Small-Cap Charm

Thesis and Ideas for 1Q 11

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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.

What you can expect from us…

Small & mid caps

- We maintain our focus on HK-listed small & mid cap stocks with market capitalization range US$100-1,000m.

Emerging sectors

- Although we don't have particular sector preference, extra attention will be allocated to emerging sectors for high growth potential.

Quality stock picks

- Instead of a universal coverage, we pursue a more active stock selection approach to generate quality picks.

Bottom-up method

- Our research will concentrate on corporate-level, emphasizing business insight and management access.

Step-by-step research procedure

Stock under screening

- Not-rated research reports, containing mainly factual information and our basic opinions.
- Following-up update will be available on a selective basis.

Picked stock

- Not-rated research reports with reference price target and preliminary forecasts.
- Following-up update will be provided.
- Formal coverage will initiate in due course.

Recommended stock

- Rating research reports with target price and full model.
- Follow-up update will be provided.
- Stock performance will be traced and measured.
- Coverage will cease on a notifying basis.

Thesis and ideas within existing work

New product driven

- Substantial contribution from new products in near future.
- Manageable execution risk associated.
- Reasonable capital expenditure and foreseeable cash generation from the new products.
- Undemanding valuation.
- Current picks: HL Technology (1087 HK), Tongda (0698 HK).
- Other candidates: IRICO (0438 HK), COSTIN New Material (2228 HK)

Laggard play

- Lagging sectors within the context of recovering global economy.
- Relatively clear bottom-out / further picking-up industry trend.
- Individual company's leading position within a certain sector.
- Significant margin expansion in expectation.
- Undemanding valuation.
- Current picks: RMIH (1997 HK), China XLX (1866 HK).
- Other candidates: Far East Global (0830 HK), EcoGreen (2341 HK)

Energy saving concept

- Industry potential revealed by the Chinese government's massive effort on achieving energy saving target last year, which triggered even power rationing.
- Identifiable demand, which can translate into growth in short term.
- Solid competitive strength of individual company.
- Sound valuation.
- Current picks: Comtec Solar (0712 HK)
- Other candidates: Greens Holdings (1318 HK), Fong's (0641 HK)

HL Technology (1087 HK) (click here…)

Stock statistics	Market cap: US$244m (closing price: HK$2.64); daily turnover: US$2.8m
Principal business	a “one-stop” provider of cable assembly and connectors, which are mainly used in consumer electronics.
Competitive edges	• HLT has one of the highest research budgets among the industry, which enables it to: 1) trace technology and market movement; 2) develop more profitable new products. • A vertically-integrated operation model has been established. Compared with its peers, HLT has extra advantages on localization of nationwide manufacturing network. • The company outperformed the whole industry in the past three years witnessed by expanding market shares for all its principal products.
Growth drivers	• Consumer electronics industry is anticipated to maintain double-digit growth backed by economy recovery and technology innovation. • The company has been qualified by several Japanese brands such as Canon and shipment will start this year. The management estimates new customers will contribute 5-10% of its total revenue in FY12/11F. • Operation of wireless antenna and low smoke free halogen insulating material started already. Automotive wiring harness, specialty power cable and solar connector will launch this year. Sales of these products are expected to account for ~10% of FY12/11F revenue and ~30% FY12/12F.
Our opinions	• Industry entry barriers are witnessed by the high market concentration. Top five vendors captured 71-94% global market share in 1H 2010. • The company’s new products are mainly natural extension of existing ones with immaterial capex requirement, which reduces execution risks. • The management guided Rmb150m+ net profit for FY12/10F. We are looking for another 54% jump on top line to Rmb2,104m the next year and bottom line is said to reach Rmb184m FY12/11F.
Valuation	• The counter now is trading at 9.0x FY12/11F P/E (consensus: 7.8x), which is 15% lower than industry average of 10.6. Our reference price target is HK$3.00 based on 10x FY12/11F P/E ratio.

Tongda Group (0698 HK) (click here…)

Stock statistics	Market cap: US$290m (closing price: HK$0.485); daily turnover: US$0.9m
Principal business	A supplier of plastic casings for consumer electronics such as notebook, handset and electrical appliances.
Competitive edges	• TDG is the world largest manufacturer for in-mould lamination (IML) plastic casings with patented technology. IML has been attracting increasing attention for its durableness and less strict minimal order quantity requirement, which was partly proved by the 53% top line surge in 1H FY12/10A.
Growth drivers	• Both notebook PC and mobile handset are expected to have some double-digit growth in 2011. Meanwhile, for each product category, the company is likely to book extra gain from rising market acceptance of IML technology. • Production of small-size touch screen glass substrate kicked off in 2010. Relevant sales accounted for 3-4% of total revenue in FY12/10F, which will increase to 7-8% this year. • A 55:45 JV has been set up between TDG and Matsushita Shokai, for production of LED TV light guide plate (LGP). Shipment commenced already. The JV's capacity will be 1.5m pieces in 2010 and, then, increase to 6m in 2011. ASP and gross margin is guided at US$20 per piece and 20%+, respectively, suggesting a potential contribution of HK$936m revenue and HK$187m+ gross profit.
Our opinions	• Assuming a YoY flat top line in 2H, TDG will have HK$2,162m revenue for the full FY12/10F, up 20% YoY. Net profit will increase 70% to HK$174m. • As a brand new business, the LPG JV faces quite high execution uncertainty, which is more or less compensated by the insignificant capital investment associated (<HK$100m). Under 20% gross margin, we estimate it can generate HK$51m net profit for TDG in FY12/11F. • Therefore, the whole company's net profit will increase 35% to HK$235m, even when existing businesses book only low single-digit growth.
Valuation	• Share price increased 20% since our first report on 9 Dec 2010. The counter now is trading at 7.1-8.4x of our projected FY12/11F earnings.

RMIH (1997 HK) (click here…)

Stock statistics	Market cap: US$820m (closing price: HK$6.30); daily turnover: US$0.9m
Principal business	A specialist of surface mounting technology (SMT) solutions, concentrating in LCD panel control boards (CB), LED light bars (LB) and TV main boards (MB).
Competitive edges	• Although entry barriers are low, RMIH is probably the only sizable independent player in the market now. Its core competitiveness relies on scale, specialization and management efficiency, which allows it to provide cost effective SMT solutions.
Growth drivers	• By carefully expanding product portfolio and client base, RMIH is able to grow its business continuously. The company launched LB business in 2008 and MB in 2010, apart from the original CB business. • FY12/10F sales reached US$1,143m, up 48% YoY. The growth was spotted in every segment owe to improving macros. Momentum may retain for the next year. Global PC shipment is anticipated to increase 14% in 2011 while LCD TV 14%. In particular, LED backlight TV shipment will rise from 37m units to 107m. • CMO will probably increase CB outsourcing due to high defect rate internally. Meanwhile, Samsung will shift some TV production from Korea to China to lower manufacturing cost. Both may benefit RMIH. • MB shipment to Haier started in Mar and expanded to Hisense in Jun. Trial for several other brands commenced in Nov. RMIH expects the volume can increase to 700,000-800,000 pieces a month, translating into US$76-86m revenue a year and equivalent to ~5% of the company's annual turnover. • RMIH's gross margin of a single product is highly correlated to the production scale, implying probability of margin expansion for LB and MB divisions.
Our opinions	• We estimate net profit in FY12/10F will increase 34% YoY to US$74m. • For FY12/11F, total turnover is expected to go up 21% to US$1,395m. Gross margin may stabilize at 9.9%. As effective tax rate will hike to 25% from 20%, net profit is calculated to increase 14% to US$85m.
Valuation	• Share price surged 57% since our first report on 23 Dec 2010. We think upside potential still exists given RMIH's solid growth pattern, although the stock might suffer short-term profit-taking pressure.

China XLX (1866 HK) (click here…)

Stock statistics	Market cap: US$411m (closing price: HK$3.21); daily turnover: US$0.1m
Principal business	One of the largest non-state-owned coal-based urea producers in China, located in Xinxiang, Henan. Capacity includes 1.25m mt urea, 0.2m mt methanol and 0.6m mt compound fertilizer.
Competitive edges	• Production cost is the most critical issue for urea producer. XLX is a cost leader among the industry. For each tonnage of urea production, it consumes only 627 kg coal (~55% of COGS) and 740 kwh electricity (~20% of COGS), compared to industry average of 824 kg and 850 kwh. We attribute this difference to technology, scale, experience and, in particular, management system. In 1-3Q FY12/10A, XLX's unit COGS for urea was Rmb1,328/mt, ~15% the industry's ~Rmb1,600/mt.
Growth drivers	• The urea industry is cyclical in terms of profitability. The downside phase might end soon, as ~60% industry participants are suffering net loss now. We expect the market to bottom out gradually this year. • Coal cost (~60% of COGS) hiked ~25% QoQ in 4Q 2010. In addition, the nationwide electricity power rationing in 4Q 2010 hit XLX as well and reduced its output by ~10%. We expect 4Q FY12/10F net profit to drop 29% YoY to Rmb20m (full year: Rmb147m). • With expected market recovery, we estimated XLX's net profit will return to Rmb169m in FY12/11F • A #4 production line (800,000 mt urea) was announced in Sep 2010. By using coal water slurry technology, its production cost can be ~16% lower than existing ones. Operation is expected to launch in 1H 2013. Related capex is estimated at ~Rmb3b.
Our opinions	• We derived a normal gross margin for XLX by averaging its actual margin during the downside semi-cycle (FY12/07A-10F), which is 23%. Based on this number, XLX's net profit can reach Rmb374m based on existing capacities. • Under the normal gross margin assumption, the #4 line can yield additional Rmb1.7b revenue and Rmb344m net profit in full operation, implying a payback period of ~6 years (capital structure unchanged).
Valuation	• As a capital-intensive company, XLX is trading at 1.8x P/B (3Q FY12/10A), versus industry average 2.5x.

Comtec Solar (0712 HK) (click here…)

Stock statistics	Market cap: US$439m (closing price: HK$3.02); daily turnover: US$2.1m
Principal business	Comtec Solar is a pure-play monocrystalline solar ingot and wafer manufacturer based in China.
Competitive edges	• Comtec wafer has higher conversion level of ~18%, compared to ~17% industry average according to Solarbuzz. Quality wafers provides price premium in good times and helps securing sales in difficult times which lowers per unit cost of production. • With lower electricity cost, energy usage and specific input arrangement, Comtec has lower non-silicon production cost at US$0.27 per W by the end of 2011, compared to average of US0.30+ per W among other major wafer producers.
Growth drivers	• Comtec Solar should benefit from its aggressive post-crisis capacity expansion, being one of the best prepared for sector recovery. By end of 2010, it ramps-up its capacity to 600MW from 200MW, and the company has planned for current year expansion to 1,000MW+. • 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). • Gross margin is up to over 40% for Q4 2010. Although we believe this level is not sustainable in 2011, we expect full year gross margin would stay above 20%.
Our opinions	• Market research firm iSuppli has revised its forecast of worldwide installation of 15.8GW last year, growing to 19.3GW in 2011, which represents 22% YoY growth next year. iSuppli was bold enough to forecast that worldwide PV installations could top 13.6GW earlier in last year, double the figure of 7.0GW in 2009. • Solar supply in the upper stream, for instance, polysilicon and wafer, should stay tight in 2011.
Valuation	• Share price surged 110% since our first report on 7 Jun 2010. • The counter now is trading at 11.6x, which is lower than industry average of 13.5x.

Candidates at a glance (I)

IRICO (0438 HK)	• Located in Xi'an, Shaanxi province, IRICO used to be a key manufacturer of TV Cathode Ray Tube (CRT) in China. CRT business is recovering temporarily due to TV demand in China, stimulated by "Home Appliance at Countryside" policy. • For long term growth, the company is diversifying into production of LCD panel glass substrate and solar glass substrate by leveraging its experience in processing glass. Trial operation of both LCD panel glass substrate and solar glass substrate production lines launched last year. Feedback so far is positive, suggesting moderated execution uncertainty associated. The company is constructing more lines to boost its operation scale. • The two new businesses are expected to contribute this year. They are able to substantially change IRICO's earnings picture after full operation. • We reckon the stock potentially yields a sound risk/profit trade-off at current stage.
COSTIN New Material (2228 HK)	• COSTIN New Materials engaged in research, production and sales of non-woven materials and recycled chemical fibers, representing ~80% and ~20% gross profit respectively for 1H FY12/10A. • COSTIN is recognized as a Provincial-level Corporate Technology Centre in Fujian Province. Besides, approved by National Development and Reform Commission (NDRC), COSTIN collaborates with 5 other institutions to compile industry guidelines and standard for 3 types of non-woven fabrics. • COSTIN is investing RMB250-300m for production lines with equipments from Germany to produce filtration materials of 10m sqm capacity. Expecting to commerce production within the year, the company might produce 3m sqm 2011F and up to 8.5m sqm in 2012F. If pricing of filtration materials is 10%-20% lower than Du Pont's (DD US), ASP could be RMB80 per sqm, which would translate to RMB240m and RMB800m segment turnover for 2011F and 2012F with 40%+ gross margin.

Candidates at a glance (II)

Far East Global (0830 HK)	• Founded in 1969, the company undertook more than 400 projects worldwide and established a strong reputation in the curtain wall industry. Latest landmark buildings completed include Burj Khalifa (Dubai, UAE), the highest building completed in 2009. • Global high-end properties such as skyscrapers are especially sensitive to macro environment. FE is well positioned to capture global demand upon economic recovery • We expect the company to be in a position to select projects. In general, the company has to set aside cash equivalent to 10%-15% contract value for each project as working capital. Therefore, with around HK$500m cash on hand by Jun 2010, the company could simultaneously work on HK$4,000m projects. • As of HK$1,100m backlog, possibly HK$900m will be recognized in 2011F. This is a secured amount. With its HK$500m cash capacity, we believe the company could acquire HK$1,000m to HK$1,500m new projects in the coming year. Given construction cycle of 1.5-2 years with 30%-40% recognition in the first year, top-line for 2011F could be HK$1,200m to HK$1,500m (counting in HK$900m backlog), comparing to HK$860m back in 2009 and HK$1,285m in 2008.
EcoGreen (2341 HK)	• Ecogreen is a leading fine chemical company in China. Core products are natural turpentine aroma chemicals, which makes up to ~50% of the total revenue. The company has ~25% market share around the world for these particular products. • China is the largest supplier of gum turpentine oil in the world, which gives Ecogreen a natural advantage in sourcing raw material. Meanwhile, the company's innovated technology (heterogeneous catalytic reaction via fixed bed process technology) allows mass production in a cost-effective way. • Development of new generation of heterogeneous catalytic reaction via fixed bed process technology has completed, which, according to the management, can double production output while lowering cost by ~20%. Construction of a new line based on this technology completed and operation will commence in 1Q 11, adding 600 mt extra capacity to existing 3,500 mt. Old lines, meanwhile, will upgraded gradually.

Candidates at a glance (III)

Greens Holdings (1318 HK)	• Greens inherited long-established intellectual properties from UK to produce economizers and related products in China with Chinese coal-fire power plants as its major sales target. • Products include economizers and waste heat recovery solutions to reduce fuel consumption to achieve target power output. The company also targets to provide 200 units wind turbine tower since 2011. • Although domestic thermal demand may remain stable, overseas demand in developed market such as Europe as well as emerging market such as India may serve as surprising source of growth.
Fong's (0641 HK)	• Fong's is a long-historical supplier of textile dyeing machines with three renown brands, Fong's, Then and Goller, on the shelf. It also operates Monforts brand through a joint venture. • The textile industry is recovering. Fong's witnessed 71% revenue growth in 1H FY12/10A to HK$1.3b and, sequentially, turned around in bottom line to book HK$152m net profit. The management expects the industry prosperity to last for at least 12-24 months and is undertaking capacity expansion at present. A new plant in Zhongshan is under construction. With doubled capacity, it will be used to gradually replace existing Shenzhen plant and the whole migration process is expected to finish in 2013. • The new Then-Aireflow dyeing machine and Fong's water re-use system hit the "water-saving" concept, as the whole textile dyeing industry is suffering increasing governmental regulation. The prior is designed to reduce water consumption by 20% during processing while the latter offers turnkey solutions and can help dyeing factories save water consumption by 70%.

End

Thank You!

SBI Research Team
(852) 2533 3700
sbie2research@sbie2capital.com