

Comtec Solar

Concern over new leadership in China

to summarize...

- FY12/12A results lower-than-expected with 4.7% reported gross margin in 2H
- Comtec strong balance sheet in contrast to liquidity-tight peers
- Suntech insolvency timing hinted industry consolidation under new leadership
- Customer SunPower has improving profitability; targeting Sanyo by Q3 2013F
- Outlook for 2013F with corresponding downward adjustment
- Delays margin recovery and downgrades to HOLD with new TP at HK\$1.40

FY12/12A results lower-than-expected with 4.7% reported gross margin in 2H.

Comtec announced annual results yesterday during lunch break. For 2H 2012A, revenue came in at RMB569.4m with reported gross profit of RMB26.6m for the 6 months taken RMB5.1m inventory write-down into account, compared to RMB31.85m for Q3 alone. The management attributed unexpected Q4 break-even in gross profit to sales of p-type wafers with good credit terms and sales of certain amount of polysilicon and ingots that both off-set double digit margin of n-type wafers. As such, for the full year, while revenue was slightly below our estimates by 6.3%, gross profit largely missed our expectation by as much as 41% and adjusted net profit missed our projection by 18.6% for FY12/12A.

Table 1. 2H key financial figures

RMBm	1H 11A	2H 11A	1H 12A	2H 12A
Revenue	574.7	442.0	456.2	569.4
Reported gross profit	135.4	(42.9)	56.8	26.6
Gain / loss of one-off items	14.1	(165.8)	(166.0)	(67.6)
Reported net profit	101.6	(147.9)	(121.1)	(43.9)
Adjusted net profit	87.5	17.8	44.9	23.7

Table 2. Actual figures for FY12/12A and previous estimates

RMBm	FY12/12A	Our estimates	Deviation
Revenue	1,025.6	1,094.0	-6.3%
Gross profit (inventory impairment adj)	88.6	149.8	-40.9%
Other one-off items	(228.5)	(220.0)	n.a.
Net profit	(165.0)	(135.7)	n.a.
Net profit (adjusted)	68.6	84.3	-18.6%

Source: SBI E2-Capital

Comtec strong balance sheet in contrast to liquidity-tight peers. While ASPs of various solar products tended to stabilize in recent months, a good portion of manufacturers continued to record operating losses. Through credit lines China has supported 12 solar companies including Suntech (STP US), LDK (US), Trina Solar (TSK) and Yingli Green Energy (YGE) by local government and state-backed agencies. Yet, Suntech went bankrupt earlier this month. In fact, by end of Mar 2012, Suntech (STP US) had US\$1,575m short-term debt, US\$580m account payable and US\$511m current portion of CB on the balance sheet. Current ratio and quick ratio were low at 0.64x and 0.47x respectively as of Mar 2012 yet the company was loss-making. As for Comtec, excluding one-off non-cash items, the company was making RMB68.6m net profit in 2012A. By end of the year, Comtec was in net cash position of RMB32.0m with RMB56m raised in Dec and further added RMB203.8m equity in Jan this year to survive the consolidation and position for next up-cycle.

Ticker	0712 HK
Rating	HOLD
Price (HK\$)	1.38
Target Price (HK\$)	1.40 (+1.5%)
12m Price Range (HK\$)	0.63 - 2.19
Market cap. (US\$m)	230.7
Daily t/o (US\$m)	9.3
Free float (%)	49.0

Financial summary

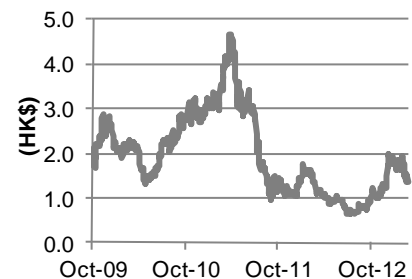
Year to Dec	11A	12A	13F	14F	15F
Turnover (RMBm)	1,017	1,026	1,049	1,323	1,588
Re.Net Profit (RMBm)	(46)	(165)	99	144	183
EPS (RMB)	(0.041)	(0.146)	0.087	0.127	0.162
P/E (x)	-	-	12.7	8.7	6.9
P/B (x)	0.76	0.86	0.72	0.67	0.61
EV/Re EBITDA (x)	11.4	-	4.8	3.8	3.3
Yield (%)	0.0	0.0	0.8	1.1	1.5
ROE (%)	-	-	6.1	7.9	9.3
ROCE (%)	1.3	-	7.8	9.9	11.1
N. Gear. (%)	Cash	Cash	Cash	3.2	11.5

Source: SBI E2

	13F	14F	15F
Consensus EPS (RMB)	0.085	0.117	-
Previous earnings (RMBm)	162.7	201.7	-
Previous EPS (RMB)	0.143	0.178	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(14.7)	12.7	(2.1)
Actual price changes (%)	(16.9)	11.3	5.3



Source: Bloomberg

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Suntech insolvency anticipated yet timing hinted industry consolidation under new leadership. Earlier this month, Suntech defaulted on US\$541m bonds and prompted Chinese banks to ask the local court to push its main subsidiary Suntech Wuxi into insolvency. In fact, suppliers blocked its factory for months trying to recover part of the payments. Since Q2 2012 results announcement in May 2012 and before news on CB default, the counter was trading between 0.11x to 0.46x historical P/B. Its CB was trading as low as 25 cents a dollar last Dec. While there was speculation of local government support that boosted price to 50-60 cents a dollar for a few days, we believe CB and equity investors noticed the fact and speculated bailout. On the other hand, however, we believe letting Suntech go bankrupt in mid of March during "National People's Congress" and "Chinese People's Political Consultative Conference" was itself symbolic. While government raised 2015F solar target further in Jan this year to 35GW from original plan of 5GW announced in Dec 2011, the credit event at such sensitive time may reflect new leadership support tends to be even more selective, in our view. While in medium term it is good for the industry to remove less competitive players, in short-term full-blown solar products ASP rebound is less likely. As such, we review our gross margin projections such that even with n-type wafers, Comtec would not earn margin ~20% at least until 2015F.

Customer SunPower has improving profitability; targeting Sanyo by Q3 2013F. Although we revise our ASP and margin estimates, we still believe Comtec and its customer were both financially strong. As we have discussed, we believe it is reasonable for Comtec to sell its wafers to SunPower (SPWR US) in Philippines. In addition to avoiding extra duties on panels by Chinese manufacturers, SunPower itself had improving profit margin as of Q4 2012A and positive view on Q1 2013F. As of Q4 2012A, SunPower gross margin further improved to 18.7% from 14.1% in Q3 2012A and 11.3% in Q4 2011A. Net income was widened to US\$21.7m for the latest quarter. At the same time, its net debt-to-equity was lowered to 35.8% by end of Dec 2012 compared to 39.5% 6 months ago. In addition to SunPower, Comtec had been in discussion with Sanyo (6764 JP) for quite some time. The management expects to commence sales of n-type wafers to Sanyo Malaysian plant by end of 1H.

Table 3. Comtec reliance on SunPower in 2012A

	FY12/12A
Total revenue	RMB1,026m
Revenue of n-type wafers	RMB857m
Revenue to SunPower in Philippines	RMB797m

Table 4. SunPower's key financial figures in Q4 2012A

	FY12/12A
<u>SunPower</u>	
Market capitalization	US\$736m
Capacity	Ramping-up from 680MW to 1,200MW
Total revenue (non-GAAP)	US\$785m
Gross margin (non-GAAP)	18.7%
Net income (non-GAAP)	US\$21.7m
Total debt (CB plus bank loan)	US\$829m
Total cash (cash on hands plus pledged cash)	US\$473m
Net debt-to-equity ratio	35.8%

Source: SBI E2-Capital

Outlook for 2013F with corresponding downward adjustment in short-term. As a major customer of Comtec, SunPower management provided guidance of 18%-22% gross margin on 150MW to 170MW sales for Q1 2013F. Nevertheless, suppliers of SunPower were becoming relative stable after Q3 last year. We slightly revise down our shipment forecast to reflect slower shipment growth in 1H 2013F. At the same time, Comtec management is looking for bargain purchase of equipment with substantial discount. With reduced CAPEX and electricity costs, the management is still working to establish GW-scale production plant in Malaysia. With potential gradual roll-out in the year, Comtec targets to raise shipment in 2H with sales to Sanyo.

Table 5. Revised selected key operational data

	FY12/11A	FY12/12A	FY12/13F	FY12/14F	FY12/15F
Nameplate capacity MW	600	600	1,000	1,400	1,800
Shipment MW	222.1	561.7	530.0	857.5	1,172.5
Revenue (RMBm)	1,017	1,026	1,049	1,323	1,588
Overall gross margin	9.1%	8.1%	14.1%	17.9%	19.8%
Overall net margin	-5%	-16%	5%	7%	9%
Net profit (RMBm)	(46.3)	(165.0)	52.5	97.8	139.5
Adjusted net profit (RMBm)	105.3	68.6	52.5	97.8	139.5

Source: SBI E2-Capital

Delays margin recovery and downgrades to HOLD with new TP at HK\$1.40. Comtec was trading up to as high as HK\$2.19 in early Jan from as low as HK\$0.63 in late Jul last year. While we believe Comtec and its customers to stay financially healthy in industry consolidation, recent credit event of Suntech may be sign for further ASP downtrend that largely limits room for margin recovery in short-term, in our view. Though on the right track to further develop profitable n-type wafer and raised HK\$259.8m to capture opportunities in post-consolidation period, our view on Comtec short-term performance becomes less positive. Our target price is slightly adjusted to HK\$1.40 from HK\$1.48, representing 14.6x and 10.0x P/E on net profit of RMB99.1m and RMB144.4m for FY12/13F and FY12/14F respectively. We downgrade the counter to HOLD, unless stronger supportive policy rolls out or margin recovery is faster than expected.

Table 6. Profit and loss forecast (Full-year)

RMB m	FY12/11A	FY12/12A	FY12/13F	FY12/14F	FY12/15F
Revenue	1,016.7	1,025.6	1,048.5	1,323.0	1,588.4
Cost of sales	(924.3)	(942.2)	(900.9)	(1,086.4)	(1,273.4)
Gross profit / loss	92.5	83.5	147.6	236.6	315.0
Other income	40.1	48.0	40.0	40.0	40.0
Other expenses	(61.4)	(190.9)	0.0	0.0	0.0
Selling and distribution expenses	(1.8)	(4.8)	(4.9)	(6.1)	(7.4)
Administrative expenses	(48.7)	(60.6)	(61.9)	(78.1)	(93.8)
EBIT	20.6	(124.8)	120.8	192.3	253.8
Finance Costs	(38.6)	(39.0)	(0.7)	(17.2)	(31.5)
EBT	(18.0)	(163.8)	120.1	175.1	222.3
Income tax expenses	(28.3)	(1.2)	(21.0)	(30.6)	(38.9)
Reported profit for the year	(46.3)	(165.0)	99.1	144.4	183.4
Reported EPS (RMB)	(0.041)	(0.146)	0.087	0.127	0.162
Adjusted net profit	105.3	68.6	99.1	144.4	183.4

Table 7. Selected balance sheet items

RMB m	FY12/11A	FY12/12A	FY12/13F	FY12/14F	FY12/15F
Non-current assets	1,324	1,206	1,205	1,556	1,860
Property, plant and equipment	856	796	822	1,173	1,477
Other non-current assets	469	410	383	383	383
Current assets	1,330	1,234	938	1,053	1,187
Inventories	218	296	296	327	351
Trade and other receivables	214	296	345	399	435
Cash and cash equivalent	746	342	223	252	327
Other current assets	152	300	74	74	74
Non-current liability	484	118	62	62	62
CB	402	0	0	0	0
Other non-current liabilities	81	118	62	62	62
Current liabilities	517	858	321	657	934
Trade and other payables	199	385	321	357	384
Short-term bank loans	318	470	0	300	550
Other current liabilities	0	3	0	0	0
Total Equity	1,654	1,465	1,760	1,889	2,051

Source: SBI E2-Capital

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