

16 November 2009

GCL-Poly Energy

Superior low cost advantage

P

BUY

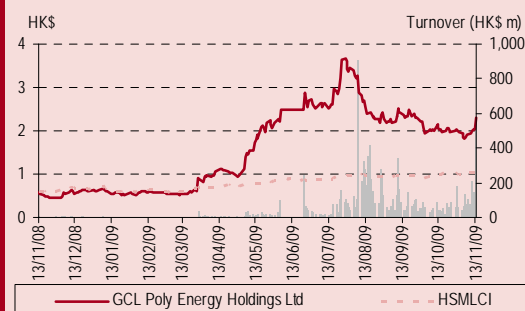
3800.HK – HK\$2.31

Target Price: HK\$2.80 (↓3.00)

LI Bo

+86 21 6860 4866 (8594)
brandon.li@bocigroup.com

Share Price vs Index



Sources: Bloomberg, BOCI Research

Share Price Performance

(%)	YTD	1M	3M	12M
Absolute	279	12	(10)	298
Relative to HSMLCI	222	6	(16)	219

Sources: Bloomberg, BOCI Research

Key Data

Total issued shares (m)	1,236
Free float (%)	65.5
Free float mkt. cap. (HK\$ m)	1,650
3M avg. daily turnover (HK\$ m)	109
Net debt/equity (%) (2009 E)	17.8
Major shareholder (%)	
Zhu Gongshan	34.5

Sources: Company data, Bloomberg, BOCI Research

GCL-Poly's 9M09 earnings from polysilicon were in line with our expectation. Considering the supply and demand dynamic of polysilicon, we believe the ultimately successful players will be those with costs below US\$40/kg. We lower our target price for GCL-Poly to HK\$2.80, but reaffirm **BUY**.

Key Factors for Rating

- For 9M09, revenue, gross profit margin and EBITDA of GCL Solar came in at about Rmb1,917.7m, 38% and Rmb730.0m, respectively. During the period, the group sold 3,603m tonnes of polysilicon and 25.2 MW of wafers.
- The spot price of polysilicon has been below the US\$60/kg mark since October. Due to the increasing supply of polysilicon and uncertainty over the growth of the photovoltaic (PV) market, we lower our polysilicon price forecasts for 2010 and 2011.
- The company's polysilicon production is on schedule. The production volume for October 2009 came in at about 1,000 tonnes. Polysilicon capacity should reach 18,000 tonnes per annum (tpa) full-year 2009.

Key Risks to Rating

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

Valuation

- Due to the unexpectedly decreasing price of polysilicon, we lower our polysilicon price forecasts in 2010 and 2011 to US\$56/kg and US\$50/kg, respectively. We lower our 2009-11 EPS forecasts for GCL-Poly to Rmb0.06, Rmb0.16 and Rmb0.23.
- Its profit should increase sharply due to the volume growth of polysilicon sales after 2010, based on our estimates. Based on 15x 2010E P/E, we lower our target price for the stock to HK\$2.80, but reiterate our **BUY** rating for it.

Figure 1. Investment Summary

Year ended 31 Dec	2007	2008	2009E	2010E	2011E
Revenue (Rmb m)	1,845	3,693	5,970	10,720	13,982
Change (%)	97.6	100.2	61.6	79.6	30.4
Net profit (Rmb m)	(267)	131	700	1,951	2,858
Fully diluted EPS (Rmb)	(0.02)	0.01	0.06	0.16	0.23
Change (%)	(114.0)	(149.2)	433.2	178.6	46.5
Fully diluted P/E (x)	(94.38)	191.73	35.96	12.91	8.81
CFPS (Rmb)	0.22	0.66	0.16	0.52	0.44
P/CF (x)	9.25	3.08	13.12	3.92	4.62
EV/EBITDA (x)	13.18	9.20	2.64	0.86	0.12
DPS (Rmb)	0.00	0.02	0.02	0.05	0.08
Yield (%)	0.00	1.00	0.94	2.61	3.82

Sources: Company data, BOCI Research estimates

BOCI research is available electronically on Bloomberg (BOCR <go>), firstcall.com, multex.com and at www.bociresearch.com.

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)

Gross Margin of Polysilicon down on Lower ASP

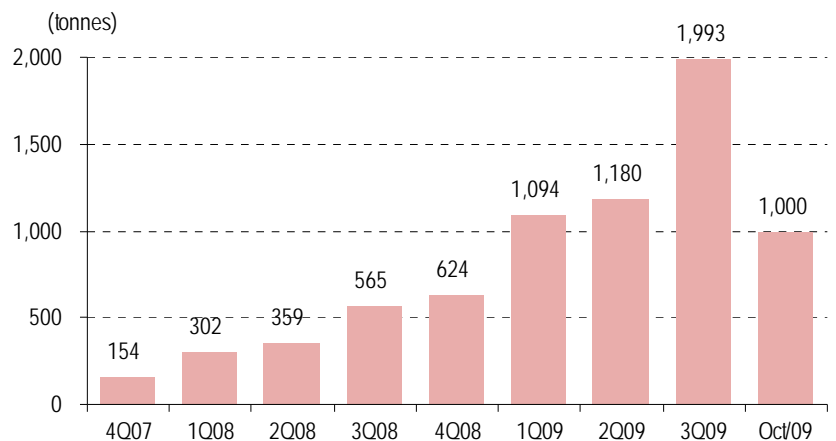
For 9M09, revenue, gross profit margin and EBITDA of GCL Solar came in at about Rmb1,917.7m, 38% and Rmb730.0m, respectively. During the period, the group sold 3,603 tonnes of polysilicon and 25.2 MW of wafers, with average selling prices of US\$71.7/kg and US\$0.80/W respectively. Polysilicon production volume and average production costs for the period were 4,266 tonnes and US\$41.7/kg, respectively.

Polysilicon Production Volume of GCL-Poly for Oct 2009 of 1,000 Tonnes

Polysilicon production volume reached 1,993 tonnes for 3Q09, an increase of 253% from 565 tonnes for the same period last year and representing a rise of 68.9% from the 1,180 tonnes in 2Q09. Polysilicon production volume for 9M09 came in at 4,266 tonnes, an increase of 248% from the 1,226 tonnes produced in 9M08.

The company's polysilicon production is on schedule, and the production volume for October 2009 was approximately 1,000 tonnes.

Figure 2. Polysilicon Production Volume Growth



Sources: Photon Consulting, BOCI Research

Sales-to-production Ratio up Slightly

The sales-to-production ratio rose from 84.3% in 1H09 to 84.6% in 3Q09. The sales of polysilicon for the 9M09 were as we had expected, over 70% of which were sales to customers under long-term contracts and to other major customers.

Figure 3. Polysilicon Sales of GCL-Poly

	9M09	1H09	3Q09	3Q09/1H09 Change %
Capacity (tonnes)	13,000	8,000	13,000	n.a
Sales (tonnes)	3,603	1,917	1,686	n.a
ASP (US\$/kg)	71.7	80.0	62.3	(22.2)
Production (tonnes)	4,266	2,274	1,992	n.a
Sales-to-production ratio (%)	84.5	84.3	84.6	0.3ppts
Cost (US\$/kg)	41.7	43.4	39.8	(8.4)
Gross profit margin (%)	38.1	41.4	33.5	(7.9ppts)

Sources: Company data, BOCI Research

Cost Leader in Polysilicon industry

Due to its technology advantages, the cost of GCL-Poly was below US\$36/kg in September. Most of its peer competitors in China have to bear polysilicon costs of above US\$55/kg, and some at even US\$100/kg, according to Photon Consulting. Currently, the spot price is only US\$60/kg, so some of them have discontinued production due to the high costs. We believe the ultimately successful players will be those with costs below US\$40/kg.

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.

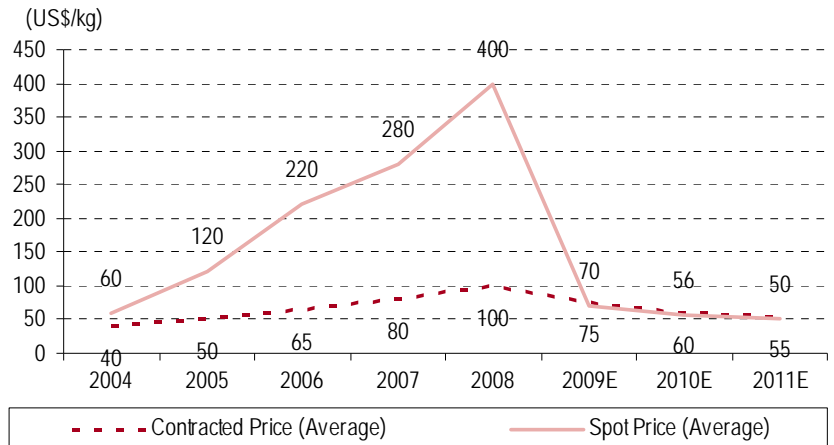
Downstream to PV Power Plant

GCL Poly announced that its 20MW PV power plant will be completed in the late 2009 in Jiawang District, Xuzhou City. Considering the Rmb2.15/KWh FIT in Jiangsu Province in 2009, the IRR should be about 10%.

The company entered into PV industry power plants after already having produced polysilicon and wafers. Depending on its experience in power plant construction, the company should be able to capitalise on this business. In addition, it will serve to create good partnerships with PV module companies.

Polysilicon Prices down to below US\$60/kg in October 2009

The spot price of polysilicon has been below the US\$60/kg mark since October, mainly because of the increasing supply of polysilicon. Due to its increasing supply and the uncertain growth outlook for the PV market, we lower our polysilicon price forecasts for 2010 and 2011 to US\$56/kg and US\$50/kg, respectively.

Figure 4. Polysilicon Contract and Spot Price


Sources: Photon Consulting, BOCI Research

Power Business Continues Healthy Growth

The monthly gross power generation for October 2009 amounted to 535,131 MWh, representing an increase of 16.1% from 461,099 MWh for the same period last year. The gross power generation for 10M09 was up 13.2% to 5,570,450 MWh (January to October 2008: 4,920,816MWh). Considering higher grid-tariffs and lower coal costs, we expect the gross profit from the power business to increase nearly 40% YoY for full-year 2009.

Profit Projection for Polysilicon and Wafer

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

Figure 5. 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 6. 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
ASP (US\$/kg)	258	80	60	66	56	50
Previous (US\$/kg)			68	72	67	63
<i>Change (%)</i>			<i>(12)</i>	<i>(9)</i>	<i>(17)</i>	<i>(20)</i>
Cost (US\$/kg)	65	47	35	38	34	33
Revenue (Rmb m)	2,840	1,043	2,050	3,093	4,075	3,668
Gross profit margin (%)	75	41	42	42	40	35
Gross profit (Rmb m)	2,120	432	854	1,286	1,610	1,277
Wafers						
Capacity (MW)					1,000	2,000
Sales (MW)	39	9	35	44	487	1,316
ASP (US\$/W)	2.41	0.78	0.64	0.66	0.64	0.60
Previous (US\$/W)			0.64	0.67	0.64	0.6
<i>Change (%)</i>			<i>0</i>	<i>(1)</i>	<i>0</i>	<i>0</i>
Cost (US\$/W)	0.87	0.51	0.40	0.42	0.37	0.34
Revenue (Rmb m)	681	49	150	199	2,094	5,309
Gross profit margin (%)	64	35	38	37	43	43
Gross profit (Rmb m)	435	17	57	74	897	2,303

Sources: Company data, BOCI Research estimates

Valuation

Due to the unexpected price decrease, we lower our polysilicon price forecasts for 2010 and 2011 to US\$56/kg and US\$50/kg, respectively. We lower our 2009-11 EPS forecasts for GCL-Poly to Rmb0.06, Rmb0.16 and Rmb0.23.

Earnings of GCL-Poly should increase sharply due to the volume growth in polysilicon after 2010, based on our estimates. Considering its leading position in terms of cost in China, we are optimistic about its future development. Based on 15x 2010E P/E, we lower our target price for the stock to HK\$2.80 but reiterate our **BUY** rating.

Figure 7. Valuation Comparison of Polysilicon Companies Worldwide

Company	Code	Currency	Share price (Local currency)	EPS (Local currency)			P/E (x)			ROE (%)	
				2008	2009E	2010E	2008	2009E	2010E	2009E	2010E
OCI	010060.KS	KRW	208,500	14,493	22,613	37,545	14	9	6	32	37
MEMC	WFR. US	US\$	12.73	3.25	<i>(0.06)</i>	0.87	4		15	1	9
Wacker	WCH. GR	€	108.77	8.85	2.37	7.78	12	46	14	7	16
REC	REC. NO	NOK	33.58	3.63	<i>(0.54)</i>	2.06	9		16	4	11
Tokuyama	4030.JP	¥	524.00	<i>(20.42)</i>	26.35	38.23		20	14	5	6
TWBB	600550.SS	Rmb	32.94	0.81	0.78	1.10	41	42	30	20	23
Average							16	29	16	12	17
GCL-Poly	3800.HK	HK\$	2.31	0.01	0.07	0.18	231	34	13	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 will 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	5,970	10,720	13,982
Cost of sales	(1,482)	(3,196)	(4,537)	(7,408)	(9,363)
Operating expenses (exclude Depreciation & amortisation)	(125)	(124)	440	710	635
EBITDA	237	373	1,873	4,021	5,254
Depreciation & amortisation	(18)	(96)	(786)	(1,314)	(1,419)
Operating profit (EBIT)	220	277	1,086	2,708	3,835
Net interest income/(expenses)	(162)	(259)	(269)	(293)	(274)
Other gains/(losses)	(274)	189	51	51	51
Pre-tax profit	(216)	207	868	2,465	3,612
Tax on profit	4	(27)	(54)	(197)	(289)
Minority interests	(55)	(48)	(114)	(318)	(465)
Net profit	(267)	131	700	1,951	2,858
Core net profit	(267)	131	700	1,951	2,858
EPS (Rmb)	(0.02)	0.01	0.06	0.16	0.23
Core EPS (Rmb)	(0.02)	0.01	0.06	0.16	0.23
DPS (Rmb)	0.00	0.02	0.02	0.05	0.08
Revenue growth (%)		100	62	80	30
EBIT growth (%)		26	292	149	42
EBITDA growth (%)		57	402	115	31
EPS growth (%)		(149)	433	179	47
Core EPS growth (%)		(149)	433	179	47

Sources: Company data, BOCI Research estimates

Balance Sheet (Rmb m)

As at 31 Dec	2007	2008	2009E	2010E	2011E
Cash & cash equivalents	804	414	3,254	6,265	9,527
Receivables	566	494	572	1,028	1,341
Inventories	127	259	348	568	718
Other current assets	251	241	931	1,183	1,365
Total current assets	1,748	1,407	5,105	9,044	12,951
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	755	802	835
Total long-term assets	5,119	5,662	20,877	22,064	22,150
Total assets	6,867	7,070	25,982	31,109	35,101
Creditors	661	881	1,865	3,044	3,848
Short-term debt	1,492	1,652	2,438	2,301	2,142
Other current liabilities	5	8	2,758	3,448	4,054
Total current liabilities	2,157	2,542	7,062	8,793	10,043
Long-term borrowings	1,988	1,597	3,017	4,017	4,017
Other long-term liabilities	85	107	3,523	4,235	4,724
Share capital	93	93	1,103	1,103	1,103
Reserves	2,180	2,323	10,756	12,121	13,979
Shareholders' equity	2,273	2,416	11,859	13,224	15,082
Minority interests	364	408	522	839	1,235
Total liabilities & equity	6,867	7,070	25,982	31,109	35,101
Book value per share (Rmb)	2.34	2.48	1.08	1.20	1.37
Tangible assets per share (Rmb)	2.20	2.35	0.44	0.57	0.74
Net debt/(cash)per share (Rmb)	2.75	2.92	0.20	0.00	(0.31)

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	868	2,465	3,612
Depreciation & amortisation	18	96	786	1,314	1,419
Net interest expenses	17	20	268	292	273
Change in working capital	(13)	(102)	159	704	602
Tax paid	4	(27)	(54)	(197)	(289)
Other operating cash flows	404	450	(318)	1,148	(765)
Cash flow from operations	214	644	1,709	5,725	4,852
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)	(2,890)	862	(159)
Dividends paid	0	(20)	(210)	(585)	(857)
Other financing cash flows	(1,495)	(282)	3,183	(791)	(273)
Cash flow from financing	538	(532)	212	(514)	(1,290)
Change in cash	628	(378)	421	3,011	3,262
Cash at beginning of year	188	804	414	3,254	6,265
Free cash flow to firm	105	174	223	3,592	4,665
Free cash flow to equity	1,869	(335)	(2,956)	4,090	4,113

Sources: Company data, BOCI Research estimates

Key Ratios

Year ended 31 Dec	2007	2008	2009E	2010E	2011E
Profitability (%)					
EBITDA margin	12.9	10.1	31.4	37.5	37.6
EBIT margin	11.9	7.5	18.2	25.3	27.4
Pre-tax margin	(11.7)	5.6	14.5	23.0	25.8
Net profit margin	(14.5)	3.6	11.7	18.2	20.4
Liquidity (x)					
Current ratio	0.8	0.6	0.7	1.0	1.3
Interest coverage	1.2	1.0	3.8	7.4	9.8
Net debt to equity (%)	101.5	100.4	17.8	0.4	Net cash
Quick ratio	0.8	0.5	0.7	1.0	1.2
Valuation (x)					
P/E	(94.4)	191.7	36.0	12.9	8.8
Core P/E	(94.4)	191.7	36.0	12.9	8.8
Core P/E @ target price	(44.6)	90.7	17.0	6.1	4.2
P/B	0.9	0.8	1.9	1.7	1.5
P/CF	9.3	3.1	13.1	3.9	4.6
EV/EBITDA	13.2	9.2	2.6	0.9	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	5.9	14.8	19.0
Return on assets	3.2	3.4	3.9	8.0	10.1
Return on capital employed	3.8	4.9	6.2	13.6	17.6

Sources: Company data, BOCI Research estimates

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20/F, Bank of China Tower
1 Garden Road
Hong Kong
Tel: (852) 2867 6333
Fax: (852) 2147 9513

Toll free numbers to Hong Kong:

China North: 10800 8521065
China South: 10800 1521065
Singapore: 800 852 3392

BOCI Securities Limited

20/F, Bank of China Tower
1 Garden Road
Hong Kong
Tel: (852) 2867 6333
Fax: (852) 2147 9513

BOC International (UK) Limited

90 Cannon Street
London EC4N 6HA
United Kingdom
Tel: (4420) 7022 8888
Fax: (4420) 7022 8877

BOC International (USA) Inc.

Room 202, 1270 Avenue of the Americas
New York, NY, 10020, USA
Tel: (1) 212 259 0888
Fax: (1) 212 259 0889

BOC International (Singapore) Pte. Ltd. Reg. No. 199303046Z

4 Battery Road
4/F Bank of China Building
Singapore 049908
Tel: (65) 6412 8856 / 6412 8630
Fax: (65) 6534 3996 / 6532 3371

BOC International (China) Ltd

39/F Bank of China Tower
200 Yincheng Zhong Road
Shanghai Pudong District
200121 China
Tel: (8621) 6860 4866
Fax: (8621) 5888 3554

BOC International Holdings Ltd Representative Office

15/F, Tower 2
Yingtai Business Center No.28
Finance Street, Xicheng District
Beijing 100032, China
Tel: (8610) 6622 9000
Fax: (8610) 6657 8950