


TECHNOLOGY

Swee-Koon Tan CFA
 +(852) 25251118
 sk.tan@oskasia.com.hk

1H FY10 Results Review

Private Circulation Only

COMTEC Solar (712.HK)

BUY	Maintain
Price	HK\$2.23
Target	HK\$3.10 <i>(from HK\$2.55)</i>

Volume growth, resilient ASP, margin expansion
Stock Profile/Statistics

Bloomberg ticker	712 HK
Hang Seng Index	21,112.1
Issued share capital (m)	1,031.7
Market capitalization (HK\$m)	2,300.8
52 week H L price (HK\$)	2.95 1.22
Average volume (3m) '000	2,810.9
YTD returns	-20.9%
Net gearing (x)	7.6%
Altman Z-Score	5.43
ROCE/WACC	16.7%
Beta (x)	N/A
Book value/share (RMB)	1.03

Major Shareholders (%)

John Zhang (Chairman, CEO)	66.39%
CMTF Private Equity One	5.99%

Share Performance (%)

Month	Absolute	Relative
1m	33.53%	25.09%
3m	34.98%	25.91%
6m	8.63%	1.95%
12m	N/A	N/A

12-month Share Price Performance


Supported by a 3.1% QoQ increase in shipment volume, and a 2.5% QoQ increase in ASP, Comtec's turnover increased 133% YoY, to RMB429.1m. This was in line with our estimate of RMB428.3m. Gross margin expanded by 10.5% QoQ, mainly due to lower polysilicon costs, resulting in a 1H10 gross margin of 22.8%. This is a 12.7% YoY improvement. At the operating level, the operating profit of RMB84.6m translates to an operating margin of 19.7%, a 14.4% YoY improvement which resulted from the growth in scale of operations. The operating profit margin would have been better, if not for a RMB5.1m FX loss. Net profit of RMB68.6m is 10.1% / 20.8% higher than our / consensus estimates respectively (Exhibit 1).

Specialization reaps benefits. In the race towards Grid Parity, the downward price pressure on solar wafers is inevitable. Improved operating efficiency is needed to reduce unit production costs. Comtec shall focus on improving the conversion efficiency of its monocrystalline wafers, while also striving to improve on its operational efficiency through supply chain management and more efficient use of consumables, and enhancing financial capital management. In this scenario, we believe that specialization can achieve these, plus reduce the costs of linkages.

Timely expansion. The incremental 400MW is expected to be ready by 4Q10. With a strong order book till end-2010, we estimate 97.5% utilization on the current 200MW, and 30% utilization on the incremental 400MW based on management's guidance. We have fine-tuned our FY10F EPS estimate upwards by 1.4%. Farther ahead, Comtec expects an installed capacity of 1GW in 2011. Our upward earnings revisions (Exhibit 6) translate to an EPS CAGR (FY09A-12F) of 177%

Undemanding valuation. Even though Comtec is smaller (in terms of market capitalization) than its peers, its growth potential, operating efficiencies (translated to better profit margins), strong balance sheet (net cash position), and higher estimated dividend yield, indicates that it should be re-rated upwards (Exhibit 7). We apply a 12-month forward EV/EBITDA of 5.0x, and derive a revised target price of **HK\$3.10**. This revised target price tags the shares at our estimated 12-month forward PER of 7.0x. **Maintain BUY**

FYE Dec (RMB m)	2008A	2009A	2010F	2011F	2012F
Total revenue	762.1	506.9	1,225.7	3,008.2	3,877.3
Net profit	131.5	24.9	207.5	521.3	728.3
% chg YoY	(10.8)	(81.0)	731.9	151.2	39.7
EPS (RMB)	0.235	0.032	0.201	0.505	0.706
% chg YoY	(13.0)	(0.9)	5.2	1.5	0.4
DPS (RMB)	0.000	0.007	0.030	0.076	0.106
PER (x)	8.3	60.9	9.6	3.7	2.6
Yield (%)	0.0	0.4	1.6	4.1	5.8
P/BV	2.0	1.9	1.6	1.1	0.8
EV/EBITDA (x)	5.6	30.4	6.0	2.5	1.4

Based on August 16, 2010 closing price.

Sources: Company data; OSK Securities Hong Kong Limited

REVIEW OF 1H2010 RESULTS

Exhibit 1: Analysis of 1H2010 results

(in RMB m)

30-Jun	1H09A	1H10A	OSK 1H10E	YoY Change	% of Sales	* Difference
Sales Revenue	184.25	429.06	428.33	132.9%	100.0%	0.2%
Cost of Sales	(165.65)	(331.05)	(337.96)	99.8%	-77.2%	-2.0%
Gross Profit	18.60	98.01	90.37	427.0%	22.8%	8.5%
Other Income (excl Interest)	3.16	7.89	2.75	149.7%	1.8%	187.1%
Distribution & Selling	(1.16)	(0.79)	(1.50)	-31.5%	-0.2%	-47.3%
Administration & General	(9.42)	(18.81)	(15.89)	99.7%	-4.4%	18.4%
Other Op expenses	(1.47)	(1.73)	(1.50)	18.1%	-0.4%	15.6%
Total Op expenses	(12.04)	(21.33)	(18.89)	77.2%	-5.0%	12.9%
Operating Profit	9.72	84.58	74.23	770.0%	19.7%	13.9%
Net Interest Expenses	(3.34)	(3.80)	(0.57)	13.7%	-0.9%	569.4%
Profit before tax	6.38	80.78	73.66	1166.1%	18.8%	9.7%
Less : taxation	(1.95)	(12.22)	(11.42)	526.6%	-2.8%	7.0%
Effective tax rate (%)	30.56%	15.13%	15.5%	-50.5%	0.0%	-2.4%
Profit after tax	4.43	68.56	62.24	1447.6%	16.0%	10.1%
Minority Interest	0.00	0.00	0.00	0.0%	0.0%	0.0%
Attributable	4.43	68.559	62.24	1447.6%	16.0%	10.1%
EPS (RMB)	0.0062	0.0665	0.0589	971.8%		12.8%

Source: Company, OSK Securities Hong Kong Limited, * Actual minus OSK estimates

Based on 85.3MW shipment volume, and 1H10A ASP of US\$0.82/watt. This volume represents a 218% YoY increase

Gross margin expanded by 10.5% QoQ, resulting in a 22.8% 1H10 gross margin. This is a 12.7% YoY improvement, due to strong ASP, lower polysilicon price, and improved manufacturing efficiencies

Includes FX loss of RMB5.1m (1H09 : RMB1.99m)

Comtec's 1H10A net profit of RMB68.56m is 10.1% higher than our estimate, and 20.8% above consensus' estimate of RMB56.8m (Source: Bloomberg)

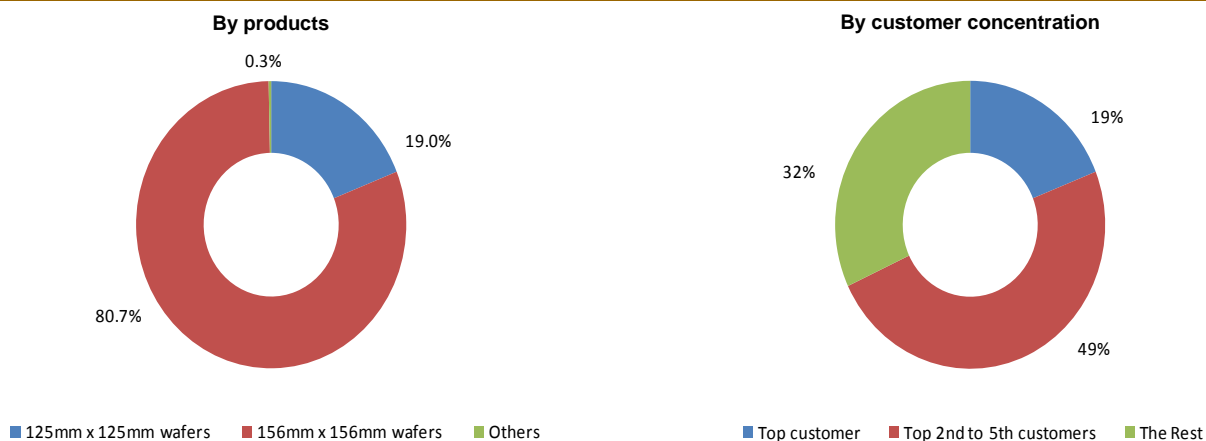
Exhibit 2: Breakdown of 1H10 performance by quarters

(in RMB m)	1Q10A	2Q10A	QoQ Change
Operational:			
Shipment volume (MW)	42.0	43.3	3.1%
ASP (RMB m / MW)	5.497	5.632	2.5%
Polysilicon costs (RMB / kg)	373.23	339.30	-9.1%
Financial:			
Revenues	198.3	230.7	16.3%
Gross Profit	34.0	64.0	88.1%
Gross Margin	17.2%	27.7%	10.5%
Net Profit	20.3	42.2	107.9%
Net Margin	10.2%	18.3%	8.1%

Source: Company

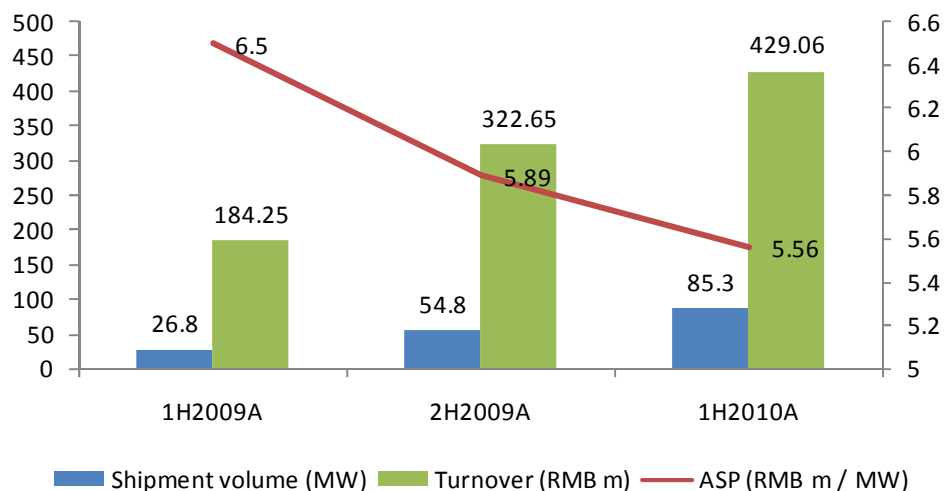
QoQ volume growth, supported by ASP increase, led to margin expansion. Total shipment volume in 1H10A was 85.3MW, translating to a utilization rate of 85% on the 100MW period capacity. Due to strong demand for its wafers, Comtec's wafer ASP increased 2.5% QoQ, from US\$0.81/watt (c RMB5.497/watt) in 1Q10A, to US\$0.83/watt (c RMB5.632/watt) in 2Q10A. Shipment volume increased from 42.0MW in 1Q10A to 43.3MW in 2Q10A, representing a 3.1% QoQ increase. In aggregate, these factors led to a QoQ gross margin expansion of 10.5%.

Exhibit 3: 1H10 revenue profile



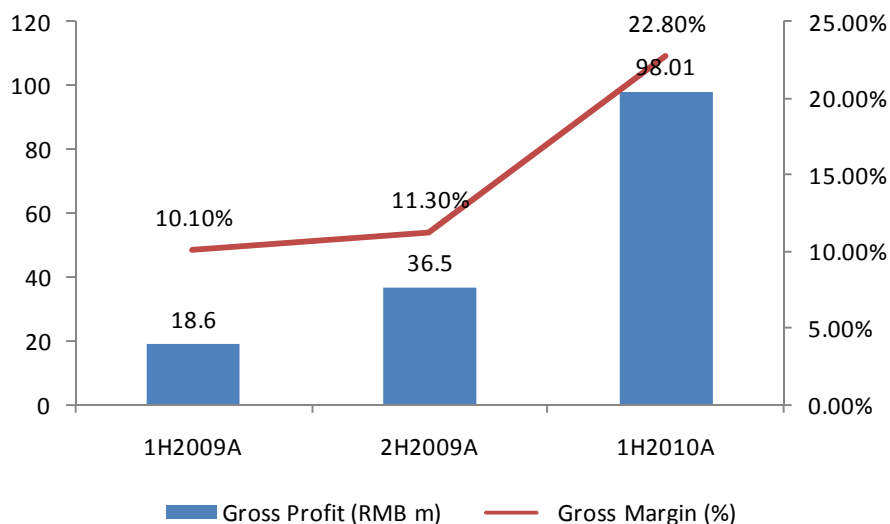
Source: Company

Exhibit 4: Analysis of HoH performance (1H09A-1H10A)



Source: Company

Exhibit 5: Analysis of gross margin (1H09A-1H10A)



Source: Company

REVISIONS TO OUR EARNINGS MODEL

Exhibit 6: Key changes to our earnings model

31 December	FY2010F			FY2011F			FY2012F		
	Original	Revised	Change	Original	Revised	Change	Original	Revised	Change
Operational:									
Planned Capacity (MW)	600.0	600.0	0.0%	1,000.0	1,000.0	0.0%	1,000.0	1,000.0	0.0%
Installed Period Capacity (MW)	300.0	300.0	0.0%	800.0	800.0	0.0%	1,000.0	1,000.0	0.0%
Production Volume (MW)	270.0	225.0	-16.7%	700.0	600.0	-14.3%	875.0	850.0	-2.9%
Utilization Rate (%)	90.0%	75.0%		87.5%	75.0%		87.5%	85.0%	
Product Mix:									
Solar Products	96.0%	99.0%		96.0%	99.0%		96.0%	100.0%	
Semiconductor Products	4.0%	1.0%		4.0%	1.0%		4.0%	0.0%	
Average Selling Price (RMB m / MW):									
125mm by 125mm Wafers	4.7230	5.4292	15.0%	3.7784	5.0220	32.9%	3.0227	4.5198	49.5%
156mm by 156mm Wafers	4.7832	5.4286	13.5%	3.8266	5.0214	31.2%	3.0612	4.5193	47.6%
210mm by 210mm Wafers	8.7000	5.4290	-37.6%	7.8300	5.0218	-35.9%	7.0470	4.5196	-35.9%
Square Wafers	5.2613	5.5000	4.5%	4.4721	5.0875	13.8%	3.8013	4.5788	20.5%
Monocrystalline Ingots	4.6001	4.6001	0.0%	3.6341	3.6341	0.0%	2.8709	2.8709	0.0%
Sales Mix of Solar Products:									
125mm by 125mm Wafers	5.0%	7.0%		6.0%	3.0%		1.5%	1.5%	
156mm by 156mm Wafers	75.0%	85.0%		50.0%	77.0%		38.5%	38.5%	
210mm by 210mm Wafers	9.0%	5.0%		18.0%	10.0%		35.0%	35.0%	
Square Wafers	10.0%	3.0%		25.0%	10.0%		25.0%	25.0%	
Monocrystalline Ingots	1.0%	0.0%		1.0%	0.0%		0.0%	0.0%	
Cost of Goods Sold assumptions:									
Polysilicon (RMB / kg)	326.5	340.1	4.2%	275.0	292.5	6.4%	236.5	236.5	0.0%
Non-PolySI conversion costs (RMB m / MW)	1.99	2.04	2.5%	1.85	1.96	5.9%	1.84	1.88	2.1%
Financials (RMB m)									
Turnover	1,359.8	1,225.7	-9.9%	3,183.8	3,008.2	-5.5%	3,923.3	3,877.3	-1.2%
Gross Profit	284.9	300.0	5.3%	718.9	757.4	5.4%	1,044.1	1,048.6	0.4%
Operating Profit	250.5	246.2	-1.7%	565.7	617.6	9.2%	752.9	854.0	13.4%
Profit Before Tax	247.7	245.5	-0.9%	562.2	616.9	9.7%	755.1	861.9	14.1%
Net Profit	204.4	207.5	1.5%	463.8	521.3	12.4%	622.9	728.3	16.9%
Attributable	204.4	207.5	1.5%	463.8	521.3	12.4%	622.9	728.3	16.9%
Earnings per Share (RMB)	0.1981	0.2011	1.5%	0.4495	0.5052	12.4%	0.6038	0.7059	16.9%
Dividends per Share (RMB)	0.0594	0.0302	-49.2%	0.1349	0.0758	-43.8%	0.1811	0.1059	-41.5%

Source: OSK Securities Hong Kong Limited

Incremental 400MW is expected to be ready by 4Q10. During the analyst briefing, management advised that the incremental 400MW capacity is planned to commence installation in September 2010, and should be ready by 4Q10. Further, with the incremental period capacity of 100MW, management advised that utilization is expected to be about 30%. Based on this, and our estimate of a 97.5% utilization on the currently installed 200MW, we revise downwards our FYF10F production volume by 16.7% to 225MW.

Focus on monocrystalline products. Management guided that, in the foreseeable future, Comtec would focus its efforts on monocrystalline photovoltaic products, rather than diversify upstream or downstream or related semi-con products. No semi-conductor products were sold in 1H10A. They estimate that the incremental 400MW this year would require an outlay of around RMB410m, while to achieve an aggregate 1GW next year would require a further RMB400m. We have incorporated these in our revised model.

Quicker adoption of 210mm by 210mm wafers could stimulate further growth. These wafers have a slightly higher ASP. Usually, customers' adoption of new products involve initial trials which could take 2-3 years. In 1H10, Comtec received pilot orders for its 210mm by 210mm wafers. Hence, while we have revised our forecasts to project a steady adoption of such wafers, if the development of modules and panels based on this larger format is adopted at a quicker pace, resulting in a positive change in product sales mix towards the 210mm by 210mm wafers, this could be a potential growth catalyst for Comtec, going forward.

Our revised estimates reflect an EPS CAGR (FY09A-12F) of 177%. Our EPS estimates for FY10F/11F/12F have been revised upwards by 1.4%/12.1%/16.4% respectively, based on the key changes reflected in Exhibit 6 above.

Conserving cash for expansion. In view of the aggregate RMB810m outlay for the capacity expansion from 200MW to 1GW, we think that there is a possibility of a reduction in the dividend payout ratio, which was 30% in FY09A. We revise downwards our dividend payout ratio estimate (FY10F-12F) from 30% to 15%.

Key risks to our forecasts. In 1H10A, Comtec's top 5 customers accounted for about 68% of revenues, up from 63% in 1H09A. The customer concentration factor is expected to continue going forward because the solar wafer business is based, *inter alia*, on quality, reliability, volume, price, and timely delivery. Hence, any decline in orders from these key customers (eg. such as a decline in demand in end-markets due to negative changes in government support policies or credit market squeeze) could negatively affect Comtec's financial performance. Further, any adverse change in polysilicon prices could compress margins, if Comtec is unable to pass on the increase in raw material costs to its customers.

VALUATION

Exhibit 7: Valuation metrics of solar wafer peer group

Company	BB Ticker	Mkt Cap (US\$m)	12-month forward				Yield (%)
			PER (x)	PEG (x)	PBR (x)	EV / EBITDA (x)	
COMTEC Solar *	712 HK	301.59	5.09	0.10	1.35	3.45	1.60
Solargiga Energy *	757 HK	418.88	19.29	0.21	1.77	12.68	1.10
GCL-Poly Energy	3800 HK	3,785.38	10.17	0.49	1.69	6.00	0.96
LDK Solar	LDK US	955.49	9.32	NA	0.97	8.21	0.00
Yingli Green	YGE US	1,568.76	10.61	1.29	1.28	5.76	0.00
Trina Solar	TSL US	1,717.87	9.65	1.43	1.39	6.30	0.00
ReneSola	SOL US	646.06	4.77	0.64	1.04	NA	0.00
Sino-American Wafer	5483 TT	982.63	17.50	0.68	2.64	11.63	0.00
Market-Cap Weighted Average			10.82	0.70	1.56	6.67	0.41

Source: Bloomberg, * OSK Securities Hong Kong Limited

Undemanding valuation. Comtec's valuation metrics are much lower than its peers' market-cap weighted average. While we recognize that Comtec is smaller (in terms of market capitalization) than its peers, its growth potential, operating efficiencies (translated to better profit margins), strong balance sheet (net cash position), and higher estimated dividend yield, indicates that it should be re-rated upwards. We apply a 12-month forward EV/EBITDA of 5.0x, and derive a **revised target price of HK\$3.10**. This revised target price tags the shares at our estimated 12-month forward PER of 7.0x. **Maintain BUY**

Financial Summary (FYE December)

Valuation and Growth					
	2008A	2009A	2010F	2011F	2012F
Valuation Ratios					
PER (Basic) (x)	8.3	60.9	9.6	3.7	2.6
Dividend yield	0.0%	0.4%	1.6%	4.1%	5.8%
P/BV (x)	2.0	1.9	1.6	1.1	0.8
Growth					
Revenue	118.3%	-33.5%	141.8%	145.4%	28.9%
Gross profit	45.6%	-76.2%	444.4%	152.5%	38.4%
Net profit	-10.8%	-81.0%	731.9%	151.2%	39.7%

Per Share Data					
(RMB)	2008A	2009A	2010F	2011F	2012F
EPS (Basic)	0.235	0.032	0.201	0.505	0.706
DPS	0.000	0.007	0.030	0.076	0.106
Payout ratio	0.0%	30.0%	15.0%	15.0%	15.0%
BV/S	1.002	1.029	1.200	1.629	2.229

Income Statement					
(RMBm)	2008A	2009A	2010F	2011F	2012F
Solar Products	725.4	485.7	1,209.7	2,986.7	3,854.1
Semiconductor Products	32.3	9.6	0.4	0.4	0.0
Other Revenues	4.4	11.6	15.6	21.1	23.2
Total Revenues	762.1	506.9	1,225.7	3,008.2	3,877.3
Cost of Goods Sold	(530.8)	(451.8)	(925.7)	(2,250.7)	(2,828.7)
Gross Profit	231.3	55.1	300.0	757.4	1,048.6
Other Income (excl Int Inc)	44.1	4.0	5.0	6.0	7.0
Less: Op Expenses	(105.6)	(23.8)	(58.8)	(145.9)	(201.6)
Operating Profit	169.9	35.3	246.2	617.6	854.0
Net Finance (exp) / inc	(3.3)	(3.9)	(0.7)	(0.7)	7.9
Profit before tax	166.6	31.3	245.5	616.9	861.9
Less: Inc Tax	(35.1)	(6.4)	(38.1)	(95.6)	(133.6)
Profit after tax	131.5	24.9	207.5	521.3	728.3
Attributable	131.5	24.9	207.5	521.3	728.3
Minority Interest	0.0	0.0	0.0	0.0	0.0

Cashflow Statement					
(RMBm)	2008A	2009A	2010F	2011F	2012F
Profit before taxation	166.6	31.3	245.5	616.9	861.9
Adjusted for:					
Depreciation (PPE)	20.8	22.9	64.8	93.2	103.1
Interest Income	(3.0)	(1.1)	(6.9)	(5.7)	(11.3)
Interest Expense	6.3	6.7	7.6	6.3	3.4
Others	90.2	0.4	63.6	(66.2)	(107.2)
Changes in Working Capital	(363.5)	(130.7)	(33.7)	(202.4)	(38.1)
Tax paid	(71.4)	(5.2)	(0.7)	(38.1)	(95.6)
Tax refunded	0.0	6.5	0.0	0.0	1.0
OP Cashflows	(154.1)	(69.2)	340.3	404.2	717.2
Interest received	3.0	1.1	6.9	5.7	11.3
Deposits for PPE	(19.0)	(16.7)	(35.3)	57.0	0.0
Capex	(53.6)	(155.9)	(410.5)	(400.0)	(186.3)
Other investing activities	(10.8)	0.3	(17.8)	(5.4)	(1.6)
INV Cashflows	(80.4)	(171.2)	(456.7)	(342.7)	(176.7)
New Bank Loans	140.0	36.0	94.4	100.0	0.0
Repayment of Bank Loans	(20.0)	(30.0)	(146.0)	(94.4)	(100.0)
Issue of Shares (IPO)	0.0	514.5	0.0	0.0	0.0
Dividends paid	0.0	0.0	(7.5)	(31.1)	(78.2)
Others	129.5	(45.9)	(7.6)	(6.3)	(3.4)
FIN Cashflows	249.5	474.5	(66.7)	(31.9)	(181.5)
Cash & Equivalents (Begin)	150.1	165.1	399.2	216.1	245.7
Net Increase in Cash & Eq	15.0	234.1	(183.1)	29.6	358.9
Cash & Equivalents (End)	165.1	399.2	216.1	245.7	604.6

Source: Company data, OSK Securities Hong Kong Limited

Financial Ratios					
	2008A	2009A	2010F	2011F	2012F
Profitability Ratios					
Gross margin	31.9%	11.3%	24.8%	25.4%	27.2%
Operating margin	23.4%	7.3%	20.4%	20.7%	22.2%
Net margin	17.3%	4.9%	16.9%	17.3%	18.8%
Pre-tax ROA	20.4%	2.2%	16.5%	27.5%	32.1%
After-tax ROE	23.5%	2.3%	16.8%	31.0%	31.7%
Balance Sheet Ratios					
Current ratio	1.4	2.2	1.9	1.7	3.5
Gross debt/equity	25.0%	13.8%	7.6%	5.9%	0.0%
Net debt/equity	-4.5%	-23.9%	-9.8%	-8.7%	-26.3%
Inventory days (average)	22.9	57.1	40.0	30.0	35.0
Receivable days (average)	17.4	54.1	32.0	25.0	28.0
Payable days (average)	70.8	124.2	60.0	37.0	38.0

Balance Sheet					
(RMBm)	2008A	2009A	2010F	2011F	2012F
Cash, and Bank Balances	165.1	399.2	216.1	245.7	604.6
Accounts Receivables	28.8	121.6	93.3	318.8	276.1
Bills Receivables	0.0	32.0	9.3	31.9	27.6
Inventory	33.1	108.4	94.5	275.4	267.0
Advances to Suppliers	45.5	36.9	48.4	52.3	40.0
Prepaid Leases (Current)	0.3	0.3	1.0	1.0	1.0
Other Current Assets	70.5	44.5	9.6	36.6	107.2
Total Current Assets	343.3	743.0	472.4	961.7	1,323.6
Prepaid Leases (non-current)	15.5	15.2	49.2	48.1	47.2
Property, Plant, Eqpt	245.6	427.6	691.8	998.5	1,083.7
Advances to Suppliers	183.3	183.8	178.3	192.6	186.5
Deposits (PPE)	22.9	39.7	75.0	18.0	18.0
Other non-current assets	6.6	1.5	19.3	24.7	26.3
Total Non-Current Assets	473.9	667.7	1,013.5	1,282.0	1,361.7
Total Assets	817.3	1,410.7	1,485.9	2,243.6	2,685.3
Total Payables	108.8	198.5	105.8	350.5	238.5
Customer Deposits	0.2	0.0	0.3	0.3	0.5
Short-term Bank Loans	140.0	146.0	94.4	100.0	0.0
Taxation Payable	5.1	0.7	38.1	95.6	133.6
Other current liabilities	0.0	0.0	4.9	11.2	7.6
Total Current Liabilities	254.1	345.3	243.4	557.6	380.2
Deferred Tax Liabilities	3.3	3.8	4.5	5.0	5.0
Promissory Notes	0.0	0.0	0.0	0.0	0.0
Total Non-Current Liabilities	3.3	3.8	4.5	5.0	5.0
Total Liabilities	257.3	349.0	247.9	562.6	385.2
Paid-in share capital	0.2	0.9	0.9	0.9	0.9
Preferred share capital	0.0	0.0	0.0	0.0	0.0
Reserves	559.7	1,060.7	1,237.1	1,680.1	2,299.2
Total Equity	559.9	1,061.6	1,238.0	1,681.1	2,300.1
Total Liabilities and Equity	817.3	1,410.7	1,485.9	2,243.6	2,685.3

Source: Company data, OSK Securities Hong Kong Limited

OSK Research Guide to Investment Ratings

Buy: Share price may exceed 10% over the next 12 months

Trading Buy: Share price may exceed 15% over the next 3 months, however longer-term outlook remains uncertain

Neutral: Share price may fall within the range of +/- 10% over the next 12 months

Take Profit: Target price has been attained. Look to accumulate at lower levels

Sell: Share price may fall by more than 10% over the next 12 months

Not Rated: Stock is not within regular research coverage

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Kuala Lumpur	Hong Kong	Singapore	Jakarta	Shanghai
Malaysia Research Office OSK Research Sdn. Bhd. 6 th Floor, Plaza OSK Jalan Ampang 50450 Kuala Lumpur Malaysia Tel : +(60) 3 9207 7688 Fax : +(60) 3 2175 3202	Hong Kong Office OSK Securities Hong Kong Ltd. 12/F, World-Wide House 19 Des Voeux Road Central, Hong Kong Tel: +(852) 2525 1118 Fax: +(852) 2537 1332	Singapore Office DMG & Partners Securities Pte. Ltd. #22-01 Ocean Towers 20 Raffles Place Singapore 048620 Tel : +(65) 6438 8810 Fax: +(65) 65354809	Jakarta Office PT OSK Nusadana Securities Indonesia Plaza Lippo, 4 th Floor, Jl. Jend. Sudirman Kav. 25. Jakarta 12920 Indonesia Tel: +(6221) 520 4599 Fax: +(6221) 520 4505	Shanghai Office OSK (China) Investment Advisory Co., Ltd. Room 6506, Plaza 66 No. 1266 West Nanjing Road Shanghai 200040 China Tel: +(8621) 6288 9611 Fax: +(8621) 6288 9633