INITIATION

Utilities ▪ Singapore

Sunpower Group

(SPWG SP/SUNP.SI)

See More Clearly Now – Turning Smog into Opportunity

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- We initiate on Sunpower Group (Sunpower) with an OUTPERFORM rating. Our fully diluted target price is S$0.91 based on SOTP valuation of its two major businesses (using DCF for GI and PE for M&S).

Financials & Key Operating Statistics

YE Dec (RMB m)	FY17	FY18	FY19F	FY20F	FY21F
Revenue	1,965	3,263	3,364	3,885	4,540
Gross Profit	408	694	835	1,026	1,201
PATMI	117	254	303	371	470
Basic EPS	16	34	38	47	59
Fully Diluted EPS	9	19	23	28	35
Basic EPS grth (%)	-18%	117%	12%	22%	27%
Basic P/E (x)	17.9	8.2	7.4	6.0	4.8
Fully diluted P/E (x)	31.5	14.9	12.4	10.1	8.0
Basic P/B (x)	1.8	1.5	1.2	1.0	0.8
Fully Diluted P/B (x)	3.1	2.5	2.0	1.7	1.4
Gross Margin (%)	21%	21%	25%	26%	26%
Net Margin (%)	6%	8%	9%	10%	10%
Net Gearing (%)	8%	36%	73%	80%	79%
Interest Coverage (x)	5.4	6.3	4.9	4.6	4.7
ROE (%)	10%	17%	16%	17%	17%

Source: Company Data, KGI Research

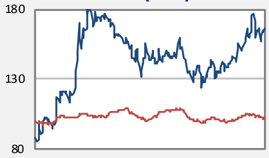
GI's "Combined Heat and Power" (CHP) plants have a bright future in China's fight to clean up the air. Sunpower's environmentally-friendly CHP plants in its growth driver and value creator GI segment can help reduce the number of small-scale environmentally hazardous plants run by industries to generate steam or power. By centralising the supply of steam and power in the hands of environmentally-friendly operators, the indiscriminate burning of coal that has been identified as one of the major sources of air pollution in China can be reduced, translating into a marked improvement in air quality.

Favourable environmental policies driving GI business growth for Sunpower. Supportive government policies have enabled Sunpower to tap into enormous opportunities to grow GI. In 2013-2018, the government increasingly started to mandatorily shut down small-scale, dirty coal-fired plants used by industries and forced them to switch to centralised, clean providers in three key areas of China. This initiative has now been expanded to the entire country, boding well for Sunpower as the accessible market that it can tap to expand the GI project portfolio is now many times larger than before. With 8 plants in operation and a target to make equity investments of RMB 2.5 billion by 2021, Sunpower is expected to benefit from its early mover advantage to secure projects at attractive returns.

Strong growth expected from Sunpower's Green Investment (GI), with its Manufacturing & Services (M&S) segment providing synergy. The GI segment is expected to see strong organic and inorganic growth in the near term as the overall designed heating capacity of the project portfolio is forecasted to surge by 58% YoY from 11.0 million tons in 2019 to 17.4 million tons in 2020. Meanwhile, its stable and

Outperform - Initiation

Price as of 5 Dec 19 (SGD)	0.55	**Performance (Absolute)**	
12M TP ($)	0.91	1 Month (%)	4.8%
Previous TP ($)	-	3 Month (%)	26.4%
Upside (%)	65.5	12 Month (%)	67.4%
Trading data		**Perf. vs STI Index (Red)**	
Mkt Cap ($mn)	446		
Issued Shares (mn)	792		
Vol - 3M Daily avg (mn)	1.0		
Val - 3M Daily avg ($mn)	0.5		
Free Float (%)	41.0%		
Major Shareholders		**Previous Recommendations**	
Guo Hongxin	19.4%	-	-
Ma Ming	17.4%	-	-
Lin Yucheng	12.6%	-	-



resilient M&S segment is expected to be able to provide energy-efficient upgrades and cutting-edge solutions to the plants acquired or invested by the GI segment in order to improve margins and drive higher returns.

Sunpower's GI projects generate high-quality cash flow with attractive double digit IRR. Within two years of its first GI project commencing operations, GI has grown to almost 50% of operating income and has steadily generated higher underlying operating cash flow. GI projects are capable of producing high-quality long-term recurring cash flows because typically 30-year operating concessions and exclusive supplier status allows them to require GI customers to pay in advance. Its overall customer base is largely diversified, supplying the resilient domestic market in China. We estimate the overall IRR of Sunpower's current GI portfolio to be 15%, based on conservative assumptions.

Valuation & Action: Using SOTP to value Sunpower and assuming its CBs and ESOS are fully converted to shares, we estimate a target price of S$0.91 after applying a 10% discount, implying an upside of 65.5% from the last closing price of S$0.55. We therefore initiate with an OUTPERFORM recommendation.

Our SOTP valuation is derived from the sum of its two business segments:

1) Fair value of S$0.85 for GI segment based on a DCF valuation with a WACC of 6.4%.

2) Fair value of S$0.16 for M&S segment based on a PE valuation of 7x earnings (5-year average before the group initiated GI business).

Risks: 1) seasonal profit margin compression due to lagging ASP adjustment and 2) decrease in sales volume due to weak demand for steam and power if customers were to move out of the industrial parks or face other headwinds.

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Company overview

Sunpower Group is an environmental protection and energy-saving solutions provider, mainly engaged in two business segments, Green Investment (GI) and Manufacturing & Services (M&S). The Group, a high-tech enterprise of the National Torch Program (a plan to develop hi-tech industries in China), is headquartered in Nanjing Jiangning National High-tech Industrial Park.

- The GI segment engages in the investment, development, and operation of centralised steam, heat, and electricity co-generation plants, technically called CHP (which stands for "Combined Heat and Power") plant, in China. As of September 2019, it had in its GI portfolio eight projects in operation, two more under construction, three more at the design stage and a robust portfolio of even more projects under evaluation.
- The M&S segment provides customised products and solutions to more than 1,500 clients across 15 industries in 30 countries. 70% of its client base are regular customers and includes global MNCs such as BASF, BP, Shell, SABIC, Dow, Alcoa, Mobil, SINOPEC, CNPC and CNOOC. As of October 2019, Sunpower's order book has been sustained at a record RMB2.5bn.
- For the foreseeable future, the group's top priority is to continue to develop its GI business which has the most long-term recurring growth potential due to exclusive operating concessions of typically 30 years, and generates high-quality, long-term cash flow as GI projects have the ability to require cash in advance from the majority of customers due to exclusive supplier status.
- Sunpower's goal is for GI to consistently contribute ~50% of total income and the bulk of its intrinsic value. As of 9M19, GI had already surpassed its target and accounted for more than 50% of total income. At the same time, it will aim to keep the M&S segment stably growing.

Growth drivers

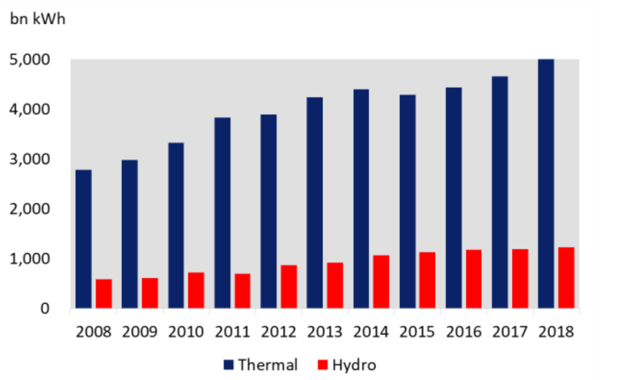
CHP plants have a bright future in China's fight to clean up the air

With rising global concern on climate change, both developed and developing countries have been working together to reduce greenhouse gas emissions. China, facing increasingly severe air pollution, has been devoting resources to implement stringent policies and regulations to fight against smog issues, even at the expense of economic growth.

In the very long term, China aims to reduce its reliance on coal consumption, which is the main cause of smog and the deterioration of air quality. However, coal is still expected to remain the major source of fuel for power generation and heating for the foreseeable future, and such demand seasonally peaks in winter. To mitigate the smog issues that are especially severe during the cold season, China has tried to shift from coal to natural gas in recent years. But as natural gas lags significantly behind coal in cost efficiency and supply (China has to import gas via pipeline and tanker because domestic supply is insufficient), the implementation has and is expected to continue to encounter challenges across China's vast territory.

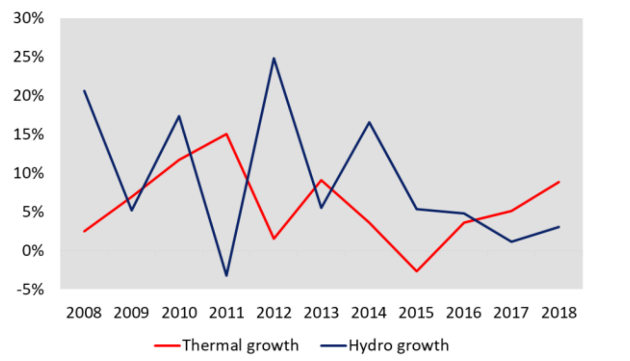
This is where CHP plants have emerged as the backbone of the national environmental agenda. The use of centralised, environmentally-friendly CHP plants can reduce the number of small-scale, environmentally hazardous plants. CHP also reduces the consumption of coal through better efficiencies hence providing an energy-saving solution for China. Accordingly, more efficient combustion of coal is a proven way to improve air quality.

Figure 1: Thermal and hydro production



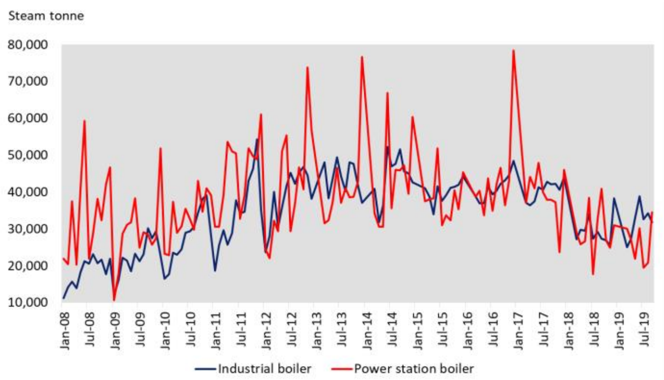
Source: National Bureau of Statistics of China, KGI Research

Figure 2: Thermal and hydro production YoY growth



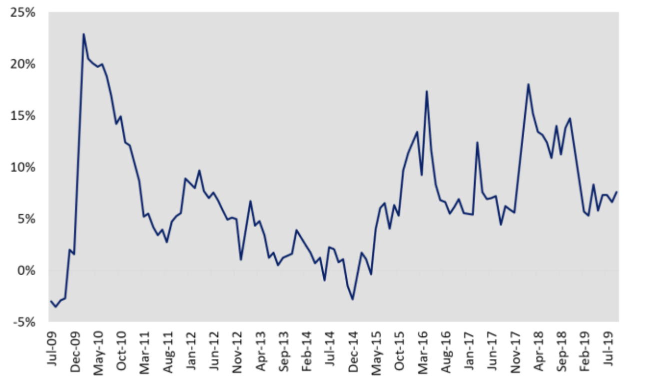
Source: National Bureau of Statistics of China, KGI Research

Figure 3: Production of industrial boiler and station power boiler



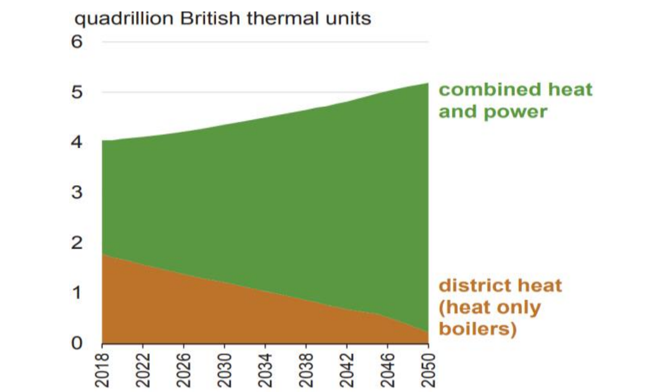
Source: China Machinery Industry Federation, KGI Research

Figure 4: Growth of coal demand from heating supply



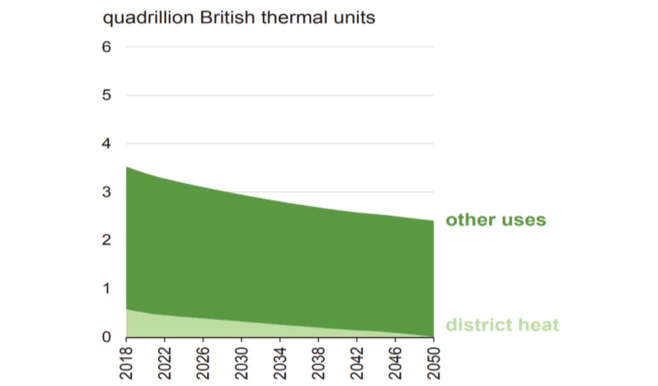
Source: China Electricity Council, KGI Research

Figure 5: Heat generation by source in China



Source: IEO 2019, EIA

Figure 6: Coal consumption by buildings in China



Source: IEO 2019, EIA

Favourable environmental policies driving GI business growth for Sunpower

Against this background, supportive government policies have enabled Sunpower to tap into enormous business opportunities to grow GI, the business segment that operates clean centralised CHP plants, since 2017 when GI first started to contribute to financial results. Under the 2013-2018 Air Pollution Prevention Action Plan, the Chinese government increasingly made it mandatory to shut down small-scale, dirty coal-fired plants being used by industries to generate steam or power, and for factories to switch to centralised, clean providers in the three key areas of Beijing-Hebei-Tianjin, the Pearl River Delta and the Yangtze River Delta.

Sunpower's success in expanding the GI business has been evident for more than six quarters now. In 2018, it grew its revenue by 66%, underlying net profit by 87% and underlying operating cash flow by 162%. This was followed up by a 47% jump in underlying net profit accompanied by a 3.4 percentage point increase in gross margin in 9M19. GI was the primary driver of the high quality cash flow-backed growth during these periods.

With the success of the initial action plan, the "clean up the air" initiative has now been expanded to the entire country with the latest 2018-2020 Three Year Action Plan for Winning the Blue Sky War. This bodes well for Sunpower as the accessible market that it can tap to expand the GI project portfolio is now larger than before. With eight operating plants and a target to make equity investments of RMB 2.5 billion in GI by 2021, Sunpower believes that it can take full advantage of its early mover advantage to secure some of the best projects at attractive returns.

Figure 7: Supportive policies for industrial development

Date	Policy	Remark
2018	Three-year actional plan for winning the blue sky war action	Speed up the construction of heating networks, fully release and improve heating capacity, and eliminate coal-fired boilers and loose coal within the scope of these networks. By the end of 2020, all coal-fired boilers and small coal-fired power plants within a 15-kilometer heating radius of 300,000-kw cogeneration power plants in key areas will be shut down and integrated. Build systems for the production, supply, storage and marketing of natural gas. In principle, no new projects for cogeneration of natural gas, heat and power, or natural gas chemical industry will be built.
2018	Energy conservation law (amended)	Encourages industrial enterprises to adopt efficient and energy-saving electric motors, boilers, kilns, fans, pumps and other equipment, and adopt technologies such as co-generation of heat and power, utilization of residual heat and pressure, clean coal and advanced monitoring and control of energy use.
2018	Environmental protection law (amended)	Urban construction shall be planned in an overall way, and cogeneration and central heating shall be promoted in areas heated by coal burning. In areas covered by central heating networks, the construction or expansion of decentralized coal-fired heating boilers shall be prohibited; Coal-fired heating boilers that have been built and whose discharge is not up to standard shall be dismantled within the time limit prescribed by the people's government of the city.
2017	13th-Five-Year plan for national eco-environmental conservation	Promote the clean use of coal. Encourage cogeneration units to replace small coal-fired boilers and promote central heating in cities.
2017	13th-Five-Year plan for electricity development	According to the principle of "heat determines electricity", cogeneration projects are planned and constructed. Priority will be given to developing back-pressure cogeneration units.
2016	13th -Five-Year Plan energy conservation and emission reduction work plan	Accelerate the development of cogeneration and central heating, and use existing cogeneration units, pure-condensing generating units and low-grade waste heat around cities and industrial parks for heating renovation, and phase out coal-fired boilers (kilns) within the range of heating gas supply.
2016	Heat-power congeration measures	The construction capacity of backpressure coal-fired cogeneration units is not subject to the national total coal power station control target.
2013	The Action Plan on Prevention and Control of Air Pollution	In chemical, papermaking, printing and dyeing, leather, pharmaceutical and other industrial agglomeration areas, the construction of heat and power cogeneration units will gradually phase out the dispersed coal-fired boilers. Approval of new coal-fired power generation projects is prohibited, with the exception of cogeneration.

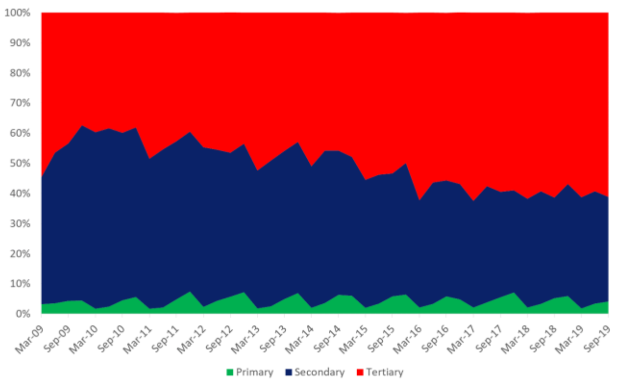
Source: Company data, open sources, KGI research

Industry background

The World Bank ranks China as the third-largest economy in the world in 2018 with a GDP of US$13.6tn, behind the US and EU with US$20.5tn and US$18.8tn respectively. This is despite the fact that China's economy has undergone a structural shift in the past decade. After decades of high growth, industries that used to prioritise quantity over quality and low value-added, labour-intensive models, causing severe air pollution and other negative environmental impacts along the way, have given way to efforts to transform and upgrade, move up the value chain and provide higher value-added products and services. China launched the ambitious strategy of "Made in China 2025" in 2015, aiming to develop its national high-end manufacturing industries and gain market share in high value-add upstream sectors.

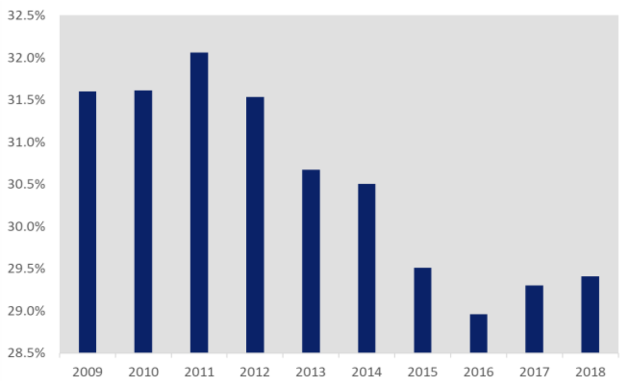
While the gains were slow in earlier years, they have been more positive in recent years. Structural transformation accelerated during the 12th-Five-Year Plan (2011-2015) when the manufacturing (secondary) sector's contribution to GDP declined from 56% to 40% before stabilising at 35% during the 13th-Five-Year Plan (2016-2020). The services (tertiary) sector now accounts for the bulk of China's GDP. In addition, while manufacturing value-add still lags behind OECD countries, it bottomed in 2016 and has risen in 2017 and 2018 as a percentage of GDP.

Figure 8: China GDP Contribution by industry



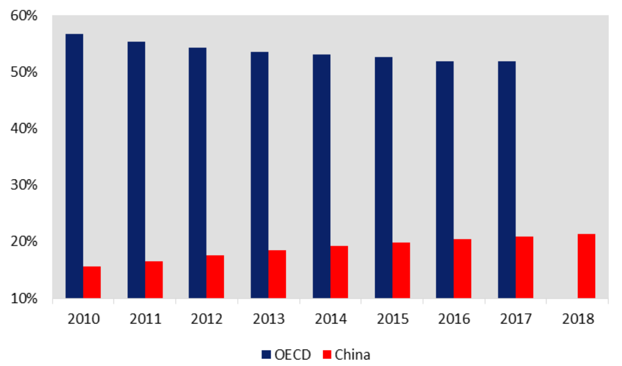
Source: National Bureau of Statistics of China, KGI Research

Figure 9: China manufacturing value add as a percentage of GDP



Source: National Bureau of Statistics of China, KGI Research

Figure 10: China is gaining market shares of manufacturing value added



Source: World Bank, KGI Research

Figure 11: Green manufacturing segment stipulated in Made in China 2025

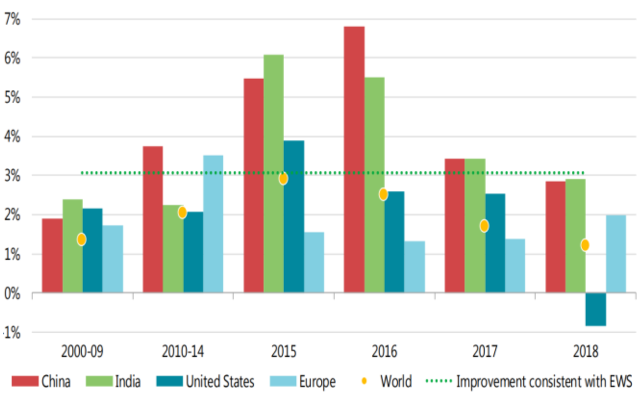
Geen manufacturing	
Area	**Remark**
Green product	1. Promote the iron and steel, nonferrous metal, chemical industry, building materials, light industry, printing and dyeing and other traditional manufacturing green transformation 2. Develop the promotion of by-product heat recycling, water recycle, heavy metal pollution reduction, poisonous and harmful material substitution, waste recycling, desulfurization denitration dust removal and other green technology equipment, speed up the application of clean and efficient casting, forging, welding, surface treatment, cutting and other processing technology, realizing green production.
Green factories	3. Strengthen the research, development and application of green products, promote technologies such as lightweight, low-power consumption and easy recovery, continue to improve the energy efficiency of end-use products such as motors, boilers, internal combustion engines and electrical appliances, and speed up the elimination of backward mechanical and electrical products and technologies.
Green industrial parks	4. Support enterprises in strengthening technological innovation and management, enhancing green and lean manufacturing capabilities, and substantially reducing energy, material and water consumption. 5. Increase the use of green and low-carbon energy, build distributed green smart micro grids in industrial parks and enterprises, and control and reduce the consumption of fossil fuels. 6. Implement the circular production mode to promote symbiosis, mutual supply of raw materials and resource sharing among enterprises, parks and industries.
Green enterprise standard and system	7. Promote the standardized and large-scale development of the resource recycling industry, strengthen technical and equipment support, and improve the comprehensive utilization of solid industrial waste, scrap metal, and discarded electrical and electronic products.

Source: gov.cn, KGI Research

From energy consumer to energy saver

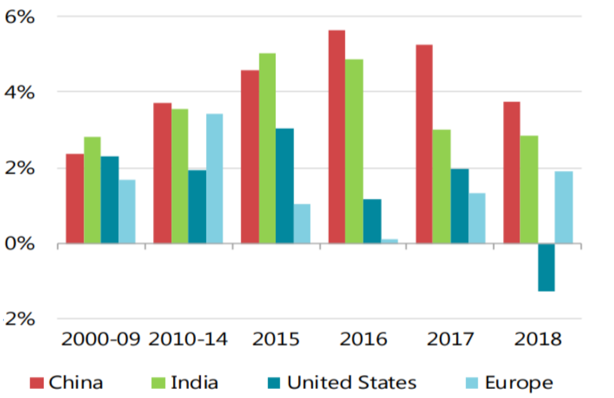
According to the International Energy Agency (IEA), primary global energy demand (oil, gas, and coal) in 2018 improved as the world used 1.2% less energy to produce each unit of GDP than in 2017. The average level of improvement was above one-third of the expected rate stated in the IEA Efficient World Strategy (EWS). Despite slowing growth, China outperformed other regions. China has been placing more effort in shifting households and businesses from coal to gas, enabling the biggest energy consumer in the world to lift its energy efficiency.

Figure 12: Primary global energy intensity improvement



Source: EIA

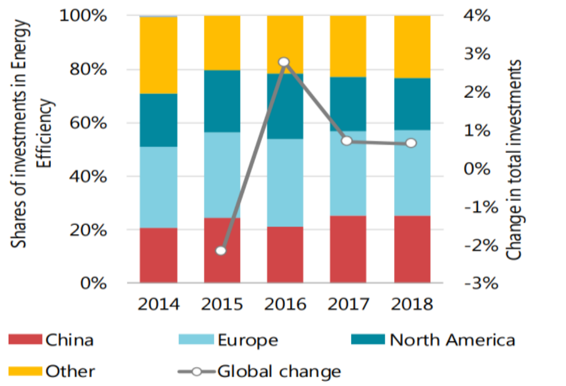
Figure 13: Final energy intensity improvement by region



Source: EIA

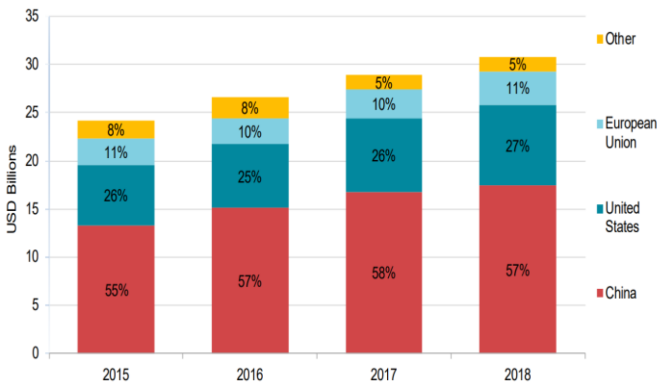
In 2018, China continued to top other regions in making the biggest investments in energy efficiency related fields. Production from the energy-saving industry grew by 15.1% to RMB477bn, and revenues from energy service companies (ESCO) grew slightly by 3% to RMB117bn in 2018. Although the withdrawal of national government subsidies dragged down growth, provincial and municipal tax rebates and financial incentives supported the expansion of the industry. The main development trend in China is to phase out non-diversified companies that are heavily reliant on subsidies. In the future, companies that survive and thrive will have to combine multiple areas of expertise, including equipment, systems, solutions, and service management provision. We believe Sunpower is one such company that will not only survive but thrive.

Figure 14: Global ESCO market growth



Source: IEA

Figure 15: Energy efficiency investment by region



Source: IEA

Primary energy intensity: primary demand per billion USD of GDP, adjusted for purchasing power parity
Final demand refers to total final consumption, the sum of consumption by the different end-use sectors and also includes non-energy use.

Investment thesis

Sunpower's GI projects generate high-quality cash flow with attractive double digit IRR

Within two years of its first GI project commencing operations, Sunpower's GI segment has grown to now account for about 50% of the group's operating income and its GI projects have generated RMB176 million in operating cash flow in 9M19 . The business generates long-term recurring cash flows that are high quality because typically 30-year operating concessions that grant exclusive supplier status allows GI projects to require most GI customers to pay in advance.

The eight operating projects are located in industrial parks that cater to a diversified customer base that includes printing & dyeing, chemical, paper making, F&B, building materials, pharmacy, paint, wood processing, chemical fertilizers, etc.

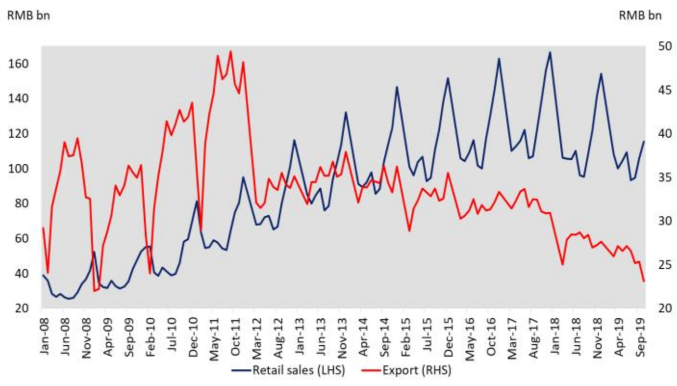
Despite trade-related headwinds this year, the textile industry in China has been resilient due to healthy domestic demand that accounts for approximately 80% of sales annually. In addition, although the labour-intensive downstream part of the textile industry in China has lost out to South Asian countries for many years now due to labour cost concerns, Sunpower's customers are mainly the printing and dyeing industries that is in the mid-stream of the textile and garments value chain, supplying semi-finished products like printed and dyed fabrics to downstream customers in South Asia where China remains the dominant partner in textile trading.

Figure 16: Main projects under operation and construction

Project	Location	Location characteristics
Changrun	Gaoyang circular economy industrial park, Hebei province	Gaoyang county is a major textile conter of China. Its production of towels, blankets, and wool yarn accounts for about 1/3 of the total output in China
Xinyuan	Qingdao city, Shandong province	In September 2017, Jimo county was classified as a district of Qingdao city. Partial industrial companies and residents from other disctricts will move to Jimo district
Lianshui	Lianshui economic development zone, Jiangsu province	Principal industries: chemicals, food, and textile
Quanjiao	Quanjiao economic development zone, Anhui province	Principal industries: clothing processing, agricultural and subsidiary products processing, machinery and electrical appliance manufacturing
Yongxing	Zhangjiagang city, Jiangsu province	Principal industries: new equipment and new energy
Suyuan	Yushan new & high-tech industrial development zone, Jiangsu province	Principal industries: spinning, printing & dyeing, weaving and garments
Xintai Zhengda	Xintai city, Shandong province	Principal industries: chemicals, food, fertilizer building materials, and paper making
Shantou	Shantou textile circular economy industrial park, Guangdong province	Principal industries: textile, garment, printing, and dyeing

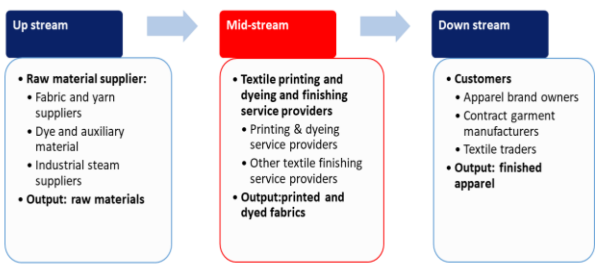
Source: Company data, KGI Research

Figure 17: Retail sales and export in the textile industry



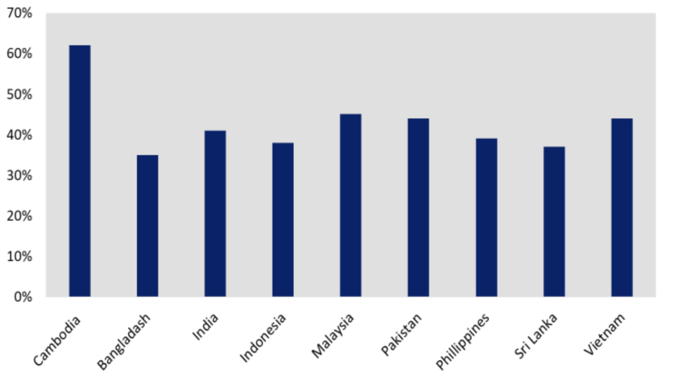
Source: National Bureau of Statistics of China, KGI Research

Figure 18: GI customers are in the mid steam of the value chain



Source: Company data, KGI Research

Figure 19: China's market share in textile imports by leading SEA countries



The percentage is based on import value during 2015-17
Source: World Integrated Trade Solution, KGI Research

Our analysis of the GI projects' internal rate of return (IRR) is based on conservative assumptions, with the overall IRR of the existing project portfolio estimated at 15%. However, the actual IRR could be higher than our calculations as we have been conservative with our coal cost and average steam ASP assumptions. As a result, the profit margins and free cash flows can potentially be higher.

Figure 20: Operating and pending projects' assumptions and IRR

Project	Changrun (Phase 1)	Xinyuan	Lianshui	Quanjiao	Yongxing	Suyuan	Xintai Zhengda (New facility)	Shantou (Phase 1)	Shantou (Phase 2)
				Steam					
Capacity (t/h)	2*220	3*75 + 1*22(	2*40	1*40	2*100 + 1*150	1*90 +2*75	3*130	3*150	2*260
Revenue p.a. (RMB mn)	**186**	**125**	**34**	**34**	**296**	**140**	**220**	**254**	**440**
				Power					
Capcity (MW)	2*25	2*6 + 1*25	-	-	2*18	1*7	1*35 + 1*18	2*20	2*30
Revenue p.a. (RMB mn)	**39**	**0**	-	-	**56**	**0**	**0**	**0**	**0**
Total revenue p.a. (RMB mn)	**225**	**125**	**34**	**34**	**352**	**140**	**220**	**254**	**440**
EBIT	**127**	**59**	**16**	**16**	**196**	**66**	**104**	**120**	**208**
Tax rate	**16%**	**16%**	**16%**	**16%**	**16%**	**16%**	**16%**	**16%**	**16%**
Depreciation & amortisation	31	8	3	3	26	11	28	21	17
Maintenance capex p.a. (1.5% of initial capex)	14	4	2	1	11	5	12	12	10
FCF p.a. (RMB mn)	**124**	**55**	**15**	**15**	**179**	**62**	**103**	**110**	**182**
Portfolio IRR	**15%**								

Source: Company data, KGI Research

Expect strong organic and inorganic growth in the near term

As of September 2019, Sunpower operated eight GI projects, including the latest acquisition Suyuan plant which only started to contribute in 3Q19. Suyuan may be expected to follow in the footsteps of Sunpower's previous successful acquisition (Yongxing plant in 3Q18) which not only will make a full year contribution in 2019 but at an enhanced level of profitability following post-acquisition plant upgrades. In addition, smaller, dirty coal-fired plants are expected to be shut down next year within Suyuan's coverage area, thus providing a larger pool of potential buyers for its steam to Suyuan.

On top of this, there are also two new plants that should start to contribute within the next financial year. Shantou Phase 1 will commence trial production soon while part of the Xintai Zhengda new plant is also expected to be completed soon with trial production commencing in 1H20.

As a result, the overall designed steam capacity of the GI projects in operation will surge by 58% YoY from 11.0 million tons in 2019 to 17.4 million tons in 2020. In a nutshell, both the top and bottom line will continue to expand with contributions from Suyuan and Shantou Phase 1 in 2020. Meanwhile, Shantou Phase 2 has started construction in 4Q19, with operations expected to start in 2021.

In addition, there are more projects in the pipeline, including three at the design stage (Xinjiang, Liutuan, and Yingtan) and others under evaluation. Sunpower has targeted to invest a total of RMB2.5bn in equity investments in GI projects by 2021, of which the group has invested and committed RMB1.6bn so far.

M&S and GI segments create synergies

Prior to 2015, Sunpower only had one business segment. The M&S business was mainly engaged in environmental engineering equipment, facilities manufacturing and energy-saving system supply. The business model of M&S is largely order book-driven and subjected to the cyclical upturns and downturns. The upstream customers' capex budget is the key factor deciding performance and growth.

However, since 2015, Sunpower has moved the business towards the higher end of the value chain by operating the CHP projects (GI segment). The transition to both manufacturer and operator enables the group not only to improve profitability but also to buffer the impact during the industrial downturn.

More importantly, both segments are able to leverage on synergies of working together. Sunpower's M&S segment is able to provide its GI projects with more energy-efficient facilities and cutting-edge solutions to reduce heat loss in order to improve margins.

Figure 21: M&S main products and services

Key products and services	Functions	Technological advantage
Heat exchangers and pressure vessels	Heat transfer, reaction, separation and storage processes of industrial production	Achieve energy savings of 30%-50% with a long life cycle
Long distance steam distribution pipelines, pipe supports, spring supports and hangers	Heat isolation from environmental temperature changes and minimise temperature loss during transmission	Improve the safe operations and service life of the distribution pipelines
Heat pipes and heat pipe exchanger	Mainly used in petrochemical, steel and chemical industries, and the construction of roads, railways and oil pipelines in permafrost regions	3,000 times faster than that of conventional products
Flare and flare gas recovery systems	Recover useful petrochemical by-products from flare or waste gas commonly generated during the production process in recover	The only officially appointed supplier of flare systems for Shell in Asia and is one of only three such suppliers for Shell in the world
Desulphurisation and denitrification solutions	Treat flue gas in boilers, metallurgical sintering machines and coke ovens	-
Zero liquid discharge system	Recycle water and recover salt from wastewater with high salinity and catalyst concentration	Meet zero emission requirements with lower capital outlay
Sulphur recovery, skidmounted equipment and formaldehyde devices	Solutions of waste heat recovery and pipeline energy saving engineering	-

Source: Company data, KGI Research

Assumptions and Valuations

We use sum-of-the-parts methodology to value Sunpower. Assuming its share base is fully diluted after the convertible bonds and ESOS are converted to shares, we estimate a target price of S$0.91 after applying a 10% discount and initiate with an OUTPERFORM recommendation, implying an upside of 65.5% from the last closing price of $S0.55.

Our SOTP valuation is derived from the sum of its two business segments:

1) Fair value of S$0.85 for its GI segment based on a DCF valuation with a WACC of 6.4%. The GI business operates projects that generate stable cash flows over the long run.

2) Fair value of S$0.16 for M&S segment based on a PE valuation with a PER of 7x (5-year average before the group initiated the GI business).

Figure 22: Assumptions and Valuations

	GI								
	Changrun (Phase 1)	Xinyuan*	Lianshui	Quanjiao	Yongxing*	Suyan*	Xintai Zhengda	Shantou (Phase 1)	Shantou (Phase 2)
FCF p.a.									
Year 1	72	41	9	12	132	43	62	84	162
Year 2	70	41	9	12	129	42	60	83	161
Year 3	67	40	9	12	126	41	58	81	159
Year 4	63	39	8	11	123	40	55	80	158
Year 5	60	38	8	11	120	39	53	78	157
Year 6	57	37	7	11	117	38	50	76	155
Year 7	53	36	7	11	114	37	47	74	154
Year 8	49	891	6	11	2,918	1,001	44	72	152
Year 9 to the end of the concession	124	-	15	15	-	-	103	110	182
NPV	309	479	52	91	3,015	956	160	447	1,420
Ownership	100%	85%	95%	100%	100%	90%	79%	51%	51%
NPV owned by Sunpower	309	407	49	91	3,015	861	126	228	724
Capital structure	Debt: 60%, Equity: 40%								
Cost of equity	9.0%								
Cost of debt	5.5%								
Tax rate	16.0%								
WACC	6.4%								
Total NPV	5,811								
	1,325								
Total number of shares if fully diluted									
TP (RMB)	4.39								
FX	5.15								
TP (SGD)	**0.85**								

	M&S
Revenue	2,602
NPM	6.0%
NP	156
PER	7x
Valuation	1,093
Total number of shares if fully diluted	1,325
TP (RMB)	0.82
FX	5.15
TP (SGD)	**0.16**
TP (SGD) based on SOTP	1.01
Discount rate	10%
Group's TP (SGD)	**0.91**

**Xinyuan, Yongxing, and Suyuan project do not have finite concession period*
Source: KGI Research

Key Risks

Risk	Remark
Market	
Seasonal profit margin compression	Prices of feedstock such as coal rise but there is a lag in steam price adjustment. Coal cost is naturally passed on to customers by a cost transfer mechanism that is built into customer supply contracts but there may be a lag if coal price increase rapidly. However, coal prices have been low for some time now due to stable market equilibrium.
Decreasing sales volume	Customers were to move out of the industrial parks or face headwinds in the decline of production. However, it is not easy for customers to move out because they are closely linked to established supply chains in the industrial parks they operate in. Also, plant capex is a big investment and relocation is not an easy decision to make, unless it is to move out of China completely. Sunpower does careful due diligence before investing to make sure the industries in the park do not fall into any vulnerable categories.
Credit	
Counterparty deliquency	Customers delay payments or default in payments. Risk is low for GI as Sunpower chooses to invest only in industrial parks containing industries that are resilient and generates strong cashflow, such as textiles, and can pay in advance. Risk is also low for M&S customers as they are mostly big SOEs and MNCs with good track records of payment.
Operation	
Accident	Accidents can result in shut-down of the plant or the industrial park.
Regulation	
Environmental inspection	Temporary suspension of the plant or the industrial park. Sunpower mitigates this risk by choosing to invest in industrial parks that do not contain highly pollutive heavy industries such as steel making as they would attract more frequent environmental bureau inspections that may disrupt operations.

Financial Summary

YE 31 Dec

INCOME STATEMENT (RMB m)	FY17	FY18	FY19F	FY20F	FY21F
Revenue	**1,965**	**3,263**	**3,364**	**3,885**	**4,540**
Cost of sales	(1,558)	(2,569)	(2,529)	(2,859)	(3,339)
Gross Profit	**408**	**694**	**835**	**1,026**	**1,201**
Other operating income/(expenses)	47	38	27	31	36
SG&A	(242)	(329)	(357)	(427)	(454)
Others	(31)	(12)	0	0	0
Profit from Operations	**182**	**391**	**506**	**630**	**784**
Finance income/(expenses)	(34)	(62)	(103)	(138)	(168)
Share of JV results	0	(1)	0	0	0
Profit before Tax	**149**	**328**	**402**	**492**	**616**
Income tax	(27)	(62)	(84)	(103)	(123)
Non-controlling interests	5	12	14	18	22
PATMI	**117**	**254**	**303**	**371**	**470**

BALANCE SHEET (RMB m)	FY17	FY18	FY19F	FY20F	FY21F
Cash and cash equivalents	903	685	489	466	548
Pledged deposit	88	112	168	207	248
Trade and other receivables	1,264	1,289	1,353	1,368	1,489
Inventory	343	500	650	780	889
Others	368	396	512	564	611
Current Assets	**2,966**	**2,982**	**3,171**	**3,385**	**3,785**
Property, plant and equipment	474	870	1,005	1,325	1,626
Intangible assets	1,284	2,074	2,442	2,881	3,319
Others	276	697	904	955	1,000
Non-current Assets	**2,034**	**3,641**	**4,351**	**5,161**	**5,945**
Total assets	**5,000**	**6,623**	**7,522**	**8,546**	**9,730**
Trade and other payables	1,740	2,499	2,304	2,431	2,595
Borrowings (current)	517	493	739	887	1,065
Others	33	73	63	63	63
Current Liabilities	**2,291**	**3,065**	**3,106**	**3,381**	**3,723**
Borrowings (non-current)	568	839	1,259	1,574	1,889
Convertible bonds	732	837	815	823	811
Others	36	148	210	211	212
Non-current liabilities	**1,336**	**1,824**	**2,284**	**2,608**	**2,912**
Total liabilities	**3,626**	**4,889**	**5,390**	**5,989**	**6,635**
Shareholders equity	1,224	1,494	1,848	2,239	2,744
Non-controlling interests	150	240	284	318	352
Total Equity	**1,374**	**1,734**	**2,132**	**2,557**	**3,095**
Total Liabilities and Equity	**5,000**	**6,623**	**7,522**	**8,546**	**9,730**

CASH FLOW STATEMENT (RMB m)	FY17	FY18	FY19F	FY20F	FY21F
Net income before tax	178	395	402	492	616
Depreciation & non cash adjustments	50	106	164	191	241
Others	(19)	0	10	9	9
Change in Working Capital	(80)	(174)	(160)	(72)	(112)
Income Tax Paid	(22)	(47)	(84)	(103)	(123)
Interest Paid	(21)	(73)	(96)	(130)	(159)
CF from operating activities	**86**	**207**	**235**	**386**	**472**
Purchase/Disposal of PPE	(52)	(71)	(70)	(70)	(70)
Purchase/Disposal of intangible assets	(522)	(228)	(350)	(300)	(300)
Others	(119)	(467)	(606)	(455)	(462)
CF from investing activities	**(693)**	**(767)**	**(1,026)**	**(825)**	**(832)**
Dividends Paid	(8)	(8)	(7)	(8)	(8)
Debt Raised / (Repaid)	461	171	666	463	492
Equity Raised / (Bought Back)	0	16	(1)	0	0
Issuance of convertible bonds	732	123	0	0	0
Others	43	40	(59)	(39)	(41)
CF from financing activities	**1,228**	**342**	**599**	**416**	**443**
Net increase in cash & cash equiv.	621	(217)	(192)	(23)	82
FX effects	(0)	0	0	0	0
Beginning Cash	281	903	685	489	466
Ending Cash	**903**	**685**	**494**	**466**	**548**

KEY RATIOS	FY17	FY18	FY19F	FY20F	FY21F
Profitability					
Basic EPS (RMB Cents)	16	34	38	47	59
Fullu diluted EPS (RMB Cents)	9	19	23	28	35
Basic EPS Growth (%)	-18%	117%	12%	22%	27%
DPS (SGD Cents)	0.12	0.19	0.19	0.19	0.19
Dividend Yield (%)	0.2%	0.3%	0.3%	0.3%	0.3%
Profitability					
Gross margin	21%	21%	25%	26%	26%
EBITDA margin	12%	15%	20%	21%	23%
Net margin	6%	8%	9%	10%	10%
ROE	10%	17%	16%	17%	17%
ROA	2%	4%	4%	4%	5%
Financial Structure (x)					
Interest coverage	5.4	6.3	4.9	4.6	4.7
Total Debt/Equity	0.9	0.9	1.1	1.1	1.1
Net Gearing	0.1	0.4	0.7	0.8	0.8

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.

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