

Equities

26 November 2010 | 10 pages

GCL-Poly Energy Holdings (3800.HK)

Ramping Wafer Output; Positive on 2011 Outlook

- **Maintain buy** — After GCL-Poly lowered its polysilicon production costs to US\$25.4/kg in 3Q10 (from US\$31.5), we expect it to ship over 1GW in solar wafers in 2H10. Given its cost-advantage, we are re-iterating our Buy/Medium Risk (1M) rating with target price of HK\$3.18 on 11.5X 11E EPS.
- **Key catalysts** — Prices for poly-si will likely fall in early 2011, but GCL-Poly will see 86% Y/Y shipment growth in wafer production in 2011E along with yield improvements; poly-si costs 50% below the spot price of US\$55/kg; vertical alliance with China-based cell/module makers. It is also increasing in-house production of crucible volume and slurry recovery.
- **Positive 2011 outlook** — Management expects to maintain its G.M. in the solar segment in 2011 (44% in 3Q), by increasing in-house TCS usage. Based on its long-term contracts, it expects near 100% wafer production utilization in 11E. We also expect the company to pursue further investments in both polysilicon and wafer production capacity, which will be ready for production by 2H11E.
- **How we differ** — While consensus remains focused on poly-si oversupply in 2011E, we see GCL-Poly's model helping it gain further market share, but working closely with its customers to manage inventories and improve cost efficiencies. As it improves its manufacturing yield, it has room to cut wafer costs to US\$0.25/watt. Our sensitivity analysis shows a US\$0.1/piece rise in the solar wafer price translates to 7.5% increase in 2011E net profit.
- **Update on power segment** — GCL-Poly's power and steam businesses remain steady in 3Q. Power and steam sales totaled to 3,580,159 MWh and 5.09m tonnes, down 8.9% and up 26.6% YoY respectively, with 11.7% GM. We see its power segment will likely face risk of higher coal prices.

■ Company Update

Buy/Medium Risk	1M
Price (25 Nov 10)	HK\$2.51
Target price	HK\$3.18
Expected share price return	26.7%
Expected dividend yield	0.0%
Expected total return	26.7%
Market Cap	HK\$38,837M US\$5,005M

Price Performance (RIC: 3800.HK, BB: 3800 HK)



Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RmbM)	(Rmb)	(%)	(x)	(x)	(%)	(%)
2008A	1,923	0.357	162.6	6.0	-12.1	nm	0.0
2009A	-176	-0.016	-104.4	nm	3.3	-3.8	0.0
2010E	2,599	0.168	na	12.8	2.8	23.4	0.0
2011E	3,682	0.238	41.7	9.1	2.5	29.1	0.0
2012E	5,263	0.340	42.9	6.3	1.9	34.5	0.0

Source: Powered by dataCentral

Asian Solar Sector

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Fiscal year end 31-Dec	2008	2009	2010E	2011E	2012E
Valuation Ratios					
P/E adjusted (x)	6.0	nm	12.8	9.1	6.3
EV/EBITDA adjusted (x)	14.9	30.0	7.2	7.2	5.2
P/BV (x)	-12.1	3.3	2.8	2.5	1.9
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0
Per Share Data (Rmb)					
EPS adjusted	0.357	-0.016	0.168	0.238	0.340
EPS reported	0.357	-0.016	0.168	0.238	0.340
BVPS	-0.178	0.660	0.771	0.861	1.109
DPS	0.000	0.000	0.000	0.000	0.000
Profit & Loss (RmbM)					
Net sales	3,521	4,356	14,805	16,616	21,062
Operating expenses	-1,181	-3,423	-10,438	-12,022	-14,447
EBIT	2,341	933	4,366	4,594	6,615
Net interest expense	-72	-307	-364	-411	-408
Non-operating/exceptionals	39	-675	-907	203	215
Pre-tax profit	2,307	-50	3,096	4,386	6,422
Tax	-143	-82	-279	-395	-706
Extraord./Min.Int./Pref.div.	-242	-44	-219	-310	-453
Reported net income	1,923	-176	2,599	3,682	5,263
Adjusted earnings	1,923	-176	2,599	3,682	5,263
Adjusted EBITDA	2,418	1,186	5,107	5,425	7,668
Growth Rates (%)					
Sales	90.9	23.7	239.9	12.2	26.8
EBIT adjusted	nm	-60.2	368.2	5.2	44.0
EBITDA adjusted	673.9	-51.0	330.7	6.2	41.3
EPS adjusted	162.6	-104.4	nm	41.7	42.9
Cash Flow (RmbM)					
Operating cash flow	4,480	310	3,132	5,058	6,733
Depreciation/amortization	77	253	740	831	1,053
Net working capital	2,076	-910	-789	-175	-444
Investing cash flow	-5,351	-1,376	-5,376	-3,926	-3,881
Capital expenditure	-3,595	-2,125	-5,125	-3,625	-3,625
Acquisitions/disposals	0	0	0	0	0
Financing cash flow	2,271	3,996	166	-990	-2,721
Borrowings	2,510	-2,346	4,800	1,491	-140
Dividends paid	0	0	0	0	0
Change in cash	1,400	2,931	-2,078	142	131
Balance Sheet (RmbM)					
Total assets	8,930	23,050	33,373	37,295	42,868
Cash & cash equivalent	1,746	4,875	2,798	2,939	3,071
Accounts receivable	102	1,382	4,291	5,272	6,682
Net fixed assets	5,053	13,712	18,097	20,891	23,462
Total liabilities	9,775	12,292	20,675	22,888	24,168
Accounts payable	652	2,109	5,489	6,190	7,589
Total Debt	6,190	7,721	11,548	13,039	12,931
Shareholders' funds	-845	10,758	12,698	14,408	18,700
Profitability/Solvency Ratios (%)					
EBITDA margin adjusted	68.7	27.2	34.5	32.6	36.4
ROE adjusted	nm	-3.8	23.4	29.1	34.5
ROIC adjusted	48.3	9.3	23.9	19.3	23.9
Net debt to equity	na	26.4	68.9	70.1	52.7
Total debt to capital	115.8	41.8	47.6	47.5	40.9

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Figure 1. Solar Prices – Likely to See Downward Pressure in 4Q10

	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Poly Spot Price	US\$515	US\$450	US\$400	US\$200	US\$100~US\$120	US\$75~US\$80	US\$60~70	US\$55-60	US\$50-55	US\$50	US\$60
Wafer Spot Price (6")	US\$10	US\$11.7	US\$9.5	US\$7.0	US\$5-6	US\$4~ US\$5	US\$3~US\$4			US\$3.2	US\$3.5
Cell Spot Price (Per Watt)	US\$3.4	US\$3.6	US\$3.0	US\$2.5	US\$2	US\$1.3	US\$1.4		US\$1.3	US\$1.35	US\$1.4
Module Spot Price							US\$1.5~1.7			US\$1.7	US\$1.6

Source: Citi Investment Research and Analysis

Figure 2. PV Solar – C-Si Based Price Trend (2008-2013E)

Assumption	2008	2009	2010E	2011E	2012E	2013E
Poly Price (US\$/kg)	100	60	55	40	35	35
Wafer Margin (%)	25%	10%	15%	11%	14%	14%
Wafer ASP (US\$/watt)	1.6	0.9	0.8	0.7	0.6	0.5
Wafer ASP (US\$/pcs)	6.0	3.3	3.2	2.5	2.2	2.1
Cell Margin (%)	18%	6%	12%	11%	10%	10%
Cell ASP (US\$/watt)	2.4	1.3	1.2	0.9	0.8	0.8
Module ASP (US\$/watt)	4.8	2.1	1.6	1.4	1.2	1.1
System ASP (US\$/watt)	7.5	4.4	3.9	3.6	3.3	3.3
c-si base (US\$/kWh)	0.52	0.31	0.27	0.25	0.23	0.23

Source: Citi Investment Research and Analysis estimates

Figure 3. GCL-Poly – Solar Business – Operating Data

	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Polysilicon sales (MT)	1,025	892	1,686	2,072	2,584	2,810	3,405
Polysilicon ASP (US\$/kg)	95.00	63.40	61.90	54.70	50.00	50.00	51.70
Polysilicon production cost (US\$/kg)	48.50	38.70	39.80	36.40	35.00	31.50	25.40
Wafer sales (MW)					31	198	435
Wafer ASP (US\$/W)					0.74	0.80	0.80
Wafer production cost (US\$/W)					0.63	0.57	0.58

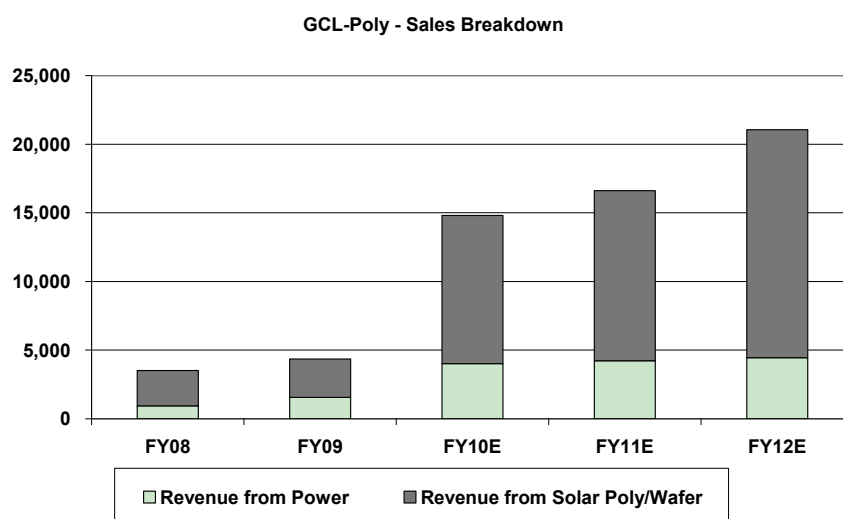
Source: Company Reports

Figure 4. GCL-Poly – Ramp of Polysilicon Production Volume (Part of Production for Internal Consumption)

	1Q08	2Q08	3Q08	4Q08	1Q09	2Q09	3Q09	4Q09	1Q10	2Q10	3Q10
Polysilicon Production	302	359	565	624	1094	1180	1993	3187	3112	3919	5068

Source: Company Reports

Figure 5. GCL-Poly – Sales Breakdown



Source: Citi Investment Research and Analysis estimates

Figure 6. GCL-Poly – Income Statement (RMB in Millions)

GCL-Poly - Income Statement	FY08	FY09	FY10E	FY11E	FY12E
Turnover	3,521	4,356	14,805	16,616	21,062
<i>Revenue from Power</i>	941	1,556	4,021	4,226	4,442
<i>Revenue from Solar Poly/Wafer</i>	2,580	2,799	10,784	12,390	16,620
Cost of sales	(967)	(3,042)	(8,596)	(9,908)	(12,146)
Gross profit	2,555	1,313	6,208	6,708	8,916
Other income	114	193	193	193	193
Distribution costs	0	(7)	(112)	(314)	(378)
Administration expenses	(199)	(359)	(1,666)	(1,728)	(1,832)
Other operating expenses	(15)	(15)	(64)	(72)	(91)
EBIT	2,454	1,126	4,560	4,787	6,808
Gain / (Loss) on disposal	(75)	(30)	0	0	0
Share of results of associates	0	9	0	10	22
Finance costs	(72)	(307)	(364)	(411)	(408)
Change in fair value of derivative financial instruments	0	(752)	(300)	0	0
Profit before taxation	2,307	(50)	3,096	4,386	6,422
Taxation	(143)	(82)	(279)	(395)	(706)
Minority interest	(242)	(44)	(219)	(310)	(453)
Net profits	1,923	(176)	2,599	3,682	5,263
Turnover YoY (%)		23.7%	239.9%	12.2%	26.8%
Net Profit YoY (%)				41.7%	42.9%

Source: Citi Investment Research and Analysis estimates

Figure 7. GCL-Poly – Expect Higher L-T Debt in 2010E

GCL-Poly - Balance Sheet (RMB m)	FY08	FY09	FY10E	FY11E	FY12E
Bank balances and cash	1,746	4,677	2,599	2,741	2,872
Pledged bank deposits	0	199	199	199	199
Account receivables	102	1,382	4,291	5,272	6,682
Inventories	67	640	1,927	1,678	2,224
Others	577	610	1,810	1,846	1,625
Current assets	2,492	7,507	10,826	11,735	13,601
PP&E	5,053	13,712	18,097	20,891	23,462
Others	1,380	1,794	4,294	4,509	5,636
Intangible asset	5	36	156	161	169
Non-current assets	6,438	15,543	22,547	25,560	29,267
Total assets	8,930	23,050	33,373	37,295	42,868
Account payables	652	2,109	5,489	6,190	7,589
Borrowings - amt due within one year	981	4,481	5,481	5,372	5,264
Amount due to related companies	3,133	123	350	350	350
Derivative financial instruments	60	24	0	0	0
Others	738	407	407	428	449
Current liabilities	5,565	7,145	11,727	12,340	13,652
Borrowings - amt due after one year	4,210	5,147	8,947	10,548	10,516
Non-current liabilities	4,210	5,147	8,947	10,548	10,516
Total liabilities	9,775	12,292	20,675	22,888	24,168
Shareholders equity	(845)	10,227	11,949	13,349	17,188
Minority interest	0	531	749	1,059	1,512
Total Equity	(845)	10,758	12,698	14,408	18,700

Source: Citi Investment Research and Analysis estimates

Figure 8. GCL-Poly – Expect Rise in Capex

GCL-Poly - Cash flow (RMB m)	FY08	FY09	FY10E	FY11E	FY12E
Operating activities					
Profit before tax	2,307	(50)	3,096	4,386	6,422
Adjustments	62	274	364	411	408
EBIT	2,369	224	3,460	4,797	6,830
Exceptional items	(10)	873	0	0	0
Depreciation & amortisation	77	253	740	831	1,053
Change in working capital	2,076	(910)	(789)	(175)	(444)
Operating cash flow	4,513	440	3,411	5,453	7,439
Interest paid	(64)	(206)	(364)	(411)	(408)
Net operating cash flow	4,480	310	3,132	5,058	6,733
Capex	(3,595)	(2,125)	(5,125)	(3,625)	(3,625)
Free cash flow	885	(1,814)	(1,993)	1,433	3,108
Change in equity	(49)	8,145	0	0	0
Change in debt	2,510	(2,346)	4,800	1,491	(140)
Other investing activities	(1,756)	749	(251)	(301)	(256)
Investing cash flow	(5,351)	(1,376)	(5,376)	(3,926)	(3,881)
Dividends paid	(7)	(26)	0	0	0
Financing cash flow	2,271	3,996	166	(990)	(2,721)
Beginning cash	346	1,746	4,677	2,599	2,741
Change in cash	1,400	2,931	(2,078)	142	131
Ending cash	1,746	4,677	2,599	2,741	2,872

Source: Citi Investment Research and Analysis estimates

GCL-Poly Energy Holdings

Valuation

Our HK\$3.18 target price is based on 11.5X 2011E earnings. The company has a short trading history, and we set our target at an 8% discount to the average earnings multiple of 12.5X for its solar sector peers (7X-19X) to take into account slower growth on its power generation business and the risk of rapid capacity expansion. We see its current share price at 8.5X 2011E earnings undemanding. Our target price also equates to 3.2X 2011E Book, compared to its ROE of 28%-30%. Our DCF valuation metric also equate to HK\$3.20 assuming further poly-silicon price reduction beyond 2012. Our model takes into account further investment in polysilicon and wafer production capacity by 2012, given expected solar industry growth and company's ambition to be one of the largest upstream suppliers. For our DCF valuation, we used WACC of 8.36% and assume a target gearing of 68%. We have a relatively high equity beta of 1.83 given the uncertainty to pricing in the solar sector.

Risks

We assign a Medium Risk rating to GCL-Poly, in line with its 260-day volatility. Our risk rating reflects uncertainty over its new wafer capacity which may take longer to improve its yield rate, while its low-cost polysilicon production should help it secure orders into 2011E. Downside risks for the stock include faster-than-expected price drop, slower demand in solar space due to affordability or changes to government subsidy programs, slower ramp of its solar farm projects, production issues with its polysilicon production, now concentrated at a single location, and yield issues with its wafer manufacturing facility.

Appendix A-1

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GCL-Poly Energy Holdings (3800.HK)

Ratings and Target Price History

Fundamental Research

Analyst: Timothy Lam

Covered since October 15 2010

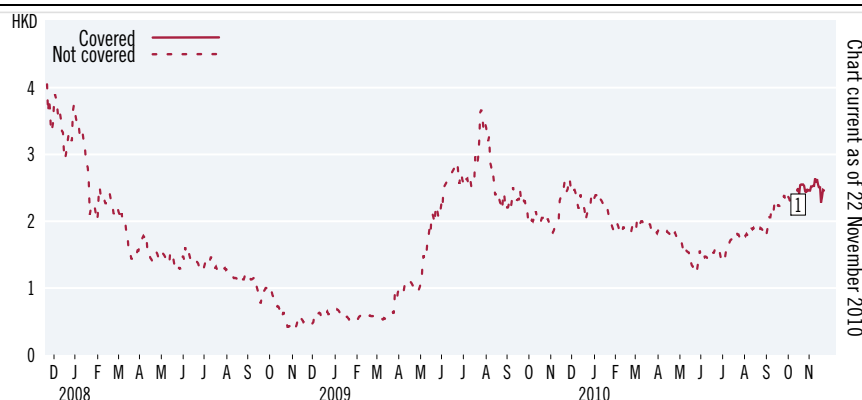


Chart current as of 22 November 2010

Date	Rating	Target Price	Closing Price
1 15-Oct-10	*1M	*3.18	2.49

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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