KGI CHINA DEVELOPMENT FINANCIAL

# Sunpower Group

(SPWG SP/SUNP.SI)

## Expecting a quick China recovery in 2Q20

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- 4Q19 results beat our expectations due to strong growth in the GI segment, offsetting a slight dip in M&S segment.
- The COVID-19 outbreak resulted in the extended shutdown of most plants under the GI segment, and the resumption of operation has been slow. Though the M&S segment remains status quo, we expect 1Q20 results to be lower YoY. However, 1Q performance is relatively weak seasonally, and we expect limited impact for the full year.
- We maintain OUTPERFORM with an unchanged TP of $0.91 given that the fundamentals of each project are intact. Our valuation is based on sum-of-the-parts method, adding up each project's discounted cash flows over their 20-30 year concession periods. Therefore, lower than expected cash flows in one or two quarters would not have a significant impact on the overall valuation.

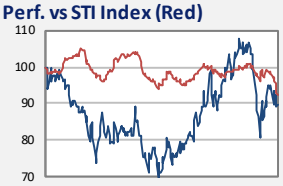
**Financials & Key Operating Statistics**

| 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 | 1,007 | 1,201 |
| PATMI | 117 | 254 | 352 | 368 | 472 |
| Basic EPS | 16 | 34 | 45 | 47 | 60 |
| Fully Diluted EPS | 9 | 19 | 27 | 28 | 36 |
| Basic EPS grth (%) | -18% | 117% | 31% | 3% | 28% |
| Basic P/E (x) | 16.9 | 7.8 | 5.9 | 5.8 | 4.5 |
| Fully diluted P/E (x) | 29.8 | 14.1 | 10.1 | 9.6 | 7.5 |
| Basic P/B (x) | 1.7 | 1.4 | 1.1 | 0.9 | 0.8 |
| Fully Diluted P/B (x) | 2.9 | 2.4 | 1.9 | 1.6 | 1.3 |
| 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% | 16% | 17% |

*Source: Company Data, KGI Research*

**Outperform - Maintain**

| | | | |
|---|---|---|---|
| Price as of 3 Mar 20 (SGD) | 0.52 | **Performance (Absolute)** | |
| 12M TP ($) | 0.91 | 1 Month (%) | 9.5% |
| Previous TP ($) | 0.91 | 3 Month (%) | -2.8% |
| Upside (%) | 75.0 | 12 Month (%) | -12.2% |
| **Trading data** | | **Perf. vs STI Index (Red)** | |
| Mkt Cap ($mn) | 422 | | |
| Issued Shares (mn) | 792 | | |
| Vol - 3M Daily avg (mn) | 1.8 | | |
| Val - 3M Daily avg ($mn) | 1.1 | | |
| Free Float (%) | 41.0% | | |
| **Major Shareholders** | | **Previous Recommendations** | |
| Guo Hongxin | 19.0% | 6-Dec-19 | OP $0.91 |
| Ma Ming | 17.0% | - | - |
| Lin Yucheng | 12.3% | - | - |




**Revenue and earnings beat estimates due to stronger than expected contributions from GI segment.** FY19 revenue and PATMI beat our forecasts by 7.1% and 16.2% respectively due mainly to the substantial growth of the Green Investment (GI) segment offsetting the dip in Manufacturing and Services (M&S) segment. During the period, GI's revenue soared by 56.7% YoY while M&S slightly dropped by 3.0% YoY. Shantou Phase 1 project (under trial-run phase) and Suyuan plant were newly added into the portfolio in 4Q19. As of December 2019, there were nine projects under operations, including one in trial-run. Another three projects are in the pipeline: Shantou Phase 2, new plant of Xintai Zhengda and Tongshan Phase 1. M&S maintained at roughly the same revenue level compared to FY18 due to full capacity. Its order book remained at RMB2.5bn as of January 2020, which will provide enough workload for 2020.

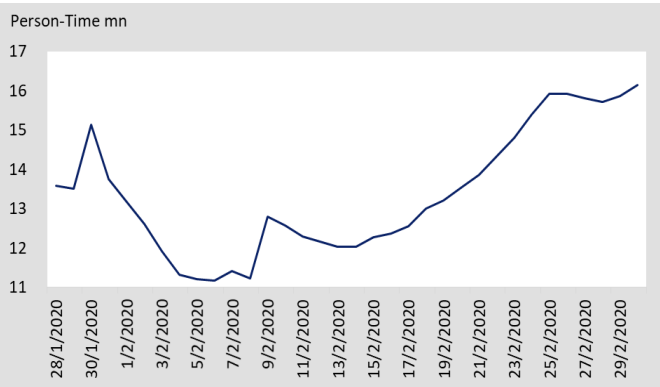
**Preliminary assessment of the COVID-19 impact.** Sunpower's business, steam/heat/power supply, heavily depends on the production in the industrial park where each plant is located and specifically serves. Officially, China extended the Spring Festival holiday for three days until 2nd February. However, according to the Ministry of Transport, the daily passenger traffic did not ramp up immediately the week after the long holiday (3rd to 9th February). Even though traffic did rise over the weekend, it subsequently tapered off.

We believe the resumption of work slowly recovered throughout the whole month but has yet to normalise as of the beginning of March. To support our estimates, we take daily coal consumption during the ongoing outbreak period as a proxy of industrial productivity in China. Coal demand volume from the six major power groups shows an L-shape in the post-Chinese New Year (CNY) period amid the COVID-19 outbreak instead of the usual V-shape recovery in each of the past years. Therefore, the data shows that productivity is still restricted at the moment.

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

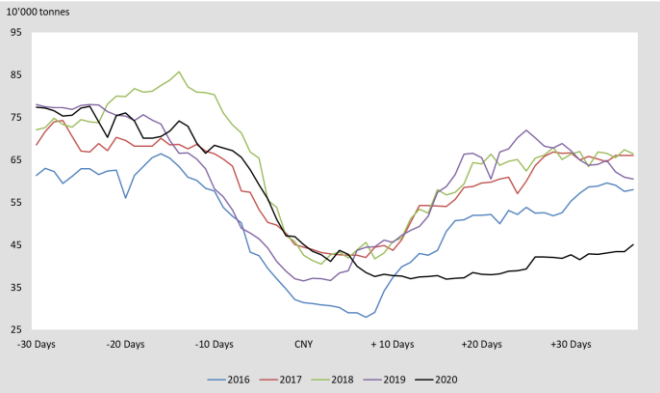
**Risks:** As of early March, the COVID-19 outbreak seems to be under control in China as the daily infected cases reported have been trending down. However, we cannot rule out the possibility that the resumption of work could result in a second wave of outbreak in China. Our valuation forecast and outlook are based on the assumption that COVID-19 will be contained by April, and overall business operations are expected to normalise accordingly. If the outbreak extends into 2Q20, then the impact for FY20 will be substantial.

**Figure 1: Daily China passenger traffic after the Spring Festival**




*Source: Ministry of Transport, KGI Research*

**Figure 2: Daily average coal demand from six major power groups**




*Source: Wind, KGI Research*

According to management, two plants, Xinyuan and Xintai Zhengda (old plant), operated non-stop throughout the whole CNY period without any changes of capacity utilisation rate. Two plants, Changrun and Suyuan, remained closed as of the end of February and is expected to normalise steam/heat/power supply by mid-March. The rest of the plants had resumed operations gradually by the end of February. Like most manufacturing companies in China, Sunpower presents a strong seasonality in that 1Q performance is relatively weak for the year. Therefore, we expect 1Q20 performance to be weaker YoY even though two more plants had been incorporated in the GI portfolio. The impact for the full year performance could be limited provided that overall business operations normalises by April.

**Management maintains an upbeat view.** There has been no order cancelations for M&S segment to date, and the group foresees an on-time delivery as scheduled. Concerns over supply chain disruption should be lifted as: 1) most of the manpower are locally hired, minimising the impact from the interprovincial restriction of traffic, 2) there are sufficient materials, and the supply chains are within the areas where the plants are located, keeping sourcing engineering parts smooth, 3) for the GI segment, each plant had stocked up coal inventories until the end of March, guaranteeing at least one month normalised operation even if coal supply is disrupted.

**The subsequent accommodative fiscal and monetary environment will alleviate cost burden.** China's Ministry of Finance and the PBOC reacted promptly to the COVID-19 outbreak, implementing a series of tax relief measures and lowering MLF rate by 10bps. With these, we believe the reduction of tax (e.g. VAT refund) and the interest expenses should enable the group to buffer the revenue decline in 1Q20. Recently, Sunpower secured an RMB800mn credit line from the Export-Import Bank of China and had drawn down RMB200mn with a borrowing rate of 3.5%. From a longer-term perspective, the financial support more than offsets the short-lived bump in operations.

**Solid fundamentals and positive outlook intact.** M&S segment maintains its order book at a record level of RMB2.5bn, which will keep its capacity fully utilised this year. GI segment is operating 8+1 plants at the moment, generating constant and stable positive cash flows quarterly. We should see the inorganic growth of earnings and cash flows from the Shantou Phase 1 and the Xintai Zhengda new plant in 2020. Shantou Phase 2 and Tongshan projects are expected to commence in 2021. On the other hand, the expansion of GI segment through project acquisitions will carry on. As of December 2019, RMB1.7bn out of the targeted RMB2.5bn deployment by 2021 has been invested/committed, another RMB800mn room for M&A could be higher if the funding capacity expands. There could be more bargain hunting opportunities emerging given the possible asset price weakness owing to COVID-19.

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) | (2,859) | (3,339) |
| **Gross Profit** | **408** | **694** | **889** | **1,007** | **1,201** |
| Other operating income/(expenses) | 47 | 38 | (56) | 31 | 36 |
| SG&A | (242) | (329) | (269) | (406) | (459) |
| Othes | (31) | (12) | (0) | 0 | 0 |
| **Profit from Operations** | **182** | **391** | **563** | **632** | **779** |
| Finance income/(expenses) | (34) | (62) | (110) | (145) | (163) |
| Share of JV results | 0 | (1) | 1 | 0 | 0 |
| **Profit before Tax** | **149** | **328** | **454** | **487** | **616** |
| Income tax | (27) | (62) | (91) | (102) | (123) |
| Non-controlling interests | 5 | 12 | 11 | 16 | 21 |
| **PATMI** | **117** | **254** | **352** | **368** | **472** |

| BALANCE SHEET (RMB m) | FY17 | FY18 | FY19 | FY20F | FY21F |
|---|---|---|---|---|---|
| Cash and cash equivalents | 903 | 685 | 690 | 697 | 681 |
| 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 | 585 | 675 |
| Others | 368 | 396 | 625 | 573 | 643 |
| **Current Assets** | **2,966** | **2,982** | **3,302** | **3,366** | **3,572** |
| 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** | **8,527** | **9,566** |
| 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 | 2,244 | 2,741 |
| Non-controlling interests | 150 | 240 | 273 | 280 | 296 |
| **Total Equity** | **1,374** | **1,734** | **2,118** | **2,524** | **3,037** |
| **Total Liabilities and Equity** | **5,000** | **6,623** | **7,653** | **8,527** | **9,566** |

| CASH FLOW STATEMENT (RMB m) | FY17 | FY18 | FY19 | FY20F | FY21F |
|---|---|---|---|---|---|
| Net income before tax | 178 | 395 | 454 | 487 | 616 |
| Depreciation & non cash adjustments | 50 | 106 | 143 | 173 | 222 |
| Others | (19) | 0 | 152 | 187 | 208 |
| Change in Working Capital | (80) | (174) | (151) | 83 | (43) |
| Income Tax Paid | (22) | (47) | (88) | (102) | (123) |
| Interest Paid | (21) | (51) | (66) | (137) | (154) |
| **CF from operating activities** | **86** | **229** | **443** | **690** | **725** |
| 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 | 7 | (17) |
| FX effects | (0) | 0 | 0 | 0 | 0 |
| Beginning Cash | 281 | 903 | 685 | 690 | 697 |
| **Ending Cash** | **903** | **685** | **695** | **697** | **681** |

| 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% | 3% | 28% |
| 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% | 16% | 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 | 0.8 | 0.8 |

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| Rating | Definition |
|---|---|
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