Small Cap Charm

Thesis and Ideas for 3Q 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 2Q

Company	Ticker	Target (HK$)	Latest update	First report	Abs. price return * (%)	HSI return (%)	MSCI ** return (%)
Core coverage							
Comtec	0712 HK	4.93	18/08/11	08/06/10	(62.8)	(18.5)	(17.7)
Tracing list							
HL Tech	1087 HK	-	18/08/11	12/22/10	(28.9)		
Tongda	0698 HK	-	15/07/11	14/01/11	(33.3)		
Ecogreen	2341 HK	-	28/03/10	09/12/10	(14.7)		
Solargiga	0757 HK	-	27/07/11	06/01/11	(54.5)		
Watching list (selective)							
Fong's	641 HK	-	14/02/11	14/02/11	-		
Boer Power	1685 HK	-	-	-	-		
Truly	732 HK	-	15/08/11	15/08/11	-		
Ming Fai	3828 HK	-	28/06/11	28/06/11	-		
NewOcean Energy	342 HK	-	21/07/10	06/05/10	-		
Leoch International	842 HK	-	19/07/10	19/07/10	-		
COSTIN New Material	2228 HK	-	-	-	-		

*Note: * calculated based on closing price on 19 Aug*
*** MSCI Hong Kong Small Cap Index*

Updated portfolio in 3Q

Company	Ticker	Target (HK$)	Latest update	First report	Analyst
Core coverage					
Comtec	0712 HK	3.47	18/08/11	08/06/10	Kevin Mak
Tracing list					
HL Tech	1087 HK	3.09	18/08/11	12/22/10	Research team
Truly	0732 HK	-	15/08/11	15/08/11	Research team
Solargiga	0757 HK	2.32	27/07/11	06/01/11	Kevin Mak
NewOcean Energy	0342 HK	2.22	21/07/11	06/05/11	Kevin Mak
Leoch International	0842 HK	4.32	19/07/11	19/07/11	Kevin Mak
Watching list (selective)					
COSTIN New Material	2228 HK	-	-	-	Kevin Mak
Ming Fai	3828 HK	-	28/06/11	28/06/11	Baron Sun
Natural Beauty	0157 HK	-	-	-	Baron Sun

Quarterly summary

- 2Q portfolio performed disappointingly, which can be attributed to:
  - ✓ Steep correction of the entire renewable energy sector triggered by market slowdown. However, our channel check suggests, despite the slowdown, leading players should still be able to maintain a sound earnings growth this year. We believe some stocks have been oversold and expect price rally after panic.
  - ✓ Consumer electronics industry hit headwind on slower-than-expected recovery in the US and Europe as well as the unprecedented Japanese earthquake. When economy outlook is still blurred, some catch-up effect can be anticipated in 3Q after the earthquake sequence was absorbed.
  - ✓ Equity market as a whole tumbled in 2Q amid current fragile macro environment.
- Therefore, we maintained Comtec (0712 HK), Solargiga (0757 HK) and HL Tech (1087 HK) in our 3Q picks. Meanwhile, two more names, Leoch International (0842 HK) and NewOcean Energy (0342 HK) were upgraded from watching list to tracing list for their foreseeable earnings growth this year.
- Additional adjustments have been made in accordance to our personnel change.

Comtec Solar (0712 HK) (click here…)

Stock statistics	Market cap: US$254.4m (closing price: HK$1.75); daily turnover: US$2.9m
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 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). Management targets to 50% wafer delivery are n-type wafers in 2012. • With lower electricity cost, energy usage, specific input arrangement and improving scale, Comtec has reached lower non-silicon production cost at US$0.27 for 1H 2011. It targets to further lower to US$0.20 per W, without considering any potential introduction of n-type wafers.
Drivers / catalysts	• Due to change in macro environment, demand for solar is not as strong as earlier expected. ASP declined for modules & cells in Q1 and the effect was partly passed to wafer in Q2 and poly in Q3. Margin guidance was lowered among global players. Renesola (SOL US) conservatively estimated Q3 margin 6%-8%. • 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).
Our opinions	• On revised shipment and margin expectation, we believe bottom line growth for 2011 is limited as margin squeeze offsets increase in shipment. Nevertheless with healthy net cash position, we believe Comtec could survive industry consolidation and benefits from recovery as it did between 2008 and 2009. We expect 2012 would be another year seeing volume expansion as well as margin improvement as 2010. • The counter rose to HK$4.80 yet missing our previous target at HK$4.93 in early May. It fell drastically by 63.5% to HK$1.75 afterwards. Our latest TP was revised to HK$3.47 at 14.0x and 7.7x target P/E for FY12/11F and FY12/12F, compared to current valuation at 7.1x and 3.9x P/E for the mentioned period.

HL Technology (1087 HK) (click here…)

Stock statistics	Market cap: US$159m (closing price: HK$1.72); daily turnover: US$0.4m
Summary / review	• HLT stepped into automobile wire & harness area through acquisition of TJRT in Feb. The other two new products, solar connector and special power cable, will be launched in 4Q as scheduled. At client acquisition side, the company was qualified by Dell and Apple in 2Q. • Top line went up 39% in 1H FY12/11A to RMB882m while net profit 27% to RMB88m. Notably, RMB17m gain was booked as other income, including RMB6m foreign exchange gains, which was incurred from change of payment method and, therefore, is recurrent and operation-natured. • The Japanese earthquake led some order delays throughout the entire electronic industry, which also affected HLT's seasonal pattern. The management expects 2H to account for 60% of full year revenue, up from 55% last year.
Drivers / catalysts	• New product and new customer are still two major drivers. • Full-year operation of the two newly acquired subsidiaries may add extra fuel to top line, although profit contribution should be minimal at the beginning stage. • Sales of thunderbolt transmission cable to Apple commenced in May. • Uncertainty remains at macro level due to blurred economy outlook in the US and Europe. • The management maintains profit guidance at RMB200m.
Our opinions	• The stock remains one of our favorites for its track record and future plan on new products development and rollout. • 1H results are broadly in line with our expectation. We fine-tuned our forecast and have a new preliminary earnings projection at RMB185m, 6% lower from the previous RMB196m. Accordingly, reference target price was penciled down from HK$3.27 to HK$3.09 on 10x forward P/E. • Our planned initial coverage was delayed due to personnel change. We will review our position next quarter.

Truly (0732 HK) (click here…)

Stock statistics	Market cap: US$419m (closing price: HK$1.18); daily turnover: US$1.6m
Summary / review	• As a major supplier of small-size display module, Truly serves mainly Chinese domestic mobile handset brands, which accounts for ~65% of the company's total revenue. According to the management, it has 50%+ market share for this specific business in China. • Revenue reached HK$7,736m in FY12/10A while net profit HK$315m. In Jan-Jul this year, turnover picked up 32% to HK$5,166m.
Drivers / catalysts	• Major Chinese domestic handset brands maintained their strong performance this year. • A major trend of mobile industry is the migration from feature phone to smartphone. As a result, demand for touch-screen display has been increasing significantly, which carries much higher ASP and gross margin than conventional one. Truly shipped 3.5m touch screen display modules (out of total 75m) in 1H, which is expected to increase to 6-10m in 2H. A second TSD production line has been completed constructed, which will bring the company's total design capacity from 1.5m/month to 4.5m. • Other than mobile handset, Truly expects automobile display to become a long term driver. The market currently is dominated by Japanese companies. Due to obvious cost advantage as well as the rising of China into the largest automotive market in the world, the management believes there is a well chance ahead. In fact, it has been qualified by all major auto brands except BMW and Mercedes. Automobile products accounted for ~5% (~HK$380m) of the company's revenue in FY12/10A. Following delivery of orders in coming years, segmental revenue is anticipated to hit HK$800-1,000m this year and maintain 50% growth even in 2012.
Our opinions	• We think the growth story is feasible backed by the company's well-integrated production capacity. • In our preliminary calculations, the company may have 29% top-line growth in FY12/11F to HK$10,011m. Gross profit will increase 25% to HK$1,140m. The two figures will increase 24% and 27%, respectively, in FY12/12F to HK$12,421m and HK$1,446m.

Solargiga (0757 HK) (click here…)

Stock statistics	Market cap: US$336.3m (closing price: HK$1.17); daily turnover: US$1.1m
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	• Solargiga has TDR in circulation and it did not release Q1 results. While Solargiga schedules to release results not until 30 this month, we believe Solargiga could break-even in May and Jun. For 1H 2011 as a whole, we believe strong growth would still be seen possibly up to RMB126.5m net profit. • 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.
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. • The counter was one touch higher than our previous reference TP at HK$2.63 and fell sharply to HK$1.17. While solar industry is under consolidation, we believe strong growth would be seen at least in 1H. We would review outlook upon results announcement. Current revised reference target price is HK$2.32. • The counter now is trading at 6.7x and 4.0x FY12/11F and FY12/12F P/E after dilution due to acquisition of cell operation.

Leoch Int'l (0842 HK) [(click here…)]

Stock statistics	Market cap: US$649.6m (closing price: HK$3.80); daily turnover: US$0.7m
Summary / review	• Leoch is principally engaged in the manufacture and development of lead-acid batteries. It has a wide range of products including UPS (Uninterruptible power supply), telecom, consumable products, SLI batteries, renewable energy and motive batteries. Leoch developed moulds for wide range of 1,500+ customized products. • Customers of Leoch include Emerson Electric (EMR US), Eaton Corp (ETN US), BMW, Juguar, US batteries, Black & Decker (SWK US), to name a few. In 2008 and 2009, Leoch sales to non-China market were 50% to 60%, while it dropped slightly to 37% due to weaker overseas market.
Drivers / catalysts	• China eventually suspended production of most of lead acid factories since May this year. All lead acid battery facilities located less than 300 meters from residential homes have been required to stop production for inspection. In China as a whole, of 1,800 facilities with production permits, over 1,000 facilities were suspended from production. • We have visited company's Zhaoqing, Jiangsu and Anhui production bases this month. All of Leoch's production bases are in industrial zone, where there is no household within a good range. MWH, an independent environmental consulting company, has confirmed there were no major non-compliance issues and generally display adequate measures to treat air emissions and wastewater discharge in 2010.
Our opinions	• Leoch has prudent pricing mechanism. Upon receiving purchase order, the company quote product price on a dollar-plus-cost basis to customers after getting lead price quotes. While revenue largely depends on lead price, we believe gross profit is largely linked to sales volume. Effect of lead price is small on Leoch. • In short-term, due to higher barrier of entrance in the industry, we believe per ton profit may reach high levels for 2H 2011 or even in 2012. At the same time, while peers are on suspension, Leoch is expanding its capacity from 5.9kWh by end of 2010 gradually to 23kWh by end of 2012 to capture the opportunity. • Current P/E valuation for FY12/11F and FY12/12F are 8.8x and 5.6x based on our preliminary forecast of RMB479m and RMB753m net profit. Since we initiate reference TP of HK$4.32, the counter rose 13.7%.

NewOcean Energy (0342 HK) (click here…)

Stock statistics	Market cap: US$262.8m (closing price: HK$1.57); daily turnover: US$0.9m
Summary / review	• 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.
Drivers / catalysts	• There are 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 up to HK$120m and the company gain extra benefit of increased sales to those 17 stations. • NewOcean Energy has applied for “Registered Gas Supply Company” license and it is reaching its final stage. The management expects to complete its LPG terminal at Lung Kwu Tan of Tuen Mun by the end of the year and penetrates Hong Kong market in 2012.
Our opinions	• NewOcean Energy announced interim results earlier this month. Revenue increased 44% YoY to HK$5,467m while gross profit was up 22.5% YoY to HK$212m. Reported net profit was HK$165m, up 160% YoY for the period partly due to non-core one-off gain. Total one-off pre-tax items were up to HK$73m, therefore core earnings were actually below our expectation. • Current P/E valuation for FY12/11F and FY12/12F are 7.1x and 6.6x based on our preliminary forecast of RMB479m and RMB753m net profit. Since we initiate reference TP of HK$2.22, the counter fell 6% to a current price of HK$1.57.

Candidates at a glance (I)

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 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.
Natural Beauty (0157 HK)	• 2011 can be a turnaround year for Natural Beauty (NB), non-core and non-performing businesses were disposed, follow by redefining of brand positioning, opening New Concept Store (NCS) and upgrading existing stores. • NCS has a new and improved image targeting walk-in and younger customers. NCS shows "Sell-In" increased 44% versus a non-NCS of -6%. Total "Sell-Thru" increased by 49%. Payback period shortened from 48-60 months to 27-36 months. • There were 80 NCS across the PRC as the end of FY2010. Targets for FY2011 is to open over 100 additional new NCS and upgrade 100 from the existing shops, bring total number to over 300. • New strategic cooperation is setup with Carrefour China, where franchisees are encourage to lease space in a Carrefour hypermarket and shopping malls.

Candidates at a glance (II)

Ming Fai (3828 HK)	• Since our last update we have visited the production facility and selective retails shops in Shenzhen. We reiterate our interest in their newly retail business take on by Ming Fai, we like to follow the development and growth of this segment. We believe this can bring significant contribution to the group. • Ming Fai International engages in the supply & manufacture of amenity products to high-end hotel chains and airlines. And now it is expanding into the retail consumption market by acquiring the "7Magic - 七色花" retail networks that sells cosmetics, skin care, fashion and hair accessories. • Last reported earnings was for FY12/10A. Revenue increased +33.8% to HK$1,085.9m from HK$811.3m in FY12/09A. Hotel business accounted for 92.2% and retail business accounted for 7.8%. Profit for the year increased +18.5% to HK$116.1 from HK$97.9m. • To further become a one-stop hospitality solution for their customers, they begin to offer off-site laundry services. The newly launched laundry service is catering to a hotel clusters in major cities, with total capacity to accommodate up to 15,000 room per day upon completion. • The "7Magic" retail networks targets young female age between 15 to 25 in the PRC. As at the end of 2010, the sales network had 1,381 POS targeting to add another 700 for 2011. • With Ming Fai's existing expertise and being able to self-design and self-produce will have an significant advantage over competitors.

Removals

Tongda (0698 HK)	• The company will announce 1H results on 22nd • It was removed due to our personnel change.
Ecogreen (2341 HK)	• The company will announce 1H results on 25th • It was removed due to our personnel change.

Thank You!

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