

LONGi – A (601012 CH)

Overseas expansion aims at US market

LONGi announced to acquire 100% equity of Ningbo Yize, which owns 3GW cell and 7GW module capacity in Vietnam. The transaction will be all cash, with initial consideration of RMB1.78bn with bet-on value adjustments based on FY19-21E earnings. We believe transaction valuation is less than 7x FY19 P/E. Considering potential ASP boost on LONGi's module sales, we think the transaction is quite attractive. After due diligence, mgmt. expected to complete the transaction in Jul-Aug 2020. After consolidation, we expect LONGi to seize more US module market shares, and to enhance its short-term profitability and long-term competitiveness.

- Expansion speed is the key.** The target Company, Ningbo Yize New Energy (宁波江北宜则新能源), controls 3GW PERC cell and 7GW bifacial half-cell module capacity in Vietnam, and specialized in providing OEM services to leading module brands in the past few years. According to mgmt., Ningbo Yize has state of the art PECR cell technologies, good costs structure and sufficient order backlog to support OEM production in 2020-21. Mgmt. explained expansion speed is the most critical consideration for initiating the deal, as acquisition will save LONGi at least 18 months of construction while CAPEX would be similar as acquisition costs.
- Aiming at the US market.** US solar module has significant pricing premium (82% higher vs. Europe) driven by ITC step down schedule (details explained in p.2-3). Additional capacity in Vietnam will help LONGi 1) boost module sales in the US; 2) avoid trade tariff from Section 301(25%) and AD/CVD(~4.1%); and more importantly, 3) bifacial mono c-Si may be exempt from Section 201 tariff (20% in 2020). US panel shipment will significantly raise LONGi's overall module sales ASP and profitability. Mgmt. intends to boost US module shipment from 1.1GW in 2019 to ~3GW in 2020. We estimate US shipments will increase overall module ASP by at least 5.8% in 2020.
- Preferential payment terms with attractive valuation.** The transaction has an initial valuation at RMB1.78bn, with adjustment mechanism based on FY19-21E earnings of RMB220/241/251mn respectively. Ningbo Yize had 9M19 earnings of RMB248mn, implying valuation less than 7x FY19E P/E. With reference to benefits from US sales, we believe deal valuation is attractive, and we noticed the transaction would be settled at 30%/30%/40% in 2020-22 respectively, bringing no financing pressures to LONGi.
- Enhancing market-leading position.** We believe the transaction will accelerate LONGi's capacity expansion pace in downstream module sales, and further enhance the Company's profitability and leading position. We raise FY20-21E EPS estimates by 2.0%/3.8% to reflect the transaction's impact, and our TP is also increased to RMB34.62 based on 21.5x FY20E P/E. **Maintain Hold.**

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	16,362	21,988	32,611	52,771	61,445
YoY growth (%)	41.9	34.4	48.3	61.8	16.4
Net income (RMB mn)	3,565	2,558	5,171	6,077	6,990
EPS (RMB)	1.29	0.93	1.50	1.61	1.85
YoY growth (%)	50.0	(27.9)	61.0	7.5	15.0
P/E (x)	26.0	36.0	22.4	20.8	18.1
P/B (x)	4.7	5.7	4.5	3.8	3.2
Yield (%)	0.5	0.3	0.6	0.7	0.8
ROE (%)	18.1	15.8	20.2	18.3	17.8
Net gearing (%)	Net Cash	0.2	Net Cash	Net Cash	Net Cash

Source: Company data, CMBIS estimates

HOLD (Maintain)

Target Price **RMB34.62**
 (Previous TP **RMB32.40**)
 Up/Downside **+3.31%**
 Current Price **RMB33.51**

China Solar Sector

Robin Xiao
 (852) 3900 0849
 robinxiao@cmbi.com.hk

Stock Data

Mkt Cap (RMB mn)	126,400
Avg 3 mths t/o (RMB mn)	1374.1
52w High/Low (RMB)	35.40/19.66
Total Issued Shares (mn)	3,774
4Source: Bloomberg	

Shareholding Structure

Li Zhenguao	15.0%
Li Chunan	11.0%
Free float	50.4%

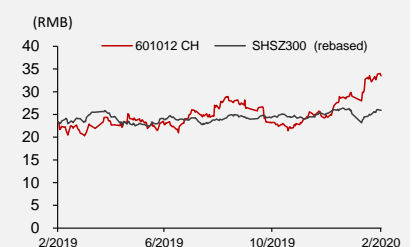
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	17.0%	13.4%
3-mth	48.2%	38.1%
6-mth	26.0%	16.5%
12-mth	45.0%	23.5%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Pricing premium for US solar panels

US module sales has significant pricing premium.

We think the pricing premium is the key reason for LONGi to initiate this surprising acquisition. According to NREL's 2Q/3Q 2019 Solar Industry Update, mono c-Si module was 52% higher in price than global average. The pricing premium in the US market is partially explained by Section 201 tariff (20% from Feb 2020 – Feb 2021), while the remaining can be explained by strong US PV demand urged to qualify for the 30% Investment Tax Credit (ITC). According to PVinfolink, mono c-Si modules pricing premium is enlarged to 82.2% (US tariff incl. price: US\$0.410/watt vs. Europe FOB price: US\$0.225/watt).

Figure 1: Comparison between trade tariffs on solar modules export to US market

Trade tariffs	China	Vietnam	
	c-Si module	c-Si module	Bifacial c-Si module
Section 201	20%	20%	exemption
Section 301	25%	nil	nil
Antidumping/ Countervailing	4.06%	nil	nil
Total	49%	20%	0%

Source: US ITC, CMBIS

What determines the premium? We think marginal supply. Based on recent mono c-Si module pricing in different regions, we compare prices by reverting Section 201 tariff, and AD/CVD + Section 301 tariffs for module supplied from China. We found that US module pricing premium over average pricing in other areas could be largely explained by additional tariff charged on Chinese module exports. According to NREL's estimates, by end-3Q19 there was 11-15GW bifacial mono c-Si capacity in Southeast Asia, less than consensus US module demand estimates of ~18GW. We think marginal supply from China to the US market would continue to support pricing premium for US solar panel sales.

Figure 2: We think marginal supply price could be an explanation for US module-pricing premium

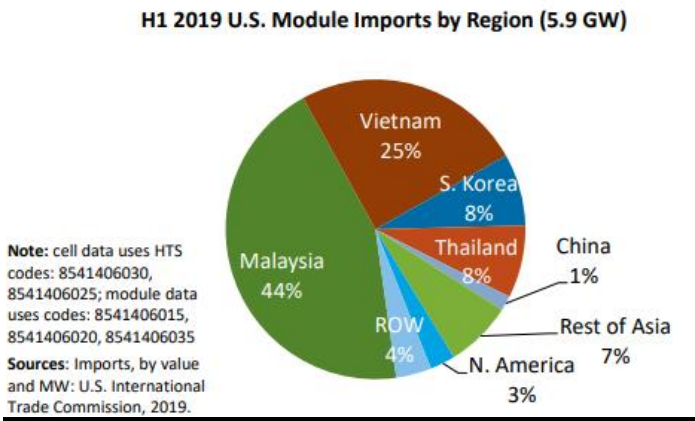
Sales Region	Pricing Components	Pvinfolink spot price (US\$/watt)	US pricing premium (%)	Excl Sec.201 impact (US\$/watt)	US pricing premium (%)	Excl all trade tariffs impact (US\$)	US pricing premium (%)
US	FOB+tariff	0.410	0	0.342	0	0.229	0
China	VAT excl	0.216	89.9%	0.216	58.2%	0.216	6.2%
Europe	FOB	0.225	82.2%	0.225	51.9%	0.225	1.9%
Australia	FOB	0.223	83.9%	0.223	53.2%	0.223	2.8%

Source: PVinfolink, CMBIS estimates

Note: PVinfolink spot price data extracted on Feb 19 2019

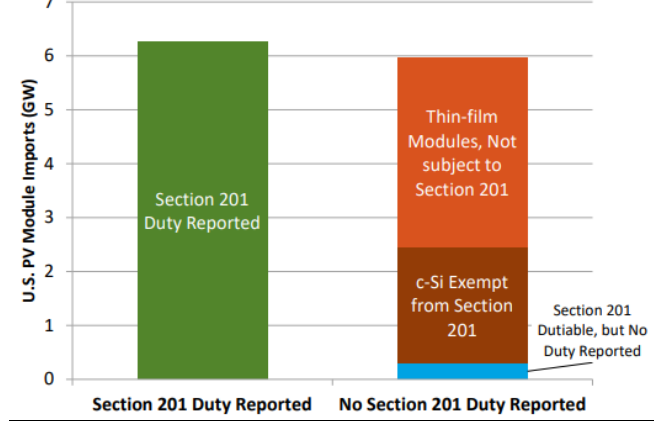
Pricing premium would largely sustain until 2021. As US solar ITC is following a step down with a sharp decline to 10% for commercial project and 0 to residential installation, we expect US PV installation will continue to expand in 2020/21. Supported by the tax credit benefit, US pricing premium would largely sustain in 2020/21, in our view.

Figure 3: Vietnam accounted for 25% US imports by value in 1H19



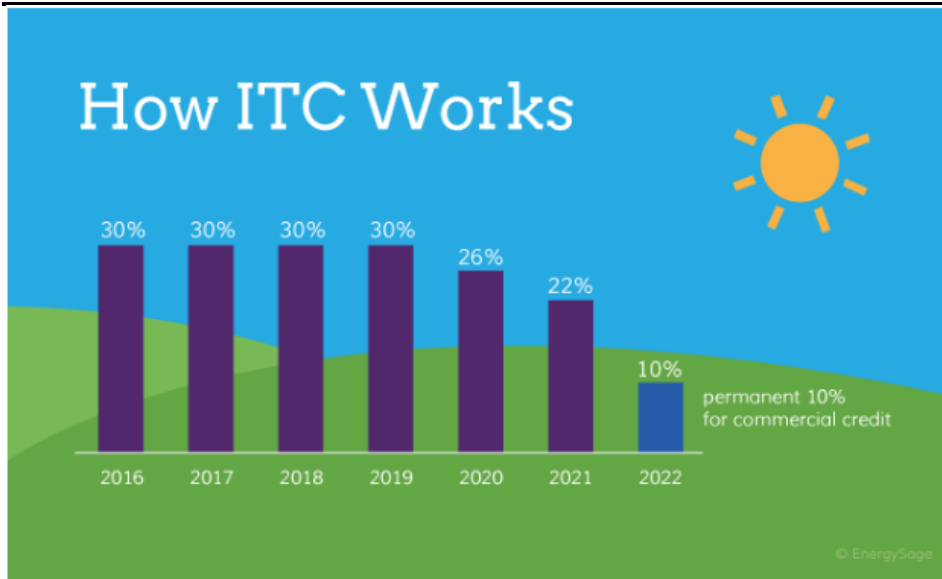
Source: NREL 1Q/2Q 2019 Solar Industry Update

Figure 4: 9M19 US module imports by tariff distribution



Source: NREL 2Q/3Q 2019 Solar Industry Update

Figure 5: US Solar ITC step down schedule



Source: Energysage

Figure 6: Earnings revision

	Old			New			Change(%)		
	2019	2020	2021	2019	2020	2021	2019	2020	2021
Revenue (RMB mn)	32,611	52,771	61,445	32,611	52,771	61,445	0.0%	0.0%	0.0%
Net Income (RMB mn)	5,171	5,956	6,737	5,171	6,077	6,990	0.0%	2.0%	3.8%
EPS (RMB)	1.50	1.58	1.79	1.50	1.61	1.85	0.0%	2.0%	3.8%

Source: CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	16,362	21,988	32,611	52,771	61,445
Mono-module	9,175	13,091	16,493	30,069	38,054
Wafer	5,753	6,116	13,111	18,727	19,000
Others	1,434	2,781	3,007	3,974	4,391
COGS	(5,280)	(4,892)	(8,941)	(11,760)	(13,578)
Gross profit	5,280	4,892	8,941	11,760	13,578
Operating expenses	1,688	2,687	3,343	5,312	6,140
Taxes & surcharges	152	117	262	398	429
Selling expenses	664	1,017	1,385	2,275	2,701
Admin expenses	500	623	913	1,478	1,720
R&D expenses	164	202	326	528	614
Impairment loss	207	728	457	633	676
Operating profit	87	61	2,205	5,598	6,447
Other income	27	142	147	237	184
Investment income	582	794	570	570	570
Asset disposal gain/(loss)	(8)	(4)	-	-	-
Finance expenses, net	-	-	(352)	(398)	(437)
Others	-	-	-	-	-
Non-operating income, net	22	(2)	15	12	8
Profit Before Tax	4,018	2,867	5,978	6,869	7,764
Income tax	(468)	(301)	(658)	(756)	(854)
Less: minority interest	15	(9)	(149)	(157)	(170)
Net profit	3,565	2,558	5,171	6,077	6,990

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	3,565	2,558	5,171	6,077	6,869
DD&A	802	1,129	1,523	1,921	2,085
Working capital change	1,680	(1,558)	(724)	(1,605)	(1,992)
Tax adjustments	(83)	85	75	187	22
Others	(4,635)	(1,040)	(1,232)	(2,410)	(1,955)
Net cash from operation	1,328	1,173	4,814	4,169	5,029
Capex & investments	(7,447)	(3,652)	(7,088)	(6,002)	(2,657)
Others	3,673	483	10	-	-
Net cash from investment	(3,774)	(3,169)	(7,078)	(6,002)	(2,657)
Equity raised	685	-	6,645	-	-
Change of debts	3,937	769	2,049	2,049	1,049
Dividend paid	(200)	(359)	(362)	(776)	(911)
Others	249	(143)	149	157	170
Net cash from financing	4,672	267	8,480	1,430	307
Net change in cash	2,227	(1,728)	6,216	(403)	2,679
Cash at the beginning	5,185	7,356	5,665	11,881	11,478
Exchange difference	(56)	38	-	-	-
Cash at the end of the year	7,356	5,665	11,881	11,478	14,157
Less: pledged cash	1,190	2,043	2,935	4,749	5,530
Cash at the balance sheet	8,546	7,708	14,816	16,227	19,687

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current Assets	13,956	16,758	22,377	26,535	27,197
Fixed Assets	10,804	13,260	17,991	22,354	22,582
Construction in Progress	1,355	856	1,311	671	671
LT Deferred Expenses	643	959	1,243	1,498	1,728
Others	1,154	1,683	1,832	2,011	2,217
Current Assets	18,927	22,901	36,713	51,813	61,188
Cash & Equivalents	8,546	7,708	14,816	16,227	19,687
Account Receivables	6,131	8,453	12,229	19,951	23,298
Inventories	2,380	4,283	5,870	9,499	11,060
Others	1,870	2,457	3,798	6,136	7,143
Current Liabilities	12,340	14,878	20,457	30,675	33,837
Account Payables	7,350	8,507	11,414	17,414	19,048
Advanced Payment	772	962	2,098	2,996	3,040
Short-term Borrowings	1,612	688	979	1,184	1,289
Current Portion of LT Debt	560	1,137	1,469	1,776	1,934
Others	2,046	3,585	4,497	7,304	8,526
Non-current Liabilities	6,299	7,956	9,872	12,940	14,386
Long-term Payables	645	1,306	1,631	2,639	3,072
Long-term Borrowings	1,656	2,659	4,045	5,582	6,368
Bond Payables	3,148	3,262	3,300	3,300	3,300
Others	850	729	896	1,420	1,646
Total net assets	14,244	16,825	28,762	34,733	40,163
Minority interests	49	373	522	679	849
Shareholders' equity	14,195	16,452	27,951	33,252	39,209

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Mono-module	56.1%	59.5%	50.6%	57.0%	61.9%
Mono-wafer	35.2%	27.8%	40.2%	35.5%	30.9%
Others	8.8%	12.6%	9.2%	7.5%	7.1%
Total	100.0%	100.0%	100.0%	100.0%	100.0%
P&L ratios (%)					
Gross profit margin	32.3%	22.2%	27.4%	22.3%	22.1%
Operating margin	22.0%	10.0%	17.2%	12.2%	12.1%
Net margin	21.8%	11.6%	15.9%	11.5%	11.2%
Effective tax rate	11.7%	10.5%	11.0%	11.0%	11.0%
Balance sheet ratios					
Current ratio (x)	1.53	1.54	1.79	1.69	1.81
Inventory turnover days	59.2	71.1	78.3	68.4	78.4
Creditor's turnover days	116.3	131.6	111.5	99.7	108.3
Debtors turnover days	111.1	121.1	115.7	111.3	128.5
Liabilities/Assets (%)	56.7	57.6	51.3	55.7	54.6
Net debt/ equity ratio (%)	Net Cash	0.22	Net Cash	Net Cash	Net Cash
Returns (%)					
ROE	25.11	15.55	18.50	18.27	17.52
ROA	10.84	6.45	8.75	7.76	7.77
Per share					
EPS (RMB)	1.29	0.93	1.50	1.61	1.82
DPS (RMB)	0.18	0.10	0.21	0.24	0.27
BVPS (RMB)	7.12	5.89	7.41	8.81	10.39

Source: Company data, CMBIS estimates

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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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