Small Cap Charm

Thesis and Ideas for 2Q 11

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Disclosure of Interests

- SBI E2-Capital Securities Limited, a parent company of SBI E2-Capital Financial Services Limited, acted as sub placing agent for Comtec Solar Systems Group Limited (stock code: 712) in September 2010.
- SBI E2-Capital Securities Limited, a parent company of SBI E2-Capital Financial Services Limited, acted as sub-placing agent for NewOcean Energy (stock code: 0342 HK) in November 2010.

Our research portfolio in 1Q

Company	Ticker	Target (HK$)	Latest update	First report	Abs. price return * (%)	HSI return (%)	MSCI ** return (%)
Core coverage							
Comtec	0712 HK	3.21	13/10/10	08/06/10	68.2	2.9	10.3
Tracing list							
RMIH	1997 HK	-	12/22/10	12/22/10	42.5	3.5	4.3
HL Tech	1087 HK	-	14/01/11	14/01/11	(6.1)	(1.8)	(2.0)
Tongda	0698 HK	-	09/12/10	09/12/10	(4.9)	3.0	2.2
China XLX	1866 HK	-	06/01/11	06/01/11	(23.6)	0.2	(1.3)
Watching list (selective)							
IRICO	0438 HK	-	-	-	-	-	-
COSTIN New Material	2228 HK	-	-	-	-	-	-
Far East Global	0830 HK	-	-	-	-	-	-
Ecogreen	2341 HK	-	-	-	-	-	-
Greens Holdings	1318 HK	-	-	-	-	-	-
Fong's	0641 HK	-	-	-	-	-	-

*Note: * calculated based on closing price on 29 Apr*
*** MSCI Hong Kong Small Cap Index*

Updated portfolio in 2Q

Company	Ticker	Target (HK$)	Latest update	First report	Analyst
Core coverage					
Comtec	0712 HK	4.93	21/04/11	08/06/10	Kevin Mak
Tracing list					
HL Tech	1087 HK	-	15/03/11	14/01/11	Norman Zhang
Tongda	0698 HK	-	17/03/10	09/12/10	Norman Zhang
Ecogreen	2341 HK	-	28/03/10	28/03/10	Norman Zhang
Solargiga	0757 HK	-	15/04/10	15/04/10	Kevin Mak
Watching list (selective)					
Fong's	0641 HK	-	14/02/11	14/02/11	Norman Zhang
Boer Power	1685 HK	-	-	-	Norman Zhang
Truly	0732 HK	-	-	-	Norman Zhang
Ming Fai	3828 HK	-	-	-	Baron Sun
NewOcean Energy	0342 HK	-	06/05/10	06/05/10	Kevin Mak
Leoch International	0842 HK	-	-	-	Kevin Mak
COSTIN New Material	2228 HK	-	-	-	Kevin Mak

Comtec Solar (0712 HK) (click here…)

Stock statistics	Market cap: US$661.4m (closing price: HK$4.55); daily turnover: US$4.7m
Summary / review	• Comtec Solar is a pure-play monocrystalline solar ingot and wafer manufacturer based in China. Its wafer has higher conversion efficiency of ~18%, compared to ~17% industry average according to Solarbuzz. The company has passed SunPower (SPWRA US) qualification on n-type ingot and it is currently under review on n-type wafers. N-type wafers has conversion efficiency as high as 22%-23%. Sanyo (6764 JP) and SunPower are major n-type cells producers (potential customers). • With lower electricity cost, energy usage, specific input arrangement and improving scale, Comtec has lower non-silicon production cost at US$0.27 per W by the end of 2011. It targets to further lower to US$0.22 per W, without considering any potential introduction of n-type wafers.
Drivers / catalysts	• 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 has previously significant investment on MEMC (WFR US). • Comtec secured 770MW wafer orders for 2011 from module producers JA Solar (JASO US), Suntech Power (STP US), Dongfang Electric (1072 HK) and Sunergy (CSUN US). While with extra proceeds from TPG and TDR to be issued, the company is to raise capacity to at least 1,500MW by 2012 from 600MW.
Our opinions	• Earthquake in Japan in Mar this year raise concerns on nuclear power and boosts optimistic view on alternative energy especially on solar energy. Valuation is fair-to-attractive in short-term due to current stock price hike, dilution effect and short-term expansion delay for a higher goal later next year. • By introduction of large wafers in 2007 and potentially n-type wafer in 2011, Comtec demonstrates product differentiation with premium quality. We believe Comtec would continue to be competitive. • Share price surged 64% from our update report on 13 Oct 2010 before Q1 strategy. Latest TP at HK$4.93. • FY12/11F P/E of the counter is 10.3x before dilution, or 13.9x after CB, warrants and TDR dilution.

HL Technology (1087 HK) (click here…)

Stock statistics	Market cap: US$223m (closing price: HK$2.42); daily turnover: US$2.8m
Summary / review	• HLT is a leading provider of cable assembly and connectors in the world. Competitive edges stand mainly upon its research ability (one of the highest R&D budgets among the industry) and a vertically-integrated operation model. The company outperformed its peers in the past three years witnessed by expanding market shares for all its principal products. • FY12/10A results met market expectation. Top line went up 62% to RMB1,414m while bottom line 73% to RMB153m, which can be partially attributed to successful client acquisition. The company had 73 new clients last year on top of existing 100.
Drivers / catalysts	• Consumer electronics industry is anticipated to maintain double-digit growth. • 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 new products are expected to account for ~10% of FY12/11F revenue and ~30% FY12/12F. • The company completed development of a new high-speed cable compatible with Intel's new Thunderbolt I/O port, which may generate some meaningful contribution in 2H FY12/11F.
Our opinions	• We like the company for its clear plan on new products development and rollout. Delivery of this plan seems exiting and can sustain HLT's growth in long run. Some new products have been launched as planed, which partly suggests the management's execution ability. • The new high-speed cable can be very eye-catching given Apple has announced to cooperate with Intel on Thunderbolt and adopted this technology in its latest Macpro laptop. • FY12/11F net profit is said to increase 28% to RMB196m in our preliminary forecast. We have a reference target price for the counter at HK$3.27, which represents an undemanding 10x FY12/11F P/E. • We intent to initiate formal coverage on this stock shortly.

Tongda Group (0698 HK) (click here…)

Stock statistics	Market cap: US$234m (closing price: HK$0.39); daily turnover: US$1.3m
Summary / review	• TDG is the world largest manufacturer for in-mould lamination (IML) plastic casings with patented technology. Its products are used mainly in consumer electronics such as notebook, handset and electrical appliances. • Revenue increased 30% to HK$2,348m in FY12/10A. Mobile handset sub-segment performed especially well with sales up 51% YoY to HK$951m thanks to the strong growth of key clients, mainly Chinese domestic brands such as ZTW, Huawei and TCL. With improved gross margin (0.6 pcp to 17.4%) and well-controlled operating expenses (down 2.1 pcps to 7.7%), net profit surged 97% HK$201m.
Drivers / catalysts	• Chinese domestic handset brands stay in good shape. Both ZTE and Huawei guided 30-40% volume growth this year. Thus, we expect momentum of TDG's mobile handset sub-segment to largely retain. • New touch screen glass substrate and LED TV light guide plate (LGP) businesses are expected to have substantial contribution this year. • In particular for the LGP business, operation launched already, according to our last site visit in Jan. Actual output in Jan/Feb was 200,000-300,000 pieces/month, which is ramping up gradually. The management maintains their guidance of 6m pieces output for full 2011. Based on this figure, we calculated it can bring TDG no less than HK$53m additional net profit in FY12/11F.
Our opinions	• Overall, we estimated the company will have 36% earnings growth in FY12/11F to HK$274m, which puts the counter at an undemanding 6.6x P/E. Of course, new businesses may carry higher operation uncertainty. • We noticed the increase in AR from HK$631m FY12/09A to HK$1,020m FY12/10A. According to the management, AR piled up due to sales expansion. As majority of the AR (HK$906m) is within general three-month credit period, we reckon associated bad debt risk is low.

Ecogreen (2341 HK) (click here…)

Stock statistics	Market cap: US$161m (closing price: HK$2.61); daily turnover: US$0.2m
Competitive edges	• Ecogreen is a leading fine chemical company in China. Core products are natural turpentine aroma chemicals, making up ~40% of the company's total sales in FY12/10A. In particular for dihydromyrcenol (27% of the total revenue), Ecogreen has ~25% share around the world. • A key strength of Ecogreen, in our view, is its innovated technology. A good example is its synthesis technology, heterogeneous Catalytic Reaction via Fixed Bed Process, which allows high production efficiency at relatively low cost. An upgraded synthesis technology has been developed, which can enhance output by 50-100% while further reduce solvent and utilities consumption, improving gross margin by 3-4 pcps.
Growth drivers	• Global flavors & fragrances market grew at 6% CAGR in 2005-09. The market is highly concentrated. In 2009, top 10 vendors controlled 72.5% market share (2008:70.7%). These leading players are gradually moving towards downstream and drifting away from cost-conscious upstream operation, which leaves business opportunity to emerging manufacturers like Ecogreen. • Demand for Ecogreen's turpentine aroma chemicals remains strong and existing capacities have been fully utilized. A new production line is under construction and will launch trial in Apr, adding 600 mt capacity to existing 4,000. Meanwhile, the company plans to re-engineer its existing lines with the new technology. • New Changtai plant, designed for intermediates (all outsourced presently) and material chemicals, completed construction and will start testing in Apr and trial in May.
Our opinions	• We appreciate the company's track record. Top line has been growing at 22% CAGR since its listing in 2004 while net profit 13% CAGR and EPS 10% CAGR. The slower bottom line growth can be largely attributed to the gum turpentine oil price hike. • We preliminary forecast the company's top line will pick up 24% in FY12/11F to RMB1,130m. Blended gross margin will stay at 25% level. Thus, net profit will increase 26% to RMB164m. The counter is trading at 6.4x of our forecasted FY12/11F earnings.

Solargiga (0757 HK) (click here…)

Stock statistics	Market cap: US$576.9m (closing price: HK$2.49); daily turnover: US$2.8m
Summary / review	• Solargiga is a China-based solar company with ingot, wafer, cell and module manufacturing capability. • In Jan, Solargiga completed acquisition of 300MW cell manufacturing capacity and built vertical integrated model. By end of Jan 2011, capacities of ingot, wafer, cell and module are 800MW, 600MW, 300MW and 26MW. This model may serve to enhance production yield and reduce earnings volatility. • Solargiga has close ties to suppliers and customers. Suppliers Hemlock and Wacker Chemie (WCH EU) signed 8 years and 6 years supply contracts with Solargiga. In addition, there is saying that cell manufacturer Suniva would increase purchase from Solargiga especially after Suniva's plan for a 500MW – 750MW solar cell production plant in Jinzhou, which is close to Solargiga manufacturing base's in the city.
Drivers / catalysts	• By end of 2011, including both mono and multi, attributable capacities of ingot, wafer, cell and module are expected to raise to 1,189MW, 1,085MW, 300MW and 77MW is expected. Shipment-wise, including minority interest, we assume sales volume growth for ingot and wafer would be 55% and 23%, while volume for cell and module are up from almost nil in 2010. • Since Solargiga is to capture a larger proportion of profit within value chain of panel manufacturing, overall gross margin of Solargiga is expected to increase in 2011 to 28.7% for 2011 from 22.3% from 2010.
Our opinions	• In additional to segment specialization, we believe formation of vertical model and strategic alliance are keys to success in the increasing competitive solar market. We look forward to its first year to reflect near-full year performance of its vertical integrated model. • We believe valuation is relatively attractive based on strong top-line and bottom-line growth of 114% and 131% in 2011 on our assumptions. • Share price surged 11% to HK$2.49 from our initial non-rated report while it was a touch higher than our reference target price at HK$2.63 in early May. • The counter now is trading at 9.5x FY12/11F P/E after dilution due to acquisition of cell operation.

Candidates at a glance (I)

Fong's (0641 HK)	• FI is a long-history supplier of textile dyeing machines in the world. It currently runs five brands (Fong's, Then, Goller, Xorella, Monforts), all leading names in their respective operation territory. • The company has just launched a new business unit to provide tailor-made waste water treatment solutions to its existing clients (e.g. dying factories). We are quite bullish on this business given FI's deep understanding of waste water emission from these factories as well as existing business relationship. • Revenue picked up 44% in FY12/10A to HK2,587m due to industry recovery. The prosperous market environment favored also gross margin, which improved 11.5pcp to 31.1%. Net profit, therefore, reached HK$303m, turning around from HK$106m loss last year. • We've planned to upgrade the counter to the tracing list. However, the management, in its latest update, mentioned negative impact of current credit tightening in the PRC, which discourages FI's customers to expand capacity and purchase new equipment. Sales in 1H FY12/11F will be affected, although 2H outlook is still blurred. Thus, we chose to remain the stock in the watching list and will review it after Jun.
Boer Power (1685 HK)	• Boer is a specialist of electrical power distribution system, connecting end-users to power grids. The market size of electrical distribution equipment is anticipated to grow at 16% CAGR between 2008 and 2012, from RMB323b to RMB586b. Bore itself concentrates on high-end market, which represents ~5% of the entire market and is expected to increase to 8% by 2012. Clients come mainly from infrastructure, telecom, waste water treatment, cement and medical equipment sectors. • Major competitors are international names. A key competitive edge of Boer is pricing, which is usually 10-15% lower than peers, combined with its track record and strategic partnership with Schneider. • Revenue increased 86% in FY12/10A to RMB911m. Net profit over doubled from RMB85m to RMB187m. The company targets at 30-40% top line growth for FY12/11F.

Candidates at a glance (II)

Truly (0732 HK)	• Truly manufactures and supplies mainly display modules (90% of FY12/10A revenue) used in mobile handsets (63%), industrial & medical equipment (10%), consumer electronics (6%), automobiles (5%), etc. For the core mobile handset display business, Truly had a market share of 8.0% worldwide in 2009, following Samsung (19.2%), Wintek (10.5%), Sharp (9.0%). Different from other vendors, the company serves mainly Chinese domestic brands. • The company suffers continuous price pressure as a common industry practice, which explained 2.5 pcps gross margin squeeze last year. Release of new products can be solution for this particular situation, which, this year, will likely be capacitive touch screen (CTS). • According to the management, CTS is more expensive (2-3 times) than conventional one and carries better gross margin (3-5 pcp). With more android-system products released by its clients this year, Truly expects demand for CTS to pick up significantly. It has been working on a second production line to expand its CTS capacity from present 2.5m pieces/month to 6m. The new line will launch operation in Jun. We, then, will re-visit the company and have our updates accordingly.
Ming Fai (3828 HK)	• Ming Fai is a supplier of amenity products to high-end hotel chains and airlines. To diversify their business, they have acquired a cosmetics retail business name “7magic” in China last August 2010. The hotel related business accounts for 92.2% of their total sales. The retail business accounts for 7.8% of the sales. Since the retail business is newly acquired, sales contribution is only for the last four months of 2010. • The retail business “7magic” franchise currently has 1381 point of sales in China all operating under franchisee model. With each shop to have 2,500 number of SKU on average. The average selling price is approximately RMB10 to RMB60. • We’re interested in the newly retail business venture, we like to follow the development and growth of this segment. We believe this can bring a significant contribution to the group.

Candidates at a glance (III)

NewOcean Energy (0342 HK)	• The principal business of the company is sales and distribution of LPG and sales of electronics products. The company initially involved retail sales of bottled LPG to domestic users of China. It subsequently expanded to the import, re-export, wholesale and retail of LPG business since 2004. It further expanded its business towards running 17 LPG refueling stations for LPG vehicles in Guangzhou since 2010. • NewOcean Energy acquired NewOcean Sea Terminal in Zhuhai in 2004, which has a berth that can handle large LGP ships up to 50,000 tonnes capacity. As a LPG importer, exporter and wholesaler, the NewOcean Sea Terminal has ranked number 1 in China since 2008 in terms of through-put volume. • There are currently 35 gas refueling stations in Guangzhou, supplying roughly 400,000 tonnes LPG a year. The 17 acquired refueling stations supplied around 240,000 tonnes to autos, of which 13 are located at bus terminals. With specific transaction arrangement, the company should enjoy the effect of the acquisition in 2011.
Leoch International (0842 HK)	• The Group is principally engaged in the manufacture and development of lead-acid batteries. The company has exclusive co-operations with industry experts, such as Dr Geoffrey J May, Chief Technical Officer of FIAMM in Italy and Technical Director at Hawker Energy Products. • Product range is wide including reserve power batteries, SLI batteries and motive power batteries. For FY12/10A, 92% revenue came from reserve power sales such as UPS, telecom, consumables and renewable energy farms. For 2010/2011, the company ranked 1st in China Unicom (0762 HK) purchase and 3rd in China Mobile (0941 HK) purchase. Moreover, Leoch is the largest lead acid batteries exporter of China which fills overseas demand on reduced supply in developed countries. • By Mar the company has 53 production lines with 5.9m KWh capacity. While ramp-up was going on, the management expects to have 110 production lines by the end of the year. Of the 57 additional production lines, 25 are planned for motive batteries, another 25 are for SLI, while the remaining 7 are designed for UPS.

Candidates at a glance (IV)

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.

Removals

RMIH **(1997 HK)**	• Revenue in 1Q FY12/11A went up 35% to US$324m. Blended gross margin narrowed 1.4 pcps to 9.1% due to lower margin of new business (e.g. TV main board). Net profit, thus, increased 17% to US$20m. The company launched SMT solutions for LED general lighting and white appliances this year. • We reckon the full-year growth picture will be more or less in line with which in 1Q. New business may ramp up quickly and push up RMIH's top line, although gross margin will likely squeeze somewhat. Overall, we are looking at a double-digit earnings growth for this year. • The counter is trading at 9.3x P/E historically, which seems fair, considering both the counter's expected double-digit earnings growth as well as industry peers' valuation range. As RMIH's share price has hiked ~45% (adjusted to the stock split) since our last not-rated report, we removed it from our tracing list to watch list. Subject to ramp-up of the new businesses, we will re-consider our decision.
China XLX **(1866 HK)**	• Share price performed disappointedly, down 24% since our latest report, although we do position it as a long-term opportunity to get exposure to the cyclic fertilizer industry. • Fundamental landscape remains unchanged. The company is one of the most cost-effective coal-base urea producer in China, which is key in our argument. • However, the poor share performance might reveal the market's concern on the whole industry. We reckon a major risk is that, with hiking coal cost and over-supplied market balance, the whole industry might stay in trough for a certain while. The situation can even further deteriorate when the Beijing government decides to interfere prices and contain inflation. • We, therefore, removed the counter to the watching list for the time being, awaiting more concrete signal of market recovery.

Thank You!

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