Company Report

GCL-Poly (3800 HK) – Sell

Semi-conductor Equipment

12-month target price: HK$1.24

Key data

Share price (HK$)	1.19
Target price (HK$)	1.24
Upside potential (%)	4.2%
52Wk H/L(HK$)	1.11 / 3.55
Issued shares (mn)	15,474.3
Market cap (HK$mn)	25,842.1
30-day avg turnover (HK$mn)	105.4
Major shareholder (%):	
Zhu Gong Shan*	32.4
China Investment Corp	20.1

**Chairman of the company*
Source: Company & Bloomberg

Revenue composition in FY11 (%)

Solar	78.2%
Wafers	71.3%
Polysilicon	4.0%
Power	19.0%
Others	2.8%

Source: Company

Share performance (%)

	Absolute	Relative*
1-mth	(8.4)	(12.2)
3-mth	(29.8)	(34.1)
6-mth	(59.0)	(55.6)

*Relative to Hang Seng Index
Source: Bloomberg

Share price performance

Source: Bloomberg

Analyst

Report Date: 27 August 2012
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Key takeaways from analyst presentation

GCL-Poly announced net loss of HK$330mn for 1H2012. Its new technology launched in 1Q2013 and the newly developed solar farm business will become upside catalysts in 2013. However, we expect the over-supply condition to sustain and remain cautious on the outlook of the industry this year. We lower our target price by 28% to HK$1.24, representing 1.0x PB. Downgrade to SELL.

Loss in 1H2012: Due to continuous drop in polysilicon and wafers ASP, the group's revenue dropped 22.4%YoY to HK$11,782mn; gross profit decreased by 71.2%YoY to HK$1,689mn in 1H2012. For 1H2012, the group posted net loss of HK$330mn. The loss was widely expected after profit warning announced on 9 Aug.

Technology breakthrough: The group announced that the new technology, which can significantly cut polysilicon production costs, will be launched in 1Q2013 and will take full effect in 2013. In our view, the breakthrough will become upside catalyst to the group but continuous technology breakthrough will just mean further potential for ASP drop, as proved in the history. In fact, downward trend in ASP is necessary in order for solar power to achieve grid parity.

Change of business strategy: In Jul 2012, the group has successfully sold two of its solar projects (92MW) with an expected US$16mn profit before tax. Selling of solar farm may become an addition revenue stream to the group. However, as most of the projects will only commence construction by the end of this year, we do not expect to see a significant contribution from solar farm sales till 2H2013.

Valuation: We expect that the group will continue to post net loss in 2H2012 but hopefully the technological breakthrough will lead to GP margin improvement and bring in profit to the group in 2013. The counter is trading at est. FY2012 PB of 0.99x. We give the stock a 1-year TP of HK$1.24, representing 1.0x PB. We downgrade our rating from Hold to Sell.

Risk factors: Increasing gearing, deteriorating financial positions, falling ASP

Results and valuation

(FY ended Dec 31)	FY09A	FY10A	FY11A	FY12F	FY13F
Revenue (Rmb mn)	4,943.6	18,471.9	25,505.6	21,537.7	20,499.3
YoY Chg (%)	40.4%	273.7%	38.1%	-15.6%	-4.8%
Net Income (Rmb mn)	(199.7)	4,023.6	4,274.9	(561.3)	412.0
YoY Chg (%)	-	-	6.2%	-113.1%	-
FD EPS (Rmb)	(0.0161)	0.2589	0.2731	(0.0359)	0.0263
YoY Chg (%)	-	-	5.5%	-113.1%	-
NBV (Rmb/share)	0.9395	1.0438	1.3294	1.2379	1.2645
PE (x)	-	-	4.50	-	46.72
PB (x)	-	-	0.93	0.99	0.97
ROAA (%)	-	12.10%	7.93%	-0.69%	0.96%
ROAE (%)	-	27.19%	21.64%	-2.67%	3.88%
Net D/E (%)	26.7%	41.9%	101.2%	175.2%	177.7%

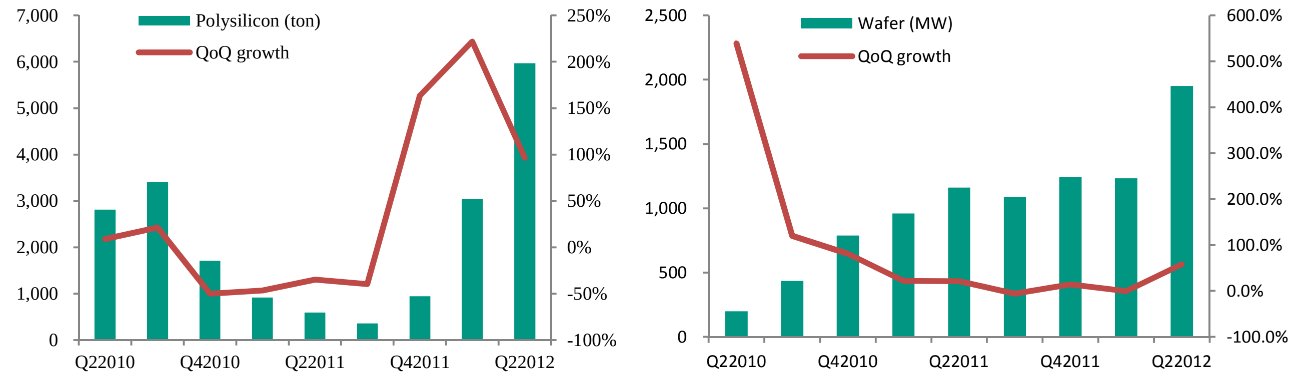
**We assume Rmb1 = HK$1.23; Source: Company, ABCI Securities estimates*

Key takeaways

Loss in 1H2012: Due to continuous drop in polysilicon and wafers ASP, the group's revenue dropped 22.4%YoY to HK$11,782mn; gross profit decreased by 71.2%YoY to HK$1,689mn in 1H2012. For 1H2012, the group posted net loss of HK$330mn as opposed to HK$3,550mn/ HK$724mn of net profit in 1H2011/2H2011. The loss was widely expected after profit warning announced on 9 Aug.

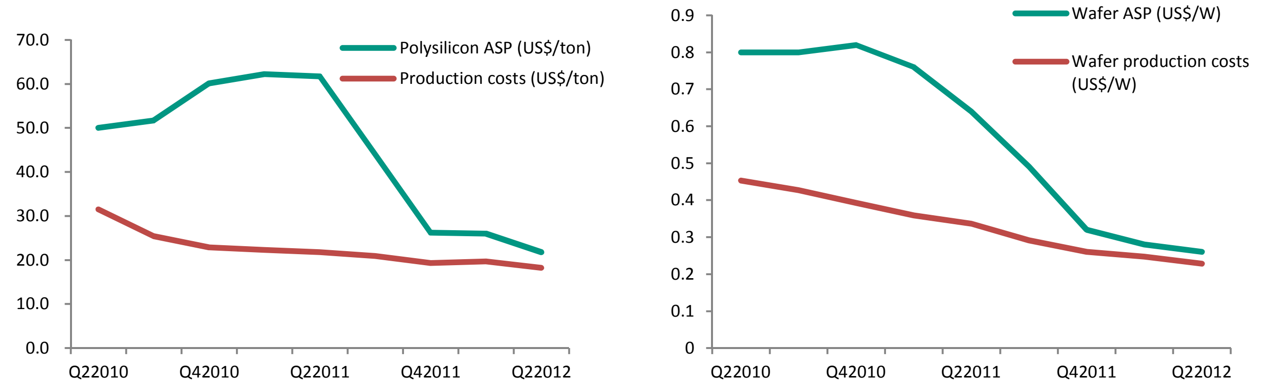
For 1H2012, polysillicon shipments increased 497.6%YoY/591.1%HoH to 9,012 tons and wafer shipments increased by 50.4%YoY/36.7%HoH to 3,186 MW. Meanwhile, production costs of polysilicon and processing cost for wafers were lowered by 14%YoY and 41%YoY to US$18.9/kg and US$0.13/W. However, the strong shipments growth and effort to production cost cut was not large enough to compensate the more significant drop in ASP. ASP of polysilicon and wafer fell by 63%YoY and 61%YoY respectively in 1H2012 to US$23.2/kg and US$0.27/W. GP margin of the group therefore dropped to 14.3% in 1H2012 from 38.6%/25.3% in 1H2011/2H2011.

Exhibit 1: Group: Polysilicon and wafer production



Source: Company, ABCI Securities

Exhibit 2: Group: ASP and production costs of polysilicon and wafer

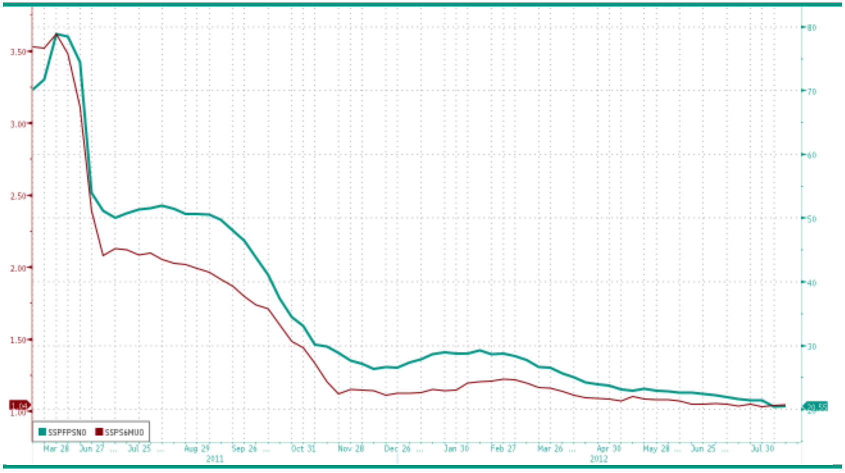


Source: Company, ABCI Securities

We see no sign in ASP recovery: The rapid installation growth in Japan and US is not large enough to cover the loss in demand in the key markets including Germany and Italy due to FiT cuts. Industry-wide over-supply persists as reflected in continue downtrend in solar components prices. In particular, polysilicon prices dropped 22.5% YTD to US$20.6/kg.and wafers (6 inch multi) prices dropped 8.0% to US$1.04/piece.

In our view, producers are fighting to lower their unit costs continuously in order to survive in such a competitive market. The easiest way to lower unit costs is through mass production to achieve economies of scale. However, with FiT cuts in European markets as well as slowing global economic growth, the demand cannot catch up with the rapid capacity expansion in solar components, therefore driving ASP down. However, producers continue to increase their production hoping to produce profit through lowering unit costs and this has led to a vicious cycle.

Exhibit 3: Market: Polysilicon price (US$/kg) vs wafers price (US$/piece)



Source: Bloomberg

Technology breakthrough: GCL is devoted in cutting production costs and has continued to be the cost leader in the industry. The group has successfully cut polysilicon and wafer production costs by 48% and 60% respectively during beginning of 2010 till 2Q2012. The group announced that the new improved technology, “The GCL Method” used in polysilicon manufacturing process will be launched in 1Q2013 and will take full effect in 2013. Through shortening turnaround time and lowering energy consumption, the new technology is expected to cut cost significantly. In our view, the breakthrough will become an upside catalyst to the group but continuous technology breakthrough will just mean further potential for ASP drop, as proved in the history. In fact, downward trend in ASP is necessary in order for solar power to achieve grid parity.

Change of business strategy: GCL has started building solar farm last year and we believe it is a way to secure a sales channel for its core poly/wafer business. In addition, selling of solar farm may become an additional revenue stream to the group. In Jul 2012, the group has successfully sold two of its California solar projects with a capacity of 92MW to Consolidated Edison Development, a major power company in the US, with an expected US$16mn profit before tax.

As of 30 Jun 2012, the group had over 469MW projects, of which approximately 95MW is currently under constructions and the remaining 374MW of projects will commence construction by the end of 2012. However, as most of the projects will only commence constructions by the end of this year, we do not expect to see a significant contribution from solar farm sales till 2H2013.

Valuation: A turnaround can only be seen when demand for solar products pick up significantly which we believe is unlikely in short to medium term as the key European markets remain weak. And the anti-dumping issues between US and China and possible imposition of related subsidies in between Europe and China trade just adds more negative uncertainties to the solar products suppliers in China. On the back of falling ASP, we expect the group will continue to post net loss in 2H2012 but hopefully the technological breakthrough will at least bring in a short term profit to the group in 2013. The counter is trading at est. FY2012 PB of 0.99x. Assuming a margin improvement in 2013 brought by the breakthrough, we estimate 2013 FD EPS to be HK$0.0263. We lower our target price by 28% to HK$1.24, representing 1.0x PB. We downgrade our rating from Hold to Sell.

Exhibit 4: Consensus

	New Forecast		**Consensus**		**Difference**	
FY ended Dec 31 (Rmbmn)	**2012F**	**2013F**	**2012F**	**2013F**	**2012F**	**2013F**
Revenue	21,538	20,499	22,708	26,927	-5.15%	-23.87%
Adjusted EBITDA	**2,814**	**3,856**	2,952	4,120	-4.68%	-6.39%
Net profit	**(561)**	**412**	-119	426	371.71%	-3.28%
FD EPS (Rmb/share)	(0.0359)	0.0263	(0.0076)	0.0420	371.92%	-37.32%

Source: Bloomberg, ABCI Securities estimates

Major Assumptions

FY ended Dec 31	**2009**	**2010**	**2011**	**2012F**	**2013F**
Sales					
Polysilicon (MT)	5,675	10,507	2,812	18,925	27,300
YoY Growth (%)	-	*85.1%*	*-73.2%*	*573.0%*	*44.3%*
Wafer (MW)	46	1,451	4,451	6,500	6,500
YoY Growth (%)	-	*3027.2%*	*206.8%*	*46.0%*	*0.0%*
ASP					
Polysilicon (US$/kg)	65.4	52.1	47.7	21.0	17.9
YoY Growth (%)	-	-20.3%	-8.4%	-56.0%	-15.0%
Wafer (US$/W)	-	0.82	0.54	0.25	0.21
YoY Growth (%)	-	-	-34.1%	-53.7%	-15.0%
Production cost					
Polysilicon (US$/kg)	39.4	27.7	20.8	18.0	13.5
Polysilicon (US$/W)	-	0.16	0.12	0.10	0.07
Non-silicon cost (US$/W)	-	0.27	0.18	0.12	0.10
Total wafer production cost (US$/W)	-	0.43	0.30	0.22	0.17
YoY Growth (%)	-	-	-29.8%	-25.7%	-21.7%

Source: Company, ABCI Securities estimates

Profit Forecast

FY ended Dec 31 (Rmbmn)	**2009**	**2010**	**2011**	**2012F**	**2013F**
Solar sales	**3,177.3**	**13,474.9**	**20,517.0**	**15,673.8**	**14,481.3**
Power sales	1,766	4,429	4,989	5,138.2	5,292.4
Others	**0.0**	**568.4**	**725.7**	**725.7**	**725.7**
Total sales	4,943.6	18,471.9	25,505.6	21,537.7	20,499.3
Cost of Sales	(3,453.0)	(11,661.2)	(17,039.3)	(18,723.7)	(16,642.9)
GP	**1,490.6**	**6,810.7**	**8,466.3**	**2,813.9**	**3,856.4**
Other income	219.3	575.2	613.2	624.6	615.0
Dist and selling expenses	(7.5)	(46.3)	(56.7)	(107.7)	(102.5)
Admin expenses	(408.3)	(996.3)	(1,617.2)	(1,615.3)	(1,435.0)
Other expenses	(159.3)	(187.5)	(321.0)	(258.5)	(307.5)
Share of results of associates	9.9	10.7	15.2	-	-
Share-based payment expenses	(852.7)	(12.7)	(82.3)	-	-
Share of lossees of jointly controlled entities	-	-	(12.0)	-	-
EBIT	**291.9**	**6,153.8**	**7,005.5**	**1,457.1**	**2,626.4**
Finance costs	(348.8)	(606.4)	(1,166.3)	(1,727.4)	(2,057.2)
EBT	**(56.9)**	**5,547.4**	**5,839.1**	**(270.4)**	**569.2**
Tax	(93.2)	(1,159.3)	(1,269.2)	(194.4)	(130.9)
MI	(49.6)	(364.5)	(295.1)	(96.6)	(26.3)
NP	**(199.7)**	**4,023.6**	**4,274.9**	**(561.3)**	**412.0**
D&A	**347.5**	**1,247.9**	**2,044.0**	**2,760.2**	**3,260.2**
EBITDA	**639.4**	**7,401.7**	**9,049.5**	**4,217.3**	**5,886.6**
No. of issued shares (mn)	12,363.4	15,474.0	15,470.7	15,474.3	15,474.3
Issuable shares (mn):					
Pre-IPO Share Option	27.0	26.6	26.3	26.3	26.3
Share options	42.0	39.0	158.9	150.3	150.3
Total	12,432.3	15,539.5	15,655.9	15,651.0	15,651.0
Per share value (Rmb)					
DPS (Rmb)	-	0.051	0.055	0.000	0.005
Basic EPS (Rmb)	-0.0162	0.2600	0.2763	-0.0363	0.0266
Fully-diluted EPS (Rmb)	-0.0161	0.2589	0.2731	-0.0359	0.0263
NBV (Rmb/share)	0.9395	1.0438	1.3294	1.2379	1.2645

Financial Ratio Analysis

FY ended Dec 31 (Rmbmn)	**2009**	**2010**	**2011**	**2012F**	**2013F**
Profitability					
GP Margin	30.2%	36.9%	33.2%	13.1%	18.8%
EBITDA Margin	12.9%	40.1%	35.5%	19.6%	28.7%
EBIT Margin	5.9%	33.3%	27.5%	6.8%	12.8%
NP Margin	-4.0%	21.8%	16.8%	-2.6%	2.0%
ROAA	12.1%	7.9%	-0.7%	1.0%	12.1%
ROAE	27.2%	21.6%	-2.7%	3.9%	27.2%
Working capital management					
Avg. inventories/COGS (days)	-	37.2	56.5	80.0	100.0
Avg. trade & bill receivables/turnover (days)	-	38.9	67.3	150.0	180.0
Avg. trade & bill payables/COGS (days)	-	103.1	126.6	100.0	100.0
Leverage					
Current ratio	1.05	1.02	1.03	1.43	1.28
Quick ratio	0.96	0.89	0.86	1.15	1.06
Interest coverage	1.83	12.21	7.76	2.44	2.86
Net debt/total equity	26.7%	41.9%	101.2%	175.2%	177.7%

Source: The group (for historical figures only), ABCI Securities estimates

Balance Sheet Forecast

As of Dec 31 (Rmbmn)	2009	2010	2011	2012F	2013F
Non-current assets	**17,652.4**	**27,708.3**	**45,472.9**	**52,712.7**	**59,452.5**
Inventories	727.3	1,646.7	3,626.7	4,581.0	4,538.5
Trade and other receivables	1,569.5	2,370.2	7,040.1	10,662.0	9,556.5
Others	114.7	160.6	416.0	416.0	416.0
Pledged and restricted bank deposits	803.7	1,960.8	4,049.7	4,049.7	4,049.7
Bank balances and cash	5,311.3	6,505.1	6,882.7	3,754.4	7,457.5
Current assets	**8,526.4**	**12,643.5**	**22,015.3**	**23,463.2**	**26,018.2**
Trade and other payables	2,395.5	4,192.7	7,628.1	2,631.5	6,487.9
Amounts due to related company	139.4	88.2	630.0	630.0	630.0
Loan from a related company	56.8	0.0	0.0	0.0	0.0
Advances from customers	436.8	988.8	1,022.4	1,022.4	1,022.4
Deferred income	25.8	41.4	75.6	75.6	75.6
Tax payables	27.3	567.7	80.2	80.2	80.2
Bank borrowings — due within one year	5,032.7	6,410.8	11,582.4	11,582.4	11,582.4
Obligations under finance leases	0.0	111.3	433.3	433.3	433.3
Convertible loan notes	0.0	0.0	0.0	0.0	0.0
Current liabilities	**8,114.4**	**12,400.9**	**21,452.1**	**16,455.5**	**20,311.9**
Amounts due to related companies	-	-	23.6	23.6	23.6
Advances from customers	1,906.6	1,978.0	2,068.0	2,068.0	2,068.0
Deferred income	168.9	320.4	404.6	404.6	404.6
Bank borrowings — due after one year	3,539.7	7,379.4	17,703.9	32,703.9	37,703.9
Long-term notes	0.0	0.0	1,831.2	1,831.2	1,831.2
Deferred tax liabilities	231.0	452.4	606.2	606.2	606.2
Non-current liabilities	**5,846.2**	**10,571.6**	**23,902.0**	**38,902.0**	**43,902.0**
Total assets	**26,178.8**	**40,351.8**	**67,488.2**	**76,176.0**	**85,470.7**
Net assets	**12,218.2**	**17,379.3**	**22,134.1**	**20,818.5**	**21,256.8**
Capital and Reserves					
Share Capital	1,547.2	1,547.4	1,547.1	1,547.1	1,547.1
Reserves	10,068.1	14,604.8	19,020.0	17,607.8	18,019.8
Equity attributable to Co. owners	**11,615.3**	**16,152.2**	**20,567.1**	**19,154.9**	**19,566.9**
MI	603.0	1,227.1	1,567.0	1,663.6	1,689.9
Total equity	**12,218.2**	**17,379.3**	**22,134.1**	**20,818.5**	**21,256.8**

Cash Flow Forecast

As of Dec 31 (Rmbmn)	2009	2010	2011	2012F	2013F
EBITDA	**1,531.7**	**7,397.0**	**9,049.5**	**4,217.3**	**5,886.6**
Change in inventories.	(364.9)	(760.7)	(1,808.7)	(954.3)	42.5
Change in trade and other receivables	(779.3)	(367.3)	(4,249.4)	(3,621.9)	1,105.6
Change in trade payables	(237.4)	1,469.8	887.6	(4,996.6)	3,856.4
Others	348.7	603.2	742.0	0.0	0.0
Cash (used in)/generated from operations	**498.8**	**8,341.9**	**4,621.0**	**(5,355.5)**	**10,891.2**
Income tax paid	(146.9)	(512.4)	(1,857.2)	(194.4)	(130.9)
CF from operating activities	**351.9**	**7,829.5**	**2,763.8**	**(5,549.9)**	**10,760.2**
Cash flows from investing activities	**(1,557.6)**	**(10,775.3)**	**(18,245.3)**	**(10,000.0)**	**(10,000.0)**
Cash flows from financing activities	**4,537.0**	**3,938.3**	**15,534.0**	**12,421.7**	**2,942.8**
Change in cash and cash equivalents	3331.3	992.6	52.5	(3,128.2)	3,703.1
Cash and cash equivalents at beg of year	1979.6	5,311.3	6,505.1	6,882.7	3,754.4
Effect of foreign exchange rates, net	0.4	203.6	325.1	-	-
Cash and cash equivalents at end of year	5311.3	6,507.5	6,882.7	3,754.4	7,457.5

Source: The group (for historical figures only), ABCI Securities estimates

Disclosures

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