least 250% higher than 165MW to 170MW sales volume in 2010, possibly doubling gross profit in the coming year.

Please refer to important disclosures at the end of this report

Ticker	0712 HK
Rating	BUY
Price (HK\$)	3.18
Target Price (HK\$)	3.91 (+23%)
12m Price Range (HK\$)	1.22-3.40
Market cap. (US\$m)	462.5
Daily t/o (US\$m)	1.6
Free float (%)	35.1

#### Financial summary

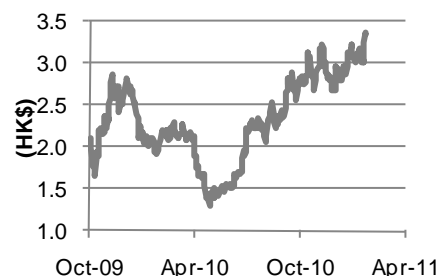
Year to Dec	08A	09A	10F	11F	12F
Turnover (RMBm)	762	507	1,028	3,136	5,043
Net Profit (RMBm)	130	25	246	502	723
EPS (RMB)	-	0.032	0.217	0.443	0.638
P/E (x)	-	83.3	12.3	6.1	4.2
P/B (x)	-	2.0	2.0	1.5	1.2
EV/EBITDA (x)	-	29.9	7.5	4.1	2.8
Yield (%)	-	0	0.8	1.7	2.4
ROE (%)	-	2.7	19.3	30.3	32.8
ROCE (%)	-	2.7	19.3	30.3	32.8
N. Gear. (%)	Cash	Cash	Cash	0.7	1.4

Source: SBI/Bloomberg

	10F	11F	12F
Consensus EPS (RMB)	0.235	0.424	0.543
Previous earnings (RMBm)	260.2	517.0	662.6
Previous EPS (RMB)	0.230	0.457	0.585

#### Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	5.2	15.8	43.1
Actual price changes (%)	1.3	13.6	61.4



Source: Bloomberg

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**Update on global cost-efficient polysilicon supply.** According to our channel checks, since our last investigation back in Mid-2010, a few among major leaders in upper stream in the sector accelerated their expansion plan. Of the top 8 polysilicon producers by volume, China-based GCL-Poly announced aggressive expansion plan to raise polysilicon capacity to 46,000 tonnes by 2011 and 65,000 tonnes by 2012. Germany-based Wacker-Chemie and US Hemlock are expanding to 42,000 tonnes and 36,000 tonnes, while LDK may reach a capacity of 18,000 by the end of this year. While apparently polysilicon supply is going up fast again in 2011F, we believe ramp-up would not be done by the end of the year and demand-supply is more balanced throughout the year. Therefore, polysilicon price may show some support and it is one of the reasons for comparatively lower profit margin for wafer producers in 2011F than in 2H 2010A. On the other hand, however, with increased polysilicon supply planned for 2011F forward, we do not see big risk for raw material supply shortage for the middle stream manufacturers in the short-to-medium term.

**Table 2. Cost-efficient polysilicon supply**

Company	Country	2009A	2010A	2011F
GCL-Poly Energy	China	18,000	21,000	46,000
Wacker-Chemie	Germany	18,100	30,000	42,000
Hemlock Semiconductor	US	19,000	27,500	36,000
OCI	Korea	17,000	17,000	27,000
LDK	China	2,000	11,000	18,000
REC Group	Norway	7,000	13,000	17,000
Tokuyama	Japan	8,200	8,200	8,200
MEMC	US	8,000	8,000	8,000
Supply subtotal		97,300	135,700	202,200

Source: SBI E2-Capital

**Update on global cost-efficient wafer supply.** We also look into efficient wafer supply by end of 2010. By the end of 2010, significant cost-efficient supply entered into the market. For instance, GCL-Poly announced expansion to 2,000MW by end of last year but it reached a capacity of 3,500MW in Nov last year, which surprised the market by its pace and quality. Last week GCL-Poly announced it would further expand its wafer capacity to 6,500MW by 2011. While with 65,000MT polysilicon capacity by 2012, GCL-Poly could support up to 10,000MW wafer capacity by that time. LDK also announced a more aggressive plan to reach 3,600MW capacity by the end of the year. Therefore, we believe there would be serious competition among wafer producers in 2011F, but companies that produce high quality wafer should be less affected. For instance, as previously announced, Comtec 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).

**Table 3. Cost-efficient wafer supply**

Company	Country	2009A	2010A	2011F
GCL-Poly Energy	China	500	3,500	6,500
LDK Solar	China	1,800	3,000	3,600
REC Group	Norway	1,000	1,760	2,500
ReneSola	China	825	1,200	1,800
Yingli Green Energy	China	600	1,000	1,700
SolarWorld	Germany	900	900	1,250
Comtec	China	200	600	1,000
Solargiga	China	210	420	630
Supply subtotal		6,035	12,380	18,980

Source: SBI E2-Capital

**Our view on the change in supply of polysilicon and wafer capacity – vertical integration of Chinese peers.** Note that among top up-stream producers in the sector, 3 of them vertically expand their value chain at large extent, where 2 of them are Chinese companies. Chinese peers tend to capture larger share from a value chain if possible. That said, GCL-Poly, LDK and REC may likely continue to maintain their positions in both polysilicon and wafer production. With vertical integration, the two companies may be able to 1) secure at least part of the polysilicon supply; 2) compete in the market with room to sell at lower ASP. Nevertheless, we are generally more positive towards specialization than vertical integration for upper-stream in this sector. With capital intensive nature and effect of learning curve, we believe specialization in part of the value chain provides better scale, maximizing profit with better volume and margin. For instance, we believe Comtec would take steps to improve its product quality. For instance, improvement in efficiency could be done by promotion of n-type wafers to its top-tier customers.

Of course, less-efficient polysilicon and wafer players may suffer from volume contraction and margin squeeze in considerable extent. To capture this scenario, we maintain our assumption of 20%-25% gross margin for Comtec, while gross margin estimation for overall industry peers stay between 15%-20%.

**Our expansion hypothesis subject to slight changes.** Comtec eventually completed its ramp-up to 600MW and we expect capacity would be gradually released since Q1. While we believe delay in ramp-up is largely due to building new facilities in Haian, execution risk for ramp-up in Shanghai or Haian in the future should be reduced. Our hypothesis on capacity plan, sales volume and profit margin for Comtec is subject to certain changes. For FY12/11F, we expect capacity would go up to 1,200MW with lowered effective utilization rate at 50% with 24.4% gross margin; while for FY12/12F, capacity would go up to 1,700MW with 65.3% effective utilization rate with 22.1% gross margin. We optimistically assume 20% to 25% gross margin for Comtec Solar, higher than 15% to 20% for peers over longer-term.

**Table 4. 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	1,700
Sales volume (MW)	44	82	167	600	1,110
Overall ASP (RMB per W)	17.32	6.18	6.16	5.23	4.54
Gross Margin (%)	30.4%	10.9%	32.3%	24.0	22.1

Source: SBI E2-Capital

**Numbers revision.** We revised our profit forecast by taking account into 1) slower ramp-up and thus weaker sales volume than previously predicted for FY12/10F and FY12/11F; 2) faster expansion than previously estimated for FY12/12F onwards. Table 5 shows the revised pro-forma profit and loss for 2010 to 2012. Net profit for FY12/11F and FY12/12F will be RMB501.6m and RMB722.6m respectively. For quarterly results 2011, we expect RMB130m to RMB170m gross profit for each of the first 3 quarters, while Q4 gross profit would be up substantially to around RMB300m.

Noted that FY12/10F results does not account for one-off non-cash expenses with respect to stock options, which may be HK\$30m+.

**Table 5. Revised pro-forma profit and loss (recurrent)**

RMB m	FY12/08A	FY12/09A	FY12/10F	FY12/11F	FY12/12F
Revenue	762.10	506.88	1,028.07	3,136.38	5,043.37
Cost of sales	(530.80)	(451.76)	(695.51)	(2,384.02)	(3,929.23)
Gross profit / loss	231.30	55.12	332.56	752.36	1,114.14
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)	(2.59)	(7.90)	(12.70)
Administrative expenses	(23.89)	(18.19)	(33.78)	(109.77)	(176.52)
EBIT	172.86	38.00	296.19	634.69	924.92
Finance Costs	(6.30)	(6.67)	(6.59)	(7.64)	(21.68)
EBT	166.57	31.33	289.60	627.05	903.24
Income tax expenses	(36.09)	(6.39)	(43.44)	(125.41)	(180.65)
Profit for the year	130.48	24.94	246.16	501.64	722.59

Source: SBI E2-Capital

**Valuation.** We continued to use discount cash flow to value Comtec Solar. As market competition becomes increasing serve, we raise discount rate to 15% to account for the macro change. TP was revised to HK\$3.91 considering improved sector sentiment and reducing execution risk as we enter 2011. Table 6 shows our target price of HK\$3.91 applying 15.0% discount rate. Based on our target price of HK\$3.90 per share and estimated net profit of RMB501.6.3m and RMB722.6m for FY12/11F and FY12/12F, forward P/E represents 7.4x and 5.2x for FY12/11F and FY12/12F. With respective estimated net equity, P/B for the said target price would be 1.9x and 1.4x for FY12/11F and FY12/12F. Reiterate BUY.

**Table 6. Our target price**

	12.5%	15.0%	17.5%
Discount Rate			
Market cap (RMB)	4,928m	3,733m	2,970m
CNY / HKD	1.1859	1.1859	1.1859
Market cap (HK\$)	5,845m	4,427m	3,522m
number of shares	1,133.3m	1,133.3m	1,133.3m
Target price	HK\$5.16	HK\$3.91	HK\$3.11

**Table 7. Implied multiples of our target price HK\$3.91**

	FY12/10F	FY12/11F	FY12/12F
Implied P/B (x)	2.5	1.9	1.4
Implied P/E (x)	15.2	7.4	5.2
Implied EV/EBITDA (x)	9.5	5.0	3.4

Source: SBI E2-Capital

**Peers comparison.** Since our initial report, stock price of Comtec Solar had risen 121% from HK\$1.44 to HK\$3.18. Compared to its peers, Comtec is trading at a below average P/B at 2.5x and below average P/E at 11.4x and 6.3x for FY12/10F and FY12/11F based on market consensus.

**Table 8. Peers comparison based on market consensus**

Company	Ticker	Fiscal Year End	Mkt Cap (US\$m)	P/B (x)	ROE (%)	FY12/10F	P/E (x) FY12/11F
GCL ENERGY HLDGS	3800 HK	12/2009	7,742.1	5.0	n.a.	18.6	11.5
LDK SOLAR CO-ADR	LDK US	12/2009	2,094.7	1.8	(28.8)	7.4	7.0
SINO-AMERICAN	5483 TT	12/2009	1,848.3	4.6	5.5	15.5	12.6
GREEN ENERGY TEC	3519 TT	12/2009	1,091.3	3.2	1.8	19.8	11.5
RENESOLA LTD-ADR	SOL US	12/2009	1,090.9	2.8	(18.5)	6.5	5.8
WAFER WORKS CORP	6182 TT	12/2009	495.8	2.0	(3.6)	21.9	14.1
COMTEC SOLAR	712 HK	12/2009	462.5	2.5	3.1	11.4	6.3
PV CRYSTALOX SOL	PVCS LN	12/2009	409.3	1.1	11.7	13.8	12.0
SOLARGIGA ENERGY	757 HK	12/2009	398.8	1.8	(7.4)	15.1	9.0
			Average	2.8	--	14.5	10.0

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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