

22 September 2009

GCL-Poly Energy

Earnings leap 250% YoY in 1H09

P
BUY
3800.HK – HK\$2.33
Target Price: HK\$3.00 (↓3.31)

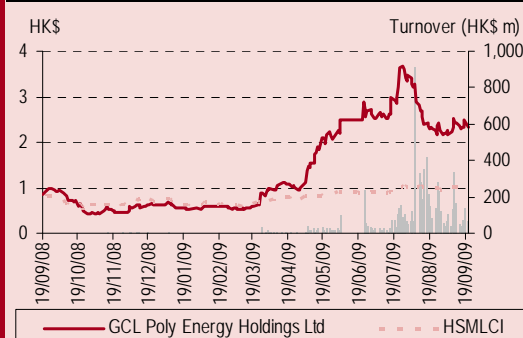
GCL-Poly's earnings for 1H09 soared 250% YoY to Rmb72m (core EPS: Rmb0.073). The earnings stemmed entirely from the electricity business, with contributions from polysilicon only coming in August. We lower our target price for GCL-Poly to HK\$3.00, but reaffirm our **BUY** rating.

Key Factors for Rating

- GCL-Poly's revenue for 1H09 grew 9% to Rmb1,952m, and its earnings surged 250% to Rmb72m (core EPS: Rmb0.073), in line with our expectations.
- The increase in profit from electricity was due to higher grid tariffs and lower coal costs. The gross margin increased from 11.2% in 1H08 to 15.4% in 1H09.
- Based on the profitability of polysilicon in 1H09, we lower our ASP assumptions for polysilicon in our projections. However, we remain optimistic about the company's future development especially since after Jiangsu Zhongneng acquisition. Its profit should increase sharply due to the volume growth of polysilicon sales after 2010, based on our estimates.

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Share Price vs Index



Sources: Bloomberg, BOCI Research

Share Price Performance

	YTD	1M	3M	12M
Absolute (%)	282	2	(7)	174
Relative to HSMLCI (%)	235	(3)	(20)	154

Sources: Bloomberg, BOCI Research

Key Data

Total issued shares (m)	12,363
Free float (%)	65.5
Free float mkt. cap. (HK\$ m)	18,714
3M avg. daily turnover (HK\$ m)	115
Net debt/equity (%) (2009E)	15.7
Major shareholder (%)	
Mr Zhu Gongshan	34.47

Sources: Company data, Bloomberg, BOCI Research

Key Risks to Rating

- Continuous capital investments and lack of accessible credit for domestic solar companies.

Valuation

- The company completed the Zhongneng acquisition on 31 July, so the earnings of polysilicon will only be included in August results. Due to the dilution effect and the decreasing profitability of polysilicon, we lower our 2009-11 EPS forecasts for GCL-Poly to Rmb0.08, Rmb0.22 and Rmb0.29. Based on 12x 2010E P/E, we lower our target price for the stock to HK\$3.00, but reiterate our **BUY** rating on the stock.

Figure 1. Investment Summary

Year ended 31 Dec	2007	2008	2009E	2010E	2011E
Revenue (Rmb m)	1,845	3,693	6,212	11,534	14,895
Change (%)	97.6	100.2	68.2	85.7	29.7
Net profit (Rmb m)	(267)	131	1,025	2,746	3,598
Fully diluted EPS (Rmb)	(0.02)	0.01	0.08	0.22	0.29
Change (%)	(114.0)	(149.2)	680.6	167.9	31.0
Previous fully diluted EPS (Rmb)	-	-	0.10	0.26	0.36
Change (%)	-	-	(17.1)	(13.4)	(20.1)
Fully diluted P/E (x)	(94.38)	191.73	24.56	9.17	7.00
CFPS (Rmb)	0.22	0.66	0.19	0.61	0.52
P/CF (x)	9.25	3.08	10.69	3.36	3.92
EV/EBITDA (x)	13.18	9.20	2.03	0.52	0.10
DPS (Rmb)	0.00	0.00	0.03	0.07	0.10
Yield (%)	0.00	0.10	1.37	3.67	4.81

Sources: Company data, BOCI Research estimates

* LI Bo made major contributions to this report

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NB: BUY = ≥+10% compared with the relevant benchmark index over a 6-month period; SELL = ≤-10% compared with the relevant benchmark index over a 6-month period; HOLD = ≤+10% and ≥-10% compared with the relevant benchmark index over a 6-month period; Not Rated (NR)

1H09 Earnings up 250% YoY

GCL-Poly's revenue for 1H09 grew 9% YoY to Rmb1,952m, and its earnings for 1H09 soared 250% to Rmb72m (core EPS: Rmb0.073). The results were much in line with our expectations. The gross margin rose from 11.2% to 15.4%, the main reason for the increase in earnings.

Figure 2. Interim Results Summary

(Rmb m)	1H08	1H09	YoY %
Revenue	1,787	1,952	9
COGS	(1,587)	(1,651)	4
Gross profit	201	301	50
Other income	67	54	(18)
Selling and distribution expenses	(3)	(3)	(8)
Administrative expenses	(108)	(109)	0
Operating profit	156	243	56
Finance costs	(130)	(113)	(13)
Share of profits of associates	17	2	(89)
Pre-tax profit	43	132	205
Tax	(6)	(17)	200
Minority interests	(17)	(43)	152
Net income	21	72	250
Key ratios (%)			
Gross margin	11.2	15.4	
Operating margin	8.7	12.5	
Net margin	1.1	3.7	

Sources: Company data, BOCI Research

Profits Soared on Higher Grid Tariffs and Lower Coal Costs

As of 30 June 2009, the group (including its subsidiaries and associated facilities) operated 19 power plants. These comprised 14 coal-fired cogeneration plants and comprehensive resource utilisation plants, two gas-fuelled cogeneration plants, two biomass cogeneration plants and one solid waste incineration plant with an attributable installed capacity of 703.8MW and an attributable steam extraction capacity of 1,756.4 tonnes/hour. This represented an increase of 3.1% and 5% respectively compared to the attributable installed capacity of 682.8MW and attributable steam extraction capacity of 1,673.3 tonnes/hour as of 30 June 2008. The increase was primarily due to the expansion of installed capacity at the Puyuan Cogeneration Plant and Taicang Incineration Plant.

The increase in on-grid tariffs in July and August 2008 resulted in higher revenue from electricity sales. The substantial drop in the spot coal price and the decrease in the bank interest rate effectively mitigated the cost pressure for fuel and financial expenses of power companies.

In addition, the company signed a five-year long-term contract coal agreement with **China Coal Energy Company Limited** (601898.SS/Rmb12.67, BUY), which ensures the company will have better control of market risks and secures coal supply to GCL-Poly's power plants.

New Progress in Renewable Energy

The company has made solid progress in expanding its renewable energy business in 1H09. The second phase of its capacity expansion at the Taicang incineration plant was completed in June 2009, increasing installed capacity from 6MW to 12MW. The installation of facilities at the Wind Power Plant located in Xilin Gol in Inner Mongolia was fully completed in May 2009, and all 66 wind-generator units are expected to commence operations in the current half.

Earnings from Polysilicon in Line with our Expectation

In June 2009, GCL-Poly announced the acquisition of a 100% stake in Jiangsu Zhongneng, the main operating entity of GCL Solar. The acquisition was completed on 31 July 2009. As such, the earnings of Zhongneng will be booked into GCL-Poly until the second half.

1H09 revenue, gross profit margin and EBITDA of Zhongneng came in at about Rmb1,112.2m, 41.40% and Rmb471.5m, respectively. In 1H09, Zhongneng sold 1,917m tonnes of polysilicon and 9.3MW of wafers, at an average selling price (ASP) of US\$80.0/kg and US\$0.78/W, respectively. Polysilicon production volume and average production cost for the corresponding period amounted to 2,274m tonnes and US\$43.4/kg, respectively.

We believe that the group's competitive advantages will be further strengthened with continuous technical upgrades and the implementation of the "direct electricity supply" policy.

1GW Wafer Plant to be Completed by Mid-2010

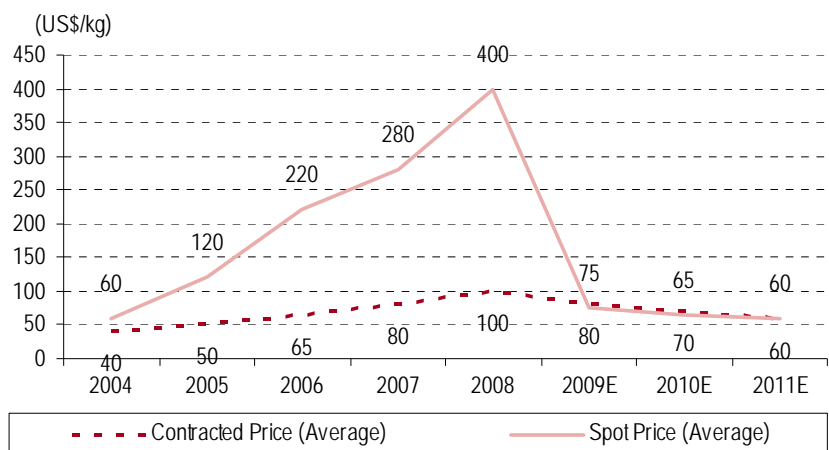
GCL-Poly entered into an agreement with the Xuzhou city government on 15 September 2009 to invest in and develop a silicon wafer project in the Jiangsu Province city, with the total investment for the first phase totaling US\$300m. The funding will be financed by internal resources and bank loans, and the Xuzhou government will provide relevant support. The project falls under the plan approved by the board of directors to invest in the production of silicon wafers in the province, with total capacity of 2GW and a planned total investment of US\$700m.

Developing wafer production will enable the group to fulfill its contractual obligation. In addition, by developing wafer production, the group can substantially raise the quality of its wafer products and lower its production costs so as to realise synergy between polysilicon manufacturing and wafer production. This would also enhance the group's competitiveness in both domestic and overseas markets. We expect the 1GW plant to be completed by mid-2010.

Polysilicon Prices Expected to Decrease to US\$65/kg by end-2009

The spot price of polysilicon fell below the US\$70/kg mark in July. With the recovery in the downstream, the price has increased 5% since. Due to the relatively weak demand expected for PV in 4Q09, we expect the spot price to decrease to about US\$65/kg by year-end.

Figure 3. Polysilicon Contract and Spot Price



Sources: Photon Consulting, BOCI Research

Profit Projection for Polysilicon and Wafer

Based on the profitability in 1H09, we lower our ASP assumption for polysilicon. Other changes are as follows:

Figure 4. Polysilicon Sales of GCL-Poly

	2008	2009E	2010E	2011E
Polysilicon (tonnes)	1,530	7,017	10,876	10,876
Wafers (MW)	39	44	487	1,316
Unit amount (g/W)	8	7.4	6.9	6.5
Polysilicon used for wafers (tonnes)	314	328	3,362	8,552
Total polysilicon (tonnes)	1,844	7,345	14,239	19,428
YoY (%)		298	94	36
Previous polysilicon forecast		7,510	14,419	19,470
Change (%)		(2.20)	(1.25)	(0.22)

Source: BOCI Research estimates

Figure 5. Profit Projections for Polysilicon and Wafer Businesses

	2008	1H09	2H09	2009E	2010E	2011E
Polysilicon						
Capacity (tonnes)	3,000	15,000	18,000	18,000	21,000	21,000
Sales (tonnes)	1,530	1,917	5,100	7,017	10,876	10,876
Previous (tonnes)				7,191	11,146	11,146
Change (%)				(2)	(2)	(2)
ASP (US\$/kg)	256	80	68	72	67	63
Previous (US\$/kg)				74	70	65
Change (%)				(3)	(4)	(3)
Cost (US\$/kg)	65	47	35	38	32	31
Revenue (Rmb m)	2,820	1,028	2,341	3,368	4,907	4,564
Gross profit margin (%)	74	41	49	47	52	50
Gross profit (Rmb m)	2,100	425	1,145	1,570	2,566	2,270
Wafers						
Capacity (MW)					1,000	2,000
Sales (MW)	39	9	35	44	487	1,316
Previous (MW)				43	474	1,281
Change (%)				2	3	3
ASP (US\$/W)	2.41	0.78	0.64	0.67	0.64	0.60
Previous (US\$/W)				0.92	0.87	0.83
Change (%)				(27)	(27)	(27)
Cost (US\$/W)	0.87	0.52	0.40	0.43	0.37	0.34
Revenue (Rmb m)	701	49	150	199	2,076	5,326
Gross profit margin (%)	65	33	37	36	42	44
Gross profit (Rmb m)	455	16	56	72	881	2,324

Source: BOCI Research estimates

Valuation

We are optimistic about GCL-Poly's future development after the Jiangsu Zhongneng acquisition. Its profit should increase sharply due to the volume growth in polysilicon after 2010, based on our estimates. The company completed the acquisition on 31 July, so the new earnings contributions will have only commenced in August.

After the acquisition of Jiangsu Zhongneng and the new share placement of 1,300m shares that was completed on 11 August 2009, total shares outstanding now stand at 12,363m. Due to the dilution effect and the decreasing profitability of polysilicon, we lower our 2009-11 EPS forecasts for GCL-Poly to Rmb0.08, Rmb0.22 and Rmb0.29. We lower our target price for the stock to HK\$3.00, based on 12x 2010E P/E, but reaffirm our **BUY** rating.

Figure 6. Valuation Comparison of Global Polysilicon Companies

Company	Code	Ccy	Share price (Local currency)	EPS (Local currency)			P/E (x)			ROE (%)	
				2008	2009E	2010E	2008	2009E	2010E	2009E	2010E
OCI	010060.KS	KRW	284,000	14,493	22,613	37,545	20	13	8	32	37
MEMC	WFR.US	US\$	18	3.3	0.1	1.0	6	206	17	1	9
Wacker	WCH.GR	€	104	8.8	2.6	7.3	12	40	14	7	16
REC	REC.NO	NOK	53	3.6	1.1	3.4	15	47	15	4	11
Tokuyama	4030.JP	¥	698	(20.4)	33.9	47.5	(34)	21	15	5	6
TWBB	600550.SS	Rmb	34	0.8	0.9	1.2	42	40	29	20	23
Average							19	61	16	12	17
GCL-Poly	3800.HK	HK\$	2.31	0.01	0.09	0.25	192	25	9	10.9	17.7

Sources: Bloomberg, BOCI Research estimates

Risk Factors

Continuous capital investments: The business of the target group may require significant and continuous capital investments which may exceed GCL-Poly's original budgets, and there is no guarantee in the intended economic results or commercial viability would be achieved. Actual capital expenditure for the business of the target group is likely to be much higher than the group's budgets because of numerous factors beyond its control. This may in turn affect the group's financial standing.

Credit accessibility for solar companies in China: Driven by the country's economic stimulus measures, it has become relatively easy for Chinese solar companies to secure funds. While this may help in the near term, we are concerned about a potential lack of disciplined capex, and hence long-term overcapacity. In addition, there is no assurance regarding the sustainability of available domestic credits to Chinese solar companies. Any failure to secure a sufficient level of credit may impact the group's financial position.

Income Statement (Rmb m)

Year ended 31 Dec	2007	2008	2009E	2010E	2011E
Revenue	1,845	3,693	6,212	11,534	14,895
Cost of sales	(1,482)	(3,196)	(4,302)	(7,086)	(9,200)
Operating expenses (ex-D&A)	(125)	(124)	413	618	524
EBITDA	237	373	2,324	5,066	6,218
Depreciation & amortisation	(18)	(96)	(786)	(1,314)	(1,419)
Operating profit (EBIT)	220	277	1,537	3,753	4,799
Net interest income/(expenses)	(162)	(259)	(268)	(283)	(253)
Other gains/(losses)	(274)	189	1	1	1
Pre-tax profit	(216)	207	1270	3470	4547
Tax on profit	4	(27)	(79)	(278)	(364)
Minority interests	(55)	(48)	(167)	(447)	(586)
Net profit	(267)	131	1,025	2,746	3,598
Core net profit	(267)	131	1,025	2,746	3,598
EPS (Rmb)	(0.02)	0.01	0.08	0.22	0.29
Core EPS (Rmb)	(0.02)	0.01	0.08	0.22	0.29
DPS (Rmb)	0.00	0.02	0.03	0.07	0.10
Revenue growth (%)		100	68	86	29
EBIT growth (%)		26	455	144	28
EBITDA growth (%)		57	523	118	23
EPS growth (%)		(149)	681	168	31
Core EPS growth (%)		(149)	681	168	31

Sources: Company data, BOCI Research estimates

Balance Sheet (Rmb m)

As at 31 Dec	2007	2008	2009E	2010E	2011E
Cash & cash equivalents	804	414	3,545	7,279	11,198
Receivables	566	494	596	1,106	1,428
Inventories	127	259	330	544	706
Other current assets	251	241	952	1,232	1,419
Total current assets	1,748	1,407	5,423	10,161	14,751
Fixed assets	4,658	4,979	13,147	14,287	14,340
Intangible assets	131	130	6,975	6,975	6,975
Other long-term assets	330	553	757	811	844
Total long-term assets	5,119	5,662	20,879	22,073	22,159
Total assets	6,867	7,070	26,302	32,234	36,910
Creditors	661	881	1,768	2,912	3,781
Short-term debt	1,492	1,652	2,437	2,295	2,128
Other current liabilities	5	8	2,824	3,587	4,221
Total current liabilities	2,157	2,542	7,029	8,794	10,129
Long-term borrowings	1,988	1,597	3,017	4,017	4,017
Other long-term liabilities	85	107	3,595	4,394	4,898
Share capital	93	93	1,103	1,103	1,103
Reserves	2,180	2,323	10,983	12,905	15,244
Shareholders' equity	2,273	2,416	12,086	14,008	16,346
Minority interests	364	408	575	1,022	1,520
Total liabilities & equity	6,867	7,070	26,302	32,234	36,910
Book value/share (Rmb)	2.34	2.48	1.10	1.27	1.48
Tangible assets/share (Rmb)	2.20	2.35	0.46	0.64	0.85
Net debt/(cash)/share (Rmb)	2.75	2.92	0.17	(0.09)	(0.46)

Sources: Company data, BOCI Research estimates

Cash-flow Statement (Rmb m)

Year ended 31 Dec	2007	2008	2009E	2010E	2011E
Pre-tax profit	(216)	207	1,270	3,470	4,547
Depreciation & amortisation	18	96	786	1,314	1,419
Net interest expenses	17	20	267	282	252
Change in working capital	(13)	(102)	62	637	664
Tax paid	4	(27)	(79)	(278)	(364)
Other operating cash flows	404	450	(209)	1,256	(801)
Cash flow from operations	214	644	2,097	6,682	5,717
Net purchase of fixed assets	(256)	(336)	(1,500)	(2,200)	(300)
Decrease/(increase) in invest.	0	0	0	0	0
Other investing cash flows	132	(154)	0	0	0
Cash flow from investing	(124)	(490)	(1,500)	(2,200)	(300)
Net increase in equity	93	0	129	0	0
Net increase in debt	1,941	(230)	(2,891)	857	(167)
Dividends paid	0	(20)	(307)	(824)	(1,079)
Other financing cash flows	(1,495)	(282)	3,184	(781)	(252)
Cash flow from financing	538	(532)	115	(748)	(1,498)
Change in cash	628	(378)	712	3,734	3,919
Cash at beginning of year	188	804	414	3,545	7,279
Free cash flow to firm	105	174	613	4,558	5,551
Free cash flow to equity	1,869	(335)	(2,567)	5,051	4,992

Sources: Company data, BOCI Research estimates

Key Ratios

Year ended 31 Dec	2007	2008	2009E	2010E	2011E
Profitability (%)					
EBITDA margin	12.9	10.1	37.4	43.9	41.7
EBIT margin	11.9	7.5	24.7	32.5	32.2
Pre-tax margin	(11.7)	5.6	20.5	30.1	30.5
Net profit margin	(14.5)	3.6	16.5	23.8	24.2
Liquidity (x)					
Current ratio	0.8	0.6	0.8	1.2	1.5
Interest coverage	1.2	1.0	5.3	10.3	12.3
Net debt to equity (%)	101.5	100.4	15.1	Net Cash	Net Cash
Quick ratio	0.8	0.5	0.7	1.1	1.4
Valuation (x)					
P/E	(94.4)	191.7	24.6	9.2	7.0
Core P/E	(94.4)	191.7	24.6	9.2	7.0
Core P/E @ target price	(65.3)	132.7	17.0	6.3	4.8
P/B	0.9	0.8	1.9	1.6	1.4
P/CF	9.3	3.1	10.7	3.4	3.9
EV/EBITDA	13.2	9.2	2.0	0.5	0.1
Activity ratios					
Inventory days	31.0	29.6	28.0	28.0	28.0
Accounts receivables days	112.0	48.8	35.0	35.0	35.0
Accounts payables days	130.8	100.7	150.0	150.0	150.0
Returns (%)					
Dividend payout ratio	0.0	15.0	30.0	30.0	30.0
Return on equity	(11.7)	5.4	8.5	19.6	22.0
Return on assets	3.2	3.4	5.5	10.7	12.0
Return on capital employed	3.8	4.9	8.6	18.0	20.6

Sources: Company data, BOCI Research estimates

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