



Hong Kong

Aug 5th, 2009

GCL-Poly Energy Holdings Limited (3800.HK)

New energy will still drive up the stock price

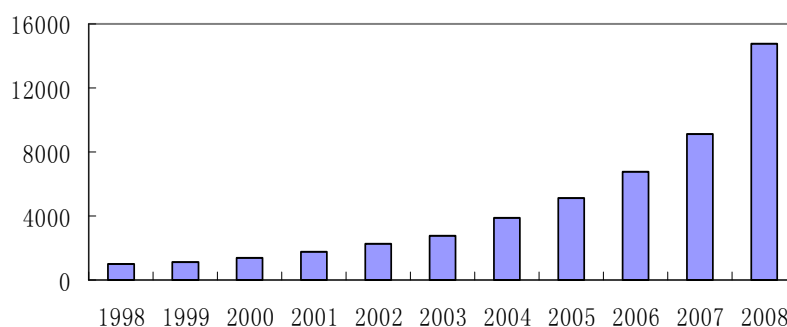
Investment summary

GCL-Poly Energy Holdings Limited (GCL-Poly or Company) has succeeded to acquiring 100% equity interest in Jiangsu Zhongneng, and the polysilicon business is expected to contribute 60%-70% revenue to the Company, meanwhile taking consideration of the cost advantage, the performance will grow significantly in future. We forecast the EPS will be RMB 0.13 and 0.25 respectively in 2009 and 2010. By the sub-segment valuation, we give it 12-month TP at HK\$4 and buy rating.

New energy policy enforcement is inevitable and practicable

Recently the stock price of GCL-Poly has benefited mainly from the acquisition of 100% equity interest in Jiangsu Zhongneng, which is a polysilicon manufacturer for solar energy sector. In the past ten years, global PV installed capacity has maintained the CAGR of over 30%. Looking forward, we expect the market will still enlarge quickly:

Figure 1: Global accumulated PV installed capacity (1998-2008, MW)



Sources: EPIA

Firstly, the development of new energy is inevitable because of the urgent demand by main economies. For the Europe and US, the old economy developing module has fallen through because of the global financial crisis, making the government place emphasis on culturing new technology to develop new economy engine. So the new energy

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Recommendation:

Buy

Previous call: buy

Previous TP: 1.99

Price

Last close : HK\$3.27

12-month TP : HK\$4.00

Basic Data

Market cap. 36,176

(HK \$m)

Shares(m) 11,063

52-wk hi/low 3.84/0.365

Major shareholder Gongshan Zhu

Float Ratio(%) 21.19%

Price performance



Source: AAstock

including solar energy has become the inevitable choice by many economies like America. As far as China is concerned, the resource reserve of oil and gas just can be used for dozen years, and the coal above one hundred years, but all shorter than the world average. In contrast, the solar resource can be used endlessly. Moreover, China's solar radiation situation ranks better among main economies, only worse than Austria and South Korea. Therefore, the solar energy development by Chinese government is also practicable and inevitable.

Secondly, solar application is feasible, because the unit cost has been downwards largely. Basing on US\$60-80/Kg of polysilicon price, 8% yield rate and 1320 utilization hours, the cost of PV Generation is around RMB 2/Kwh. And if balanced by the subsidy, the cost may be around RMB 0.7/Kwh, nearly tantamount to the cost of traditional coal generation. It can be forecasted that the PV power generation will win more and more room to develop with the advancing technology.

Positive stimulating policies for PV industry

Currently main global economies are taking positive stimulating policies to develop the solar energy, some giving investment subsidy (like America and Japan), others enforcing feed-in tariff (including German, France, Spain and Italy). China has projected the PV installed capacity will be up to 2GW by 2020. And the Department of the Treasury has been going to grant at most RMB20/Watts subsidy for solar building system.

Recently, the "Golden Sun" project has been put into practice, and China will install at least 500 megawatts of solar farms across the nation over the next two or three years. The government plans to subsidize 50 percent of the costs of building solar power projects. In remote areas that are missing the infrastructure to connect to the grid the incentive will go up to 70 percent for photovoltaic projects.

In the Jiangsu province, it has also announced a provincial subsidy to target 400MW of installed solar capacity between 2009 and 2011. This is the first feed-in tariff plan in China. And the specific tariff can make profit for solar energy producers and be expected to promote the PV industry development.

Table 1: Target PV power prices in Jiangsu province (RMB/Kwh)

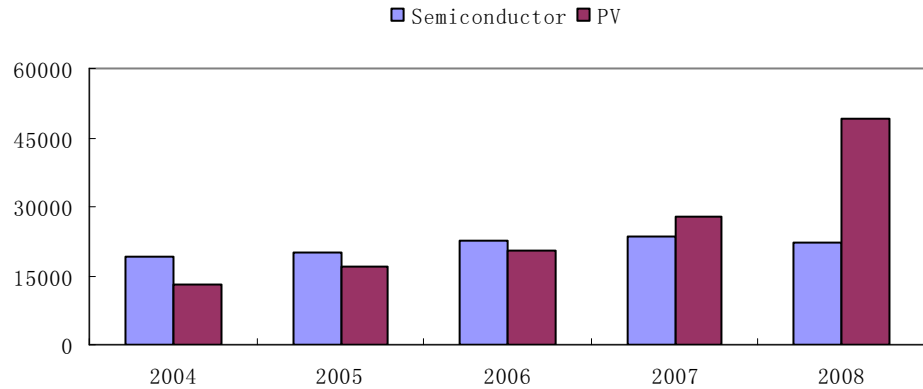
	Ground power generation	Roof power generation	Building-integrated power generation
2009	2.2	3.7	4.3
2010	1.7	3	3.5
2011	1.4	2.4	2.9

Sources: Files by Jiangsu province

Oversupply polysilicon situation will keep up, but just limited influence on Jiangsu Zhongneng in spite of plunged price

The polysilicon is mainly used for the semiconductor and solar sector. Since 2007, the latter has contributed mostly.

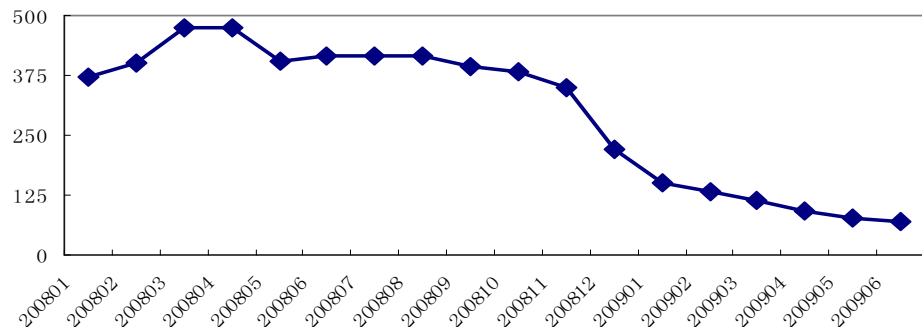
Figure 2: Polysilicon demand from semiconductor and PV sector (tons)



Sources: Solarbuzz

In 2008, nearly 2.4GW installed capacity in Spain market caused the global PV capacity increase out of expectation. However, its installed capacity will be limited up to 500MW in 2009 because of the changed industry policy. Although there are increments in other regions like Italy, it yet can't make up the gap by the Spain market. Therefore, the PV installed capacity seems inevitable to decrease in 2009 to about 5GW, over -10% y/y. Meanwhile, the polysilicon demand from the semiconductor sector is expected to reduce about 40%. But for the supply, the polysilicon may be as high as nearly 100 thousand tons, and the oversupply situation is severe. In 2010, the situation can't yet improve because the production may be 120-150 thousand tons. Therefore, the polysilicon price is forecasted to maintain low. However, benefited from the cost support, production cut and warmer international economy situation, the PV sector has seen more signs of bottoming up. And the polysilicon price has begun to rise, like in China, from RMB 0.5 million/ton to RMB 0.55 million/ton.

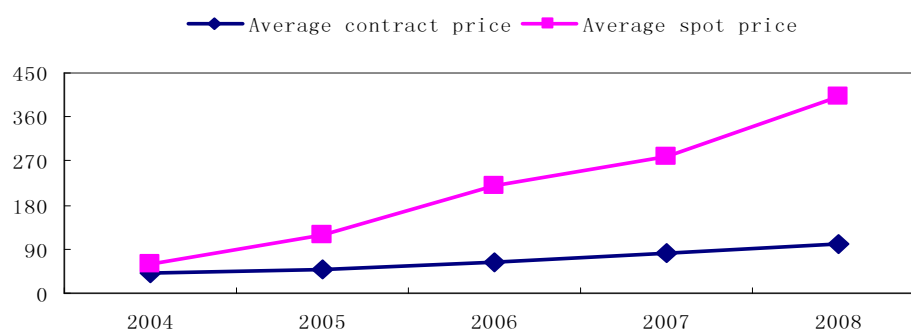
Figure 3: Polysilicon price will maintain at low level (US\$/Kg)



Sources: Photon International

However, it is worth pointing out that the plunged polysilicon price won't impact on the performance of Jiangsu Zhongneng significantly, because most of its revenue comes from long-term contract which last for 8-15 years. And the contract price is more steady, rising about 150% in the past five years, far below the 566% rise in the spot market. In 2008, the average contract price was US\$100/Kg, and we expect it will decrease to 80 around in 2009, the price level in 2007, far below the 75% decrease in the spot market.

Figure 4: Spot price VS. Contract price for polysilicon (US\$/Kg)



Sources: Phillip Securities

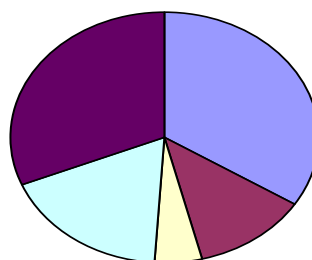
Outstanding advantages of the acquired Jiangsu Zhongneng

Jiangsu Zhongneng is operating with many advantages:

Firstly, the trichlorosilane (TCS) is a main and costly material for polysilicon production. By the end of 2008, it still came mainly from other suppliers. However, in Feb. and Sep. 2008, Jiangsu Zhongneng had embedded the producing trichlorosilane system into the Xuzhou I and II project. And the producing trichlorosilane system in the Xuzhou III project has been put in effect since Feb. 2009. Therefore, 20.9% TCS had been supplied by itself in 2008, 37.3% in 1Q09, and 77.2% in May 2009, basing on the Company's statistic. And the polysilicon cost has been cut down significantly, from US\$67.4/Kg in 2008 to about US\$36/Kg in May and June 2009, the lowest in China, far below US\$50-70/Kg of other mainland manufacturers. And it also is nearly with the cost of international leading producers.

Figure 5: Cost structure of Polysilicon

■ TCS ■ Depreciation □ Interest expense □ Others ■ Electric cost



Sources: Phillip Securities

Secondly, Jiangsu Zhongneng shares the policy of tax credit, with wholly exempted in 2008 and 2009, and half exempted from 2010 to 2012(about 12.5%).

Thirdly, the scale advantage. After consecutive three phases, the polysilicon capacity will amount to 18 thousand tons by 2009, which can ranks first in Asia and third in the world. Moreover, the months of three phases from construction to fully ramped-up production are far shorter than its peer, 25% higher efficiency, which presents better operation and management of the company.

Benefited from the capacity enlargement, its production has increased from 302 tons in 1Q08 to 624 tons in 4Q08, and 1094 tons in 1Q09, showing a rapid growth. And we expect the quarter production in 2H09 will be 2000-3000 tons.

Table 2: Production Facilities of Jiangsu Zhongneng(tons)

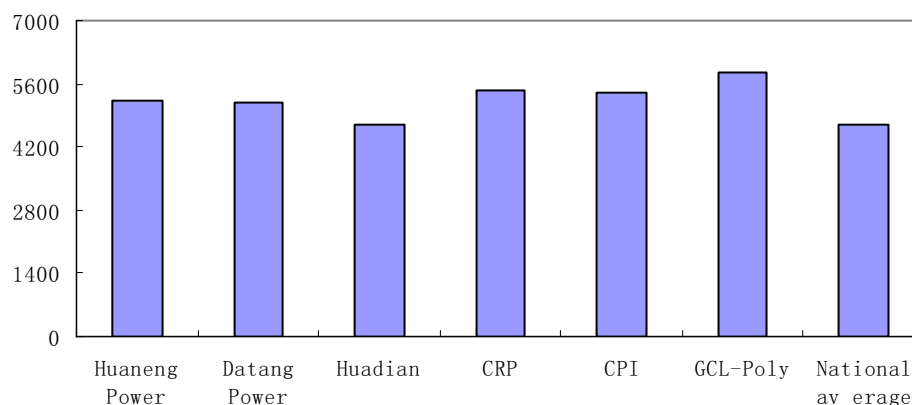
Production facility	Investment (Rmb m)	Planned annual production capacity	Commencement of commercial production	Achievement of fully ramped production capacity
Xuzhou Phase I	1,100	1,500	200710	200803
Xuzhou Phase II	850	1,500	200806	200812
Xuzhou Phase III	6,600	15,000	200812	200912

Sources: Company reports

At last, Jiangsu Zhongneng will extend its industry chain, planning to realize 1GW capacity for silicon wafer in 2010. Nowadays, downstream enterprises like JASO and STP have planed to purchase 15.2GW wafer from 2009 to 2015 in Jiangsu Zhongneng, which shows the hot market of the project. What's more, its wafer cost may be over 10% lower than the peer average.

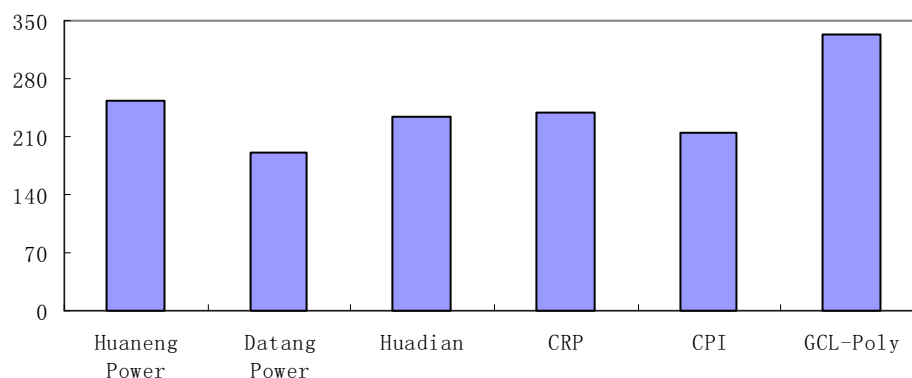
Existing business will grow and get higher performance

GCL-Poly's existing major operations in mainland are power plant to supply electricity and steam, excluding from the dominating thermal power, promotion on environmental and green energy had enhanced the Company with policy advantage, causing natural gas and environmental energy generated electricity's price be 17% to 33% higher than that for traditional thermal plant, meanwhile the Company has been entitled with priority on electrified networks dispatch and authorized with more utilization hours. What's more, we expect the main business will grow in 2009-2010, with attributable power installed capacity increasing above 50MW each year and up to 800MW in 2010, meanwhile attributable steam extraction capacity rising from 1657ton/h to about 1725ton/h.

Figure 6: Higher utilization hours of GCL-POLY

Sources: Phillip Securities

Although GCL-POLY's attributable power installed capacity was only 698 MW, far below than above 10 thousand MW of its peers, the Company can't realize scale effect and the unit cost is higher, negatively impacting on its performance. However, GCL-POLY has acquired 55% equity interest of Duolun Coal Mine, whose total coal reserve is 82.44 million tons. Now it is planned to operate in 2H09 and realize annual 1.2 million tons coal production, which can alleviate the Company's material cost. Moreover, its major shareholder Gongshan Zhu also owns over 600 million tons coal mine in Henan province, which is possible to be injected into the Company in future.

Figure 7: Higher unit coal consumption cost of GCL-POLY (RMB/Kwh)

Sources: Phillip Securities

Risk

The price of polysilicon falls down out of expectation;
Thin film solar cells squeeze the room of polysilicon largely because of the cost advantage.

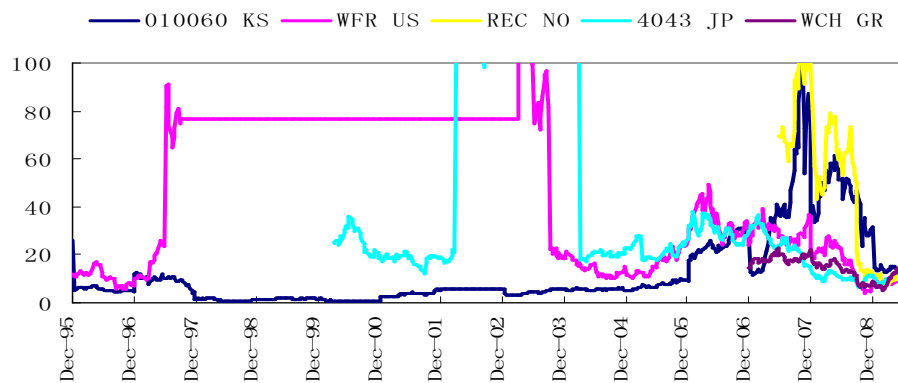
Stock price is under valuation

In all, Jiangsu Zhongneng is expected to contribute 60%-70% revenue to the Company in

the next two years, meanwhile taking consideration of the cost advantage, the performance will grow significantly. We forecast the revenue/net profit of the Company will be RMB7.6/1.6 billion and 12.6/2.7 billion respectively in 2009 and 2010. The EPS will be RMB 0.13 and 0.25, with -10% and 97% increase y/y.

Regarding valuation, the Company's existing business is defensive and new energy business will grow significantly. At present, the average leading P/E for electric enterprises listed in HK is over 10X, and that for international polysilicon and wafer manufacturer is above 40X and 20X. Taking consideration of its smaller scale, we conservatively give the two businesses 10X and 15X 2010 EPS, and the 12-month TP will be HK\$4. We give it buy rating.

Figure 8: Historical P/E for international solar energy producers



Sources: Bloomberg, Phillip Securities

Earning Forecast

RMB: mil	2006A	2007A	2008A	2008A*	2009E	2010E
Turnover	933	1,845	3,693	7,215	7,642	12,582
Cost of sales	-729	-1,482	-3,196	-4,151	-4,947	-7,616
Gross profit	204	362	497	3,064	2,695	4,965
Other income	38	109	168	271	300	350
Marketing cost	0	0	-7	-7	-10	-50
Administrative expenses	-67	-143	-213	-427	-458	-755
Other expenses	-4	-67	-24	-24	-30	-50
Operating profit	171	262	421	2,875	2,496	4,460
Financing cost	-108	-162	-259	-732	-600	-650
Profit attributable to Joint Venture	48	20	45	45	50	80
Profit before taxation	91	-216	207	2,073	1,746	3,590
Income tax expense	-4	4	-27	-129	-105	-359
Profit for the year	88	-212	180	1,943	1,641	3,231
Minority interest	28	55	48	297	246	485
Net profit	60	-267	131	1,647	1,395	2,747
EPS: RMB	0.15	-0.57	0.14	0.15	0.13	0.25
DPS:HK\$	0.00	0.00	0.02	0.02	0.02	0.05
Dividend payout ratio	0%	0%	14%	14%	14%	18%
P/E X	19.21	-	20.59	19.36	22.86	11.61
Gross profit margin	21.86%	19.62%	13.46%	42.47%	35.26%	39.46%

Sources: Company reports, Phillip Securities(2008A* has taken the polysilicon business)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

BUY	>15% upside from the current price
HOLD	Trade within $\pm 15\%$ from the current price
SELL	>15% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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