Small Cap Charm

Thesis and Ideas for 4Q 12

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Our research portfolio in 3Q

Company	Ticker						
Core coverage		Target (HK$)	Latest update	Initiation	Abs. QoQ price return (%)	MSCI QoQ return (%)	Abs. up-to-date price return (%)
Comtec Solar	0712 HK	1.48	12-Nov-12	8-Jun-10	52.2%	10.5%	-29.2%
Tongda Group	0698 HK	0.561	20-Aug-12	29-Feb-12	21.4%	10.5%	19.3%
Chu Kong Pipe	1938 HK	3.78	3-Sep-12	3-Sep-12	15.8%	10.5%	19.6%
Watch list							
Leoch International	0842 HK	-	-	-	1.9%	-	-
China Fiber Optic	3777 HK	-	-	-	13.4%	-	-
IRC	1029 HK	-	-	-	41.9%	-	-
Sino Oil and Gas	0702 HK	-	-	-	12.5%	-	-
Shengli	1080 HK	-	-	-	15.5%	-	-

*Note: * QoQ return calculated based on closing price on 3 Sep and 26 Nov, non-annualized ** MSCI Hong Kong Small Cap Index*

Updated portfolio in 4Q

Company	Ticker	Target (HK$)	Latest update	Initiation	Analyst
Core coverage					
Comtec Solar	0712 HK	1.48	12 Nov 2012	08 Jun 2010	Kevin Mak
China Fiber Optic	3777 HK	1.80	24 Sep 2012	24 Sep 2012	Kevin Mak
Tongda Group	0698 HK	0.561	20 Aug 2012	29 Feb 2012	Kevin Mak
Chu Kong Pipe	1938 HK	3.78	03 Sep 2012	03 Sep 2012	Isaac Lau
Watch list					
Leoch International	0842 HK	-	-	-	Kevin Mak
CW Group	1322 HK	-	-	-	Kevin Mak
IRC	1029 HK	-	-	-	Isaac Lau
Labixiaoxin Snacks	1262 HK	-	-	-	Isaac Lau
Sino Oil and Gas	0702 HK	-	-	-	Isaac Lau
Shengli	1080 HK	-	-	-	Isaac Lau

Core Coverage

Comtec Solar (0712 HK) (click here…)

Stock statistics	Market cap: US$154.1m (closing price: HK$1.06); daily turnover: US$1.2m
Summary / review	• Comtec Solar is a pure-play monocrystalline solar ingot and wafer manufacturer based in China. In 1H 2012, 74.4% turnover was from n-type wafers sales to SunPower (SPWR US) fabrication facilities in Philippines. According to feedback from customer, highest efficiency achieved reached 24%. The company expects to raise n-type sales to another customer, Sanyo (6764 JP), possibly in 2013F. • The company recorded RMB456.2m revenue for 1H FY12/12A, with RMB218.5m in Q1 and RMB237.7m in Q2. While for Q3, revenue was high at RMB311.9m on stabilizing wafer ASP and increased shipment with its 600MW capacity with outperforming 10.2% gross margin and 4.8% core net margin.
Drivers / catalysts	• For end of Sep, Comtec indicated that its net-to-equity ratio was 6.0%. By end of the period, Comtec had RMB510.9m cash and other financial assets. On debt side, the company had RMB472.5m short-term bank loan, RMB19.5m long-term bank loan and RMB109.6m CB on the balance sheet. After Q3 results announcement, Comtec also announced to repurchase remaining RMB163.6m. As such, net-debt-to-equity would still be healthily low at 9.6% for future opportunities. • Comtec had heavy reliance on SunPower in 1H due to n-type wader sales which presents moderate counterparty risk. Nevertheless, for the latest 6-month interim by non-GAAP standard, revenue was US$1,231m with US$26.0m operating income. By end of Jun, their net debt-to-equity ratio was still at satisfactory level of 39.5%. That said, as a major client of Comtec, we believe SunPower is to keep itself floating with certain profit and moderate financial health during this late stage of industry consolidation.
Our opinions	• Comtec was trading up to HK$1.21 from HK$0.67 since our last update in Sep after interim results announcement. We maintain our view that Comtec was bottoming-out in mid of the year and there is potential for improvement in volume in 2H. With 100-120MW wafer sales in 1H, we further review the number up to as much as 263MW with 87.5% utilization for 2H. • The counter is currently trading at 0.6x P/B based on RMB1,518m net equity FY12/12F. We revise our Target Price to HK$1.48 from HK$1.44, representing 16.0x and 8.3x P/E for FY12/12F and FY12/13F.

China Fiber Optic (3777 HK) (click here…)

Stock statistics	Market cap: US$202.9m (closing price: HK$1.30); daily turnover: US$1.7m
Summary / review	• China Fiber Optic Network System (CFONS) was listed in HK in Jun last year at HK$1.20 per share. Through processing soft optical cables and ceramic ferrules, the company offers 100+ models of fiber optic patch cords to communication industry since "Network Access License for Telecommunications Equipment" (电信设备进网许可证) was granted in 2001. Fiber optic patch cords are devices consist of soft optical cables with each of their ends connected to one or more connectors for light signal transmission purpose. • In terms of sales volume, CFONS market share in 2011 was 21.4% in China. By end of 2011 production capacity of fiber optic patch cords was 12m sets a year, which contributed to 12.9m units self-produced in addition to 5m outsourced units in 2011. As of 1H FY12/12A, revenue increased 14.4% YoY to RMB715m while net profit increased 11.5% YoY to RMB111.2m
Drivers / catalysts	• According to 12th Five-year-plan, infrastructure investment on IT is targeted at RMB2,000b for 2011A to 2015F. Average investment for the 2013F to 2015F is as much as RMB480b+ each year, up from ~RMB300m in 2012F. In particular, the draft emphasized speeding up construction of backbone network, regional network as well as FTTX applications. In Sep draft, MIIT aims to have more than 250m broadband users by 2015F up from 150m by end of 2011; and internet access speed is targeted at 20MB and 4MB for urban and rural area respectively by that time. We expect China to see strong demand for fiber optic patch cords in short-to-medium term with high penetration and speed target for FTTX applications.
Our opinions	• CFONS is working to expand its capacity from 9m sets a year in 2011 to 18m sets by end of 2012F partly with its IPO proceeds in 2H 2011. Under our conservative assumptions, CFONS will utilize 90% operating cash flow before working capital changes in one particular year for expansion of the following year, of which half goes to CAPEX and the other half serves as additional working capital. As such, we expect CFONS to maintain its net cash position while raising its capacity to 18m sets in 2012F and further to 22m sets in 2013F to capture attractive market opportunity. Based on our target price, implied P/E is 6.3x and 4.6x for FY12/12F and FY12/13F based on RMB287m and RMB395m net profit forecast respectively.

Tongda Group (0698 HK) (click here…)

Stock statistics	Market cap: US$204.6m (closing price: HK$0.335); daily turnover: US$0.14m
Summary / review	• TDG is the world largest manufacturer for in-mould lamination (IML) plastic casings with patented technology. Its products are applied in consumer electronics such as handset, notebook and electrical appliances. Major customers include fast-growing domestic brands such as ZTE (0763 HK), Huawei, Lenovo (0992 HK), Haier (1169 HK) and Midea (000527 CH). • Different from in-mould decoration (IMD) technology, which simply prints designs onto a certain surface, IML covers the patterns with a protective layer so that the finished product is much more scratch proof. Although IMD has currently larger market share and it is within 10% cheaper than IML-made products, IML is observed to be increasingly adopted.
Drivers / catalysts	• Tongda turnover was up 9.2% YoY to HK$1,398m for 1H FY12/12A. Of HK$118m increment, handset continued to be the major contributor which offset weakness in electrical appliances segment. At the same time, gross profit increased 29.6% YoY to HK$309m, representing an gross margin of 22.1%. Net profit was HK$113m for the period, up 11% YoY from a year ago partly due to HK$16.1m MI. • While handset and notebook computers sales assumption largely remain the same at HK$5,000m and HK$3,250m, we lower our sales forecast of electrical appliances to HK$784m for 2012F from HK$941m. As such, our revised total revenue forecast will be HK$3,916m and HK$5,493m for FY12/12F and FY12/13F. Due to robust demand at least in handset and notebook computer segments, gross profit was lowered slightly to HK$732m this year from HK$751m.
Our opinions	• In the past four years, Tongda recorded increase in top-line as well as profit margin despite global economic headwind. With strong sales growth of its major domestic customers, we expect Tongda to capture net earnings of HK$300m+ for 2012F and achieve bottom-line growth of 20% in short-term. • We value Tongda with discounted cash flow model at 17.5% discount rate and the target price is HK$0.561 per share, which represents 8.8x and 6.1x FY12/12F and FY12/13F P/E based on HK$300.2m and HK$431.2m net profit for the respective years

Chu Kong Pipe (1938 HK) *(click here…)*

Stock statistics	Market cap: US$405.8m (closing price: HK$3.13); daily turnover: US$1.00m
Summary / review	• Chu Kong Pipe is the leading LSAW steel pipe producer, and one of the four approved LSAW suppliers for national pipeline projects with maximum capacity of 1.3mtpa. • Chu Kong Pipe is the industry pioneer. It is the first LSAW producer, first to introduce UOE method for LSAW pipes, first developed deep sea LSAW steel pipes with 1,500m depth and first Chinese brand recognized by Shell in China. • Differentiated from the Chinese competitors, CKPNG's customer base is globally diversified with over 600 customers in over 50 regions. Overseas sales accounted for 63%, 39% and 52% of total sales from 09A to 11A orderly. • Company's products are more defensive and less sensitive to the national pipeline project down cycle. . Other appliances of LSAW pipes are 1) transmission pipe for deep-sea project, 2) construction/ infrastructure 3) city gas networks, etc. • On 31 Oct, company obtained a loan facilities of US$36m to finance the construction costs of the new production base at Lianyungang.
Drivers / catalysts	• Three key grow drivers, 1) commencing next up-cycle for national pipe sector 2) accelerating offshore development 3) emerging demand from power tower. • Chu Kong's LSAW production capacity will increase by 600ktpa to 1.9mtpa from 1.3mtpa by the end of 12F, and will further increase by 300ktpa to 2.2mtpa by end of 13F. Two new SSAW steel pipe production lines of total capacity of 660ktpa are coming online in 3Q 12F and 1Q 13F.
Our opinions	• The overall domestic pipeline industry is benefiting from the acceleration of national pipeline expansion. We are bullish on the pipeline industry with CKPNG as the top pick among peers. • We initiated last quarter BUY coverage at target price HK$3.78 and the TP is currently under review upon 4Q result. The coverage target price HK$3.78 implied target 12F P/E of 8.9x and 12F P/B of 1.3x.

Watch-list

Leoch Int’l (0842 HK)

Stock statistics	Market cap: US$188.4m (closing price: HK$1.10); daily turnover: US$0.65m
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 1,600+ 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. Leoch is one of the largest exporter in sales volume in China. • As we have discussed in the previous note, Zhaoqing facility was under suspension for self-examination and rectification, which was accounted for 20% of Leoch production capacity. As a matter of fact, production and sales for UPS clients, the core business, was negatively affected. While the management expects heavy allocation to Anhui facilities with UPS and SLI focus, Leoch needs to take time to repair relationship with major clients. Besides, the management needs to ramp-up another round of Anhui new equipments and involves as much as 7,000 staff in the base, which largely challenges management execution ability. Sales for 2H have to be revised. Sales in 1H were around 3.2m kVAh, while in base scenario full year estimates was revised down to 7.5m kVAh from previous 9.0m kVAh forecast. • For general lead acid battery providers, Leoch and its peers faced tightened regulation since 2H 2011, where a lot of facilities were suspended at least for 2012. In short-term, Leoch is still subject to the effect of increasing fixed costs due to expansion yet limited sales growth on partial capacity suspension. We would like to wait for higher visibility in respect to industry consolidation and company execution. For the time being, we downgrade Leoch to HK$1.15 from HK$2.53 though share price rose sharply yesterday after the results announcement. Net profit for FY12/12F and FY12/13F were lowered to RMB137m and RMB308m respectively from RMB293m and RMB478m. The counter is currently trading at 8.5x and 3.8x P/E according to our new forecasts.

CW Group (1322 HK)

Stock statistics	Market cap: US$105.9m (closing price: HK$1.34); daily turnover: US$0.24m
Summary / review	• CW Group is a Singapore-headquartered precision engineering solution provider. As of 1H FY12/12A, around 50% of the group turnover was contributed by precision engineering turn-key solutions. Customers are of international scale from a wide range of industries including aerospace, oil and gas, energy and automotive, including Honeywell, Rolls-Royce, Hamilton Sundstrand and HP. Management indicates that CW Group is a well-positioned turn-key provider that sources equipment from both top-tier and lower-tier equipment suppliers to provide customized according to customers needs, maintaining a balance between total cost and production performance. • In addition to turn-key solutions, CW group also manufactures industrial equipment, components and parts with its production facilities in Shanghai and Tianjin in China, which made up around 40% of turnover in 1H FY12/12A. The segment includes cement production, CNC machining centres as well as components and parts. For CNC machining centres, CW Group formed a JV with Japan's Kiwa and manufacture products under its own brand name "菲斯特"; At the same time, CW Group is the OEM of Germany's DMPG. For cement production equipment, its production was based in Tianjin. • CW Group expects to enjoy organic growth through recurring sales from existing turn-key solutions clients. According to the management, those clients are ramping up sales and marketing efforts especially in emerging markets such as Indonesia and India to capture new orders. At the same time, CW Group is with a 3-year production expansion plan to raise its capacity from 200 units CNC machines centres and 140 units components & parts by end of 2012F to 400 units CNC machines centres and 400 units components & parts by 2014 with a total CAPEX of HK$380m in the 3 years. • CW Group is achieved HK$399m revenue in 1H FY12/12A and core net profit of HK$26m in the period after adding back HK$25.8m listing expenses. The counter is currently trading at 12x historical P/E for FY12/11A.

IRC (1029 HK)

Stock statistics	Market cap: US$398.7m (closing price: HK$0.89); daily turnover: US$0.73m
Summary / review	• IRC (1029 HK) is an iron ore producer. Its key assets are located in Far East of Russia at regions namely Amur and EAO. These mines sites situated relatively close to the North-eastern Chinese border. • Currently developing iron mine assets are namely Kuranakh, K&S and Garinskoye. They are all open-pit mines along with access to national railway networks. Three prospective mining projects sustains long term development, they are namely Garinskoye Flanks, Kostenginskoye and Bolshoi Seym. • Total Measured, Indicated and Inferred Resources are 1,514m tons, of which 1,051m tons are Measured and Indicated Resources. **Update** • IRC released 3Q operating result on 18 th Oct 2012. Kuranakh continues to operate at full level. Accumulative production volume to 3Q for iron ore concentrate and ilmenite concentrate reached 684.1kt and 77.3kt, representing 83% and 62% of year target respectively. ASP of IRC iron concentrates dropped by 13%/27% QoQ/ YoY reflecting the weakening demand, while the 3Q index spot price first time dropped below the US$100/t mark since 2009. • Outlook: iron ore price recorded steepest drop in July in four years and hit the lowest at US$87/t in Sep, which was the first time since 2009 that iron ore price had dropped below US$100/t mark. For IRC, we expect 4Q result could be worse than 3Q, which is largely due to further decrease in ASP of iron ore concentrate. We expect the 4Q ASP might reach as low as US$90/t, i.e. less than its current mining cash cost. **Our opinions** • Despite the exceeding production volume in 3Q result, the lower in ASP has larger impact on dollar revenue. 3Q iron ore concentrate ASP of US$110/t and 4Q expected ASP of US$90/t would lead to segmental operating loss and greater net loss in 2H. • We expect another profit warning for year end result due to 1) previous annual ‘accounting’ profit to this year annual net loss 2) operating loss in 4Q. We maintain Hold rating for IRC at target price HK$1.12.

Labixiaoxin Snacks (1262 HK)

Stock statistics	Market cap: US$385.3m (closing price: HK$2.64); daily turnover: US$0.57m
Summary / review	**Overview** • Labixiaoxin Snacks (LBXX) is the second largest jelly snacks and beverage producer in China accounting for 10% of market share in terms of retails sales value in Jelly products. • LBXX is also engaged in sales of other snack and confectionary products, of which production process is mainly via OEM agreement or outsources. LBXX's jelly products are mainly self-produced, has annual capacity of 225,000 tons. • On Dec 2011, LBXX was listed on HKEx at market value of HK$2,982.8m/offer price of HK$2.65 at 10A P/E of 20.2x with COFCO as its second largest and pre-IPO investor with current holding of 6.4% of LBXX. **Update** • LBXX delivered good operating result for the traceable period. Historical sales and net profit growth maintained at double digit with profit margin between 38~41%. With S&D expenses between 10~13% of sales, administrative costs of 4%, LBXX resulted a net profit before tax margin between 22%~25% and net margin between 17%~21%. • LBXX targeted to double its capacity to annual production capacity of 400,000 tons from current 220,000 tons over mid-long term. Existing production bases are located in Fujian, Tianjin and Chengdu regions, and currently constructing new production factory in Chuzhou, Anhui with capacity of 90,000 tons. • The total estimated investment for the new factory is around RMB450m. We expect capex of RMB150m in 2H 12F and further RMB100m~RMB150m in 1H 13F on top of RMB450m. **Our opinion** • LBXX is a fast growing jelly snack producer with established brand that is also diversifying into other snack products market. With the existing distribution network and the established brand name, LBXX can leverage the marketing effort for new product launching.

Sino Oil and Gas(0702 HK)

Stock statistics	Market cap: US$283.6m (closing price: HK$0.18); daily turnover: US$0.77m
Summary / review	**Overview** • Sino Oil and Gas (SOG) is a resource investment company focused on upstream business of oil and gas as well as CBM exploration and development. • SOG's key asset is Sanjiao CBM project in Shaanxi which acquired in Nov 10 for consideration of HK$2.3b. • The Sanjiao CBM project is located in Shanxi and Shaanxi, with area of 382km2(previously 462km2) that operates via 70% PSC with PetroChina (857 HK). The net gas 2P and 3P reserves are 7.7b cubic meters and 15.9b cubic meters. • We estimate that taking into account of other major costs include other essential infrastructures, the aggregate capital investment will be RMB685m and RMB670m in 12 and 13, in which 30% investment cost will be undertaken by PetroChina as a result of PSC agreement. **Update** • Executive Director, Mr. King Hap Lee has been appointed as Deputy Chairman of the Company and Mr. Xu Zucheng, also Executive Director of the Company, has been appointed as the CEO of the Company to succeed Mr. King and Mr. Zhu Danping has joined the Group and being appointed as Vice President of the Company on 24 September 2012. • Company has received an approval letter from national energy administration (NEA) in relation to consent on the work for the development coal bed methane gas reserve in the Sanjiao region. • Pursuant to latest update; the Sanjiao CBM project is expected to commence soon and targeted to achieve daily CBM sales of note less than 100,000 cubic meters by the end of 2012. • We expect to see substantial improvement in company's 2013 top-line performance, as a result of the commencement of CBM production and sales.

Shengli(1080 HK)

Stock statistics	Market cap: US$216.3m (closing price: HK$0.68); daily turnover: US$0.33m
Summary / review	**Overview** • Shengli is the one of four authorized SSAW pipe producer in national pipe projects in China. Their current production capacity of 1,150k tonnes denoted roughly 33% of market share. • SSAW steel pipe is the largest pipe used in the national pipe network, representing roughly 70% of use. • Being the pure domestic player, Shengli's performance is highly correlated to the national pipeline development. • Pursuant to the 12th five-year plan, it was set to increase the total length of PRC national pipeline by 95% to 150,000km. By end of 2011, the total national length was 82,500km representing a short of 67,500km. **Update** • Preliminary estimation for 2H FY12/12F result. As a result of the new order for the China-Asia Natural Gas pipeline project, the base case for the turnover will be the contract value of the project, which is RMB723.5m representing 117% of 1H FY12/12A result, 170% of 1H FY12/11A result and 52% of 2H FY12/11A, and adding up the 1H 12/12A result, total turnover represents 74% of previous annual turnover. • On 17 Sep, Shengli formed a JV that will engaged in processing, manufacturing and distribution of dome integration house. Company will contribute RMB100m for 40% interest in the JV. **Our opinion** • As the commencement of the next national capital expenditure up-cycle coming ahead, we are bullish the welded pipe sector, while we believe Shengli has the ability to catch the rapid growth and rebound of the industry for the next three years.

Thank You!

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