KGI CHINA DEVELOPMENT FINANCIAL

Sunpower Group
(SPWG SP/SUNP.SI)

Expecting a turnaround afterwards

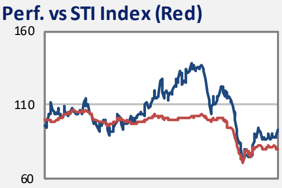
Chen Guangzhi, CFA / 65 6202 1191 / guangzhi.chen@kgi.com

- 1Q20 top line and bottom line dropped by mid-teens, better than expected mainly due to the continuous operation of Xinyuan plant during the lockdown period, as well as the newly added Suyuan plant's contribution in January.
- M&S segment surprisingly generated new orders of RMB700mn, translating into a record high RMB2.8bn net order book.
- Management remains confident to achieve the full year earnings target of RMB370mn (RMB363.5mn).
- We maintain **OUTPERFORM** with an unchanged TP of $0.91 given that the fundamentals of each project are still intact. Our valuation is based on sum-of-the-part methodology adding up each project's discounted cash flows, with projects having 20 to 30 years of concession. Therefore, lower than expected cash flows in one or two quarters is not expected to have significant impact on the overall valuation.

Outperform - Maintain

Price as of 15 May 20 (SGD)	0.43	**Performance (Absolute)**	
12M TP ($)	0.91	1 Month (%)	1.2%
Previous TP ($)	-	3 Month (%)	-20.4%
Upside (%)	111.6	12 Month (%)	-9.1%

Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	349		
Issued Shares (mn)	792		
Vol - 3M Daily avg (mn)	0.7		
Val - 3M Daily avg ($mn)	0.3		
Free Float (%)	41.0%		



Major Shareholders		**Previous Recommendations**	
Guo Hongxin	19.0%	6-Dec-19	OP $0.91
Ma Ming	17.0%	4-Mar-20	OP $0.91
Lin Yucheng	12.3%	-	-

Financials & Key Operating Statistics

YE Dec (RMB m)	FY17	FY18	FY19	FY20F	FY21F
Revenue	1,965	3,263	3,605	3,866	4,540
Gross Profit	408	694	889	1,015	1,201
PATMI	117	254	352	374	472
Basic EPS	16	34	45	47	60
Fully Diluted EPS	9	19	27	28	36
Basic EPS grth (%)	-18%	117%	31%	5%	26%
Basic P/E (x)	13.6	6.3	4.8	4.5	3.6
Fully diluted P/E (x)	23.9	11.3	8.1	7.6	6.0
Basic P/B (x)	1.4	1.1	0.9	0.7	0.6
Fully Diluted P/B (x)	2.3	1.9	1.5	1.3	1.0
Gross Margin (%)	21%	21%	25%	26%	26%
Net Margin (%)	6%	8%	10%	10%	10%
Net Gearing (%)	8%	36%	80%	75%	75%
Interest Coverage (x)	5.4	6.3	5.1	4.4	4.8
ROE (%)	10%	17%	19%	17%	17%

Source: Company Data, KGI Research

Less than expected negative impact due to Covid-19. The lockdown of cities and restriction of human traffic that resulted in nearly nationwide shutdown of the economy lasted for 1.5 to 2 months (late January to early/mid-March) in China. Consequently, 1Q20 GDP growth contracted by 6.8% YoY, and the secondary industry was hit the most with a 9.6% YoY plunge in growth. However, Sunpower buffered the impact well as the GI segment still generated revenue during the lockdown period.

Xinyuan plant (around 10% of the annualised full-year revenue) and Xintai Zhengda (old) plant operated throughout the whole 1Q20, and the rest of the plants resumed operation gradually by the end of March. Moreover, there was one more plant (Suyuan) under operation (total 8 plants vs 7 plants in 1Q19) in 1Q20. In other words, even though Suyuan plant was closed for upgrades in February, there was one more plant's contribution in January, offsetting the impact after the outbreak of COVID-19.

Figure 1: 1Q20 Financial summary

(RMB mn)	1Q20	1Q19	YoY change
GI revenue	259	287	-10%
M&S revenue	414	525	-21%
Total revenue	673	812	-17%

Source: Company, KGI Research

The GPM improved by 1.9pts to 23% due mainly to lower material costs such as coal prices. PATMI was 15.6% lower YoY because finance costs was up 28% YoY due to the expansion of GI projects. Generally, the mid-teens drop in 1Q20 top and bottom line is better than expected, which helps Sunpower to regain investors' confidence as the company has gone through the worst period.

Valuation & Action: We maintain our OUTPERFORM recommendation with an unchanged target price of S$0.91, based on sum-of-the-part methods adding up each project's discounted cash flows. These projects own 20 to 30 years of concession. Therefore, lower than expected cash flows in one or two quarters do not have significant impact on the overall valuation.

Risks: Currently, China is leading the world in terms of reopening its economy. Though there are reports of scattered COVID-19 cases, overall production and economic activities have largely normalised. However, we cannot rule out the probability that of a second wave of outbreak due to imported infections, even though the odds are small. Subsequently, the resumption of nationwide lockdown would be a blow to the rebuilding of business confidence. Meanwhile, trade tensions seem to be escalating again, which could disrupt the recovery of overall economic growth in 2H20. Our valuation forecast and outlook are based on the assumption of a V-shape rebound of the economy. If macro environment deteriorates again in 2H20, then the impact for FY20 will be substantial.

Surprising growth of new orders amid headwinds. The net book order unexpectedly increased to RMB2.8bn from RMB2.5bn a quarter ago. Given RMB414mn of sales were recognised during the period, the new orders taken amounted to RMB700mn. These 70% of new orders were from the existing clients, and 95% out of which is domestic. Though the overall M&S segment capacity is full when net order book reached RMB2.5bn. Management believes they are capable of completing the new orders since these projects have larger size but less workloads. Furthermore, Sunpower will apply more premium materials with higher prices in the projects, hence, margins will be lifted. As of 1Q20, there was no order cancellation except one Netherland project which was delayed.

Management remains optimistic to achieve the FY20 profit target and outlook. Firstly, the overall financial conditions of the diversified clients who the GI segment supplies steam and heat remained healthy in 1Q20 but only those which dealt with exports suffered as the demand from US and Europe declined. Domestic industrial production has been recovering since April in China. Secondly, management sees ongoing margin improvements in M&S segment and is prone to accept orders with higher margins. Lastly, Suyuan plant will at least contribute 9M earnings to the group, and two plants, Xintai Zhengda (new) and Shantou Phase I will commence operation in 2H20. Therefore, the abovementioned factors should enable the group to achieve RMB370mn of earnings this year.

Expecting China stimulus after the National People's Congress (NPC) and the Chinese People's Political Consultative Conference (CPPCC). Due the COVID-19 pandemic, NPC and CPPCC were postponed to 20th and 21st May. Since the outbreak, economies such as Europe, US, Japan, and South Korea have launched aggressive monetary and fiscal stimulus. Relatively, China, the first epicentre, seemed to have lagged. Apart from the RRR cut and lower MLF, the second largest economy has not announced any significant stimulus like what it did (RMB4tn) in 2008 GFC given the speed bump (negative GDP growth) is much bigger this time.

Therefore, the NPC and CPPCC are expected to be the best time and window to address the economic issues. The meeting of the politburo in April revealed the "Six ensures" or "Six guarantees" which further strengthens the "Six stabilities". We believe China will launch stimulus plans to at least bring its growth back to the normalised rate. Accordingly, Sunpower could indirectly benefit from the bottoming-out of the declining macro conditions.

YE 31 Dec

INCOME STATEMENT (RMB m)	FY17	FY18	FY19	FY20F	FY21F
Revenue	**1,965**	**3,263**	**3,605**	**3,866**	**4,540**
Cost of sales	-1,558	-2,569	-2,716	-2,851	-3,339
Gross Profit	**408**	**694**	**889**	**1,015**	**1,201**
Other operating income/(expenses)	47	38	-2	31	36
SG&A	-242	-329	-323	-406	-459
Othes	-31	-12	-0	0	0
Profit from Operations	**182**	**391**	**563**	**640**	**779**
Finance income/(expenses)	-34	-62	-110	-145	-163
Share of JV results	0	-1	1	0	0
Profit before Tax	**149**	**328**	**454**	**495**	**616**
Income tax	-27	-62	-91	-104	-123
Non-controlling interests	5	12	11	16	21
PATMI	**117**	**254**	**352**	**374**	**472**

BALANCE SHEET (RMB m)	FY17	FY18	FY19	FY20F	FY21F
Cash and cash equivalents	903	685	690	707	684
Pledged deposit	88	112	107	125	144
Trade and other receivables	1,264	1,289	1,321	1,386	1,428
Inventory	343	500	559	582	678
Others	368	396	625	573	643
Current Assets	**2,966**	**2,982**	**3,302**	**3,372**	**3,578**
Property, plant and equipment	474	870	1,013	1,375	1,719
Intangible assets	1,284	2,074	2,527	2,890	3,334
Others	276	697	811	896	941
Non-current Assets	**2,034**	**3,641**	**4,350**	**5,161**	**5,994**
Total assets	**5,000**	**6,623**	**7,653**	**8,534**	**9,572**
Trade and other payables	1,740	2,499	2,127	2,350	2,511
Borrowings (current)	517	493	1,010	1,111	1,277
Others	33	73	85	85	85
Current Liabilities	**2,291**	**3,065**	**3,221**	**3,545**	**3,873**
Borrowings (non-current)	568	839	1,272	1,399	1,609
Convertible bonds	732	837	817	823	811
Others	36	148	225	235	236
Non-current liabilities	**1,336**	**1,824**	**2,314**	**2,457**	**2,657**
Total liabilities	**3,626**	**4,889**	**5,535**	**6,003**	**6,529**
Shareholders equity	1,224	1,494	1,844	2,250	2,747
Non-controlling interests	150	240	273	280	296
Total Equity	**1,374**	**1,734**	**2,118**	**2,531**	**3,043**
Total Liabilities and Equity	**5,000**	**6,623**	**7,653**	**8,534**	**9,572**

CASH FLOW STATEMENT (RMB m)	FY17	FY18	FY19	FY20F	FY21F
Net income before tax	178	395	454	495	616
Depreciation & non cash adjustments	50	106	143	173	222
Others	-19	0	152	187	208
Change in Working Capital	-80	-174	-151	86	-49
Income Tax Paid	-22	-47	-88	-104	-123
Interest Paid	-21	-51	-66	-137	-154
CF from operating activities	**86**	**229**	**443**	**699**	**719**
Purchase/Disposal of PPE	-52	-71	-112	-100	-100
Purchase/Disposal of intangible assets	-522	-228	-565	-300	-300
Others	-119	-467	-570	-485	-695
CF from investing activities	**-693**	**-767**	**-1,246**	**-885**	**-1,095**
Dividends Paid	-8	-8	-12	-8	-5
Debt Raised / (Repaid)	461	171	877	228	376
Equity Raised / (Bought Back)	0	16	12	0	0
Issuance of convertible bonds	732	123	0	0	0
Others	43	18	-65	-18	-19
CF from financing activities	**1,228**	**320**	**813**	**202**	**353**
Net increase in cash & cash equiv.	621	-217	10	16	-23
FX effects	-0	0	0	0	0
Beginning Cash	281	903	685	690	707
Ending Cash	**903**	**685**	**695**	**707**	**684**

KEY RATIOS	FY17	FY18	FY19	FY20F	FY21F
Profitability					
Basic EPS (RMB Cents)	16	34	45	47	60
Fullu diluted EPS (RMB Cents)	9	19	27	28	36
Basic EPS Growth (%)	-18%	117%	31%	5%	26%
DPS (SGD Cents)	0.12	0.19	0.25	0.19	0.19
Dividend Yield (%)	0.2%	0.3%	0.5%	0.3%	0.3%
Profitability					
Gross margin	21%	21%	25%	26%	26%
EBITDA margin	12%	15%	20%	21%	22%
Net margin	6%	8%	10%	10%	10%
ROE	10%	17%	19%	17%	17%
ROA	2%	4%	5%	4%	5%
Financial Structure (x)					
Interest coverage	5.4	6.3	5.1	4.4	4.8
Total Debt/Equity	0.9	0.9	1.2	1.1	1.1
Net Gearing	0.1	0.4	0.8	0.7	0.7

KGI's Ratings

Rating	Definition
Outperform (OP)	We take a positive view on the stock. The stock is expected to outperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Neutral (N)	We take a neutral view on the stock. The stock is expected to perform in line with the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon.
Underperform (U)	We take a negative view on the stock. The stock is expected to underperform the expected total return of the KGI coverage universe in the related market over a 12-month investment horizon
Not Rated (NR)	The stock is not rated by KGI Securities.
Restricted (R)	KGI policy and/or applicable law regulations preclude certain types of communications, including an investment recommendation, during the course of KGI's engagement in an investment banking transaction and in certain other circumstances.

Disclaimer

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

This report is confidential. This report may not be published, circulated, reproduced or distributed and/or redistributed in whole or in part by any recipient of this report to any other person without the prior written consent of KGI Securities. This report is not intended for distribution and/or redistribution, publication to or use by any person in any jurisdiction outside Singapore or any other jurisdiction as KGI Securities may determine in its absolute discretion, where the distribution, publication or use of this report would be contrary to applicable law or would subject KGI Securities and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by KGI Securities to be reliable. However, KGI Securities makes no representation as to the accuracy or completeness of such sources or the Information and KGI Securities accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. KGI Securities and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of KGI Securities and its connected persons are subject to change without notice. KGI Securities reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) KGI Securities, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) KGI Securities, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; and (3) the officers, employees and representatives of KGI Securities may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business".)

However, as of the date of this report, neither KGI Securities nor its representative(s) who produced this report (each a "research analyst"), has any proprietary position or material interest in, and KGI Securities does not make any market in, the securities which are recommended in this report.

Each research analyst of KGI Securities who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of KGI Securities or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including KGI Securities' total revenues, a portion of which are generated from KGI Securities' business of dealing in securities.

Copyright 2020. KGI Securities (Singapore) Pte. Ltd. All rights reserved.