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Breakneck growth of Hanergy raises questions

Miles Johnson in London and Lucy Hornby in Beijing

Li Hejun, founder and owner of Hanergy

It is a Chinese company that promises to revolutionise the way solar power is used and to become the Apple of green energy.

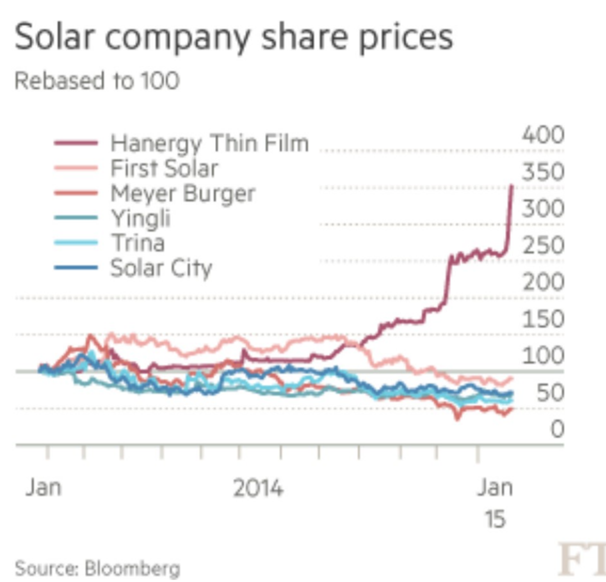
The breakneck growth of Hanergy Group, the world's largest solar company by market value, has helped to make its founder China's fifth richest man. Shares in its $18bn Hong Kong-listed subsidiary, Hanergy Thin Film Power Group, have risen more than 300 per cent since the start of 2014.

Hanergy is building factories across China and has snapped up four overseas developers of thin-film technology — a still evolving application — since 2009. Founder Li Hejun has told investors that Hanergy Group is destined to become the industry leader although, as yet, only a 10th of the world's solar production is of this thinner, lighter technology because costs are higher than for other panels.

The Financial Times, in analysing recent financial statements of the company, has found some unconventional practices behind Hanergy Group's soaring fortunes. It has been racking up enviable revenues largely through sales between its listed subsidiary, HTF, and itself.

While many of its rivals have struggled to remain profitable, HTF, which sells equipment used to make solar panels, has reported net profit margins of over 50 per cent.

It is now worth more than three times as much as its largest competitor, the US thin film solar panel company First Solar. In China, HTF is worth more than all other listed China solar companies combined. Its shares rose 10 per cent in intraday trade on Tuesday alone. On Wednesday, its shares fell as much as 5.1 per cent following this report, before recovering slightly to trade down 3.2 per cent at HK$3.61.

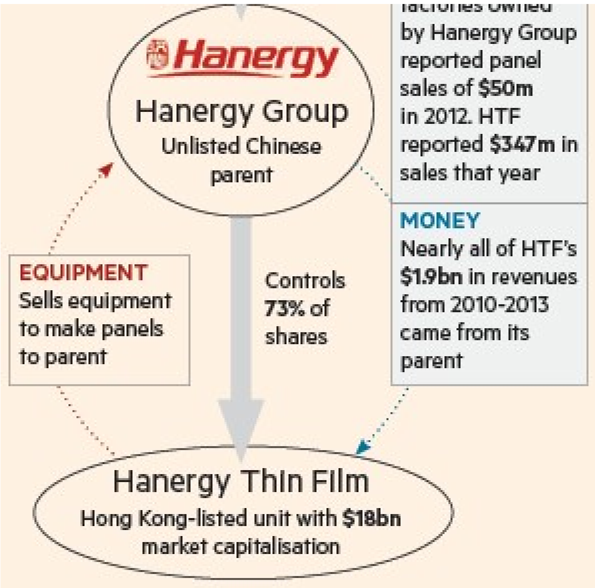


Documents reviewed by the Financial Times show that much of the growth comes from within. Nearly all of HTF's HK$14.8bn in reported revenue since 2010 has been from sales of equipment to its parent, Hanergy Group, which controls 73 per cent of its shares. Its 2013 annual report — the company's most recent full-year accounts — shows that only 35 per cent of these contracts have been settled, with the balance held as receivables.

In recent weeks, an influential analyst report on Hanergy's business model has raised other doubts about the company. Frank Dai Mingfang, chief executive of HTF, brushed off all worries in an interview with the FT — as well as reports that hedge funds were shorting its shares — as being rooted in a basic misunderstanding about Hanergy's product line. "No one else can do what we do with solar power embedded in glass windows."

He also noted a certain rare synergy, unusual outside China, regarding the sales by the Hong Kong-listed company to Hanergy. "Our client at the moment is our main shareholder. That is the point that makes other people suspicious," Mr Dai said.

Hanergy Group produces solar panels used in solar farms and on roofs and is developing technology that, if successful, would allow solar to be used widely in buildings and cars. Mr Dai said production was ramping up slowly and, as yet, no factory was operating at full capacity. Hanergy aims within the



next five years, however, to account for half of the world's projected thin film production — an ambitious target of 10 gigawatts that requires significant upfront costs in its manufacturing bases.

Hanergy Group has nine factories with one, near Chengdu, having two production lines. According to the company's financial statements, these factories are the main clients of HTF, which provides them with equipment to make thin film solar panels. A review by the FT of Chinese accounts of the factories found a large gap between the reported revenues up to 2012 and the money the factories spent buying equipment from HTF. (The FT only viewed accounts for eight of the nine factories; company representatives declined to expand or share more recent account data.)

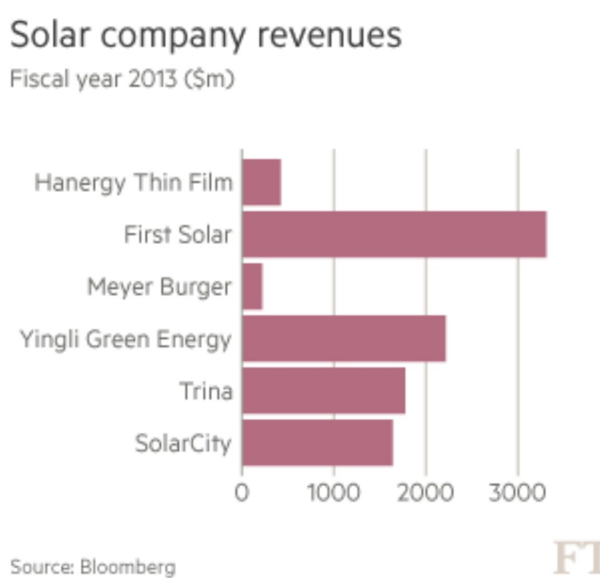
Mr Dai said that "2013 should be much better and 2014 should be good".

In 2012, the factories reported combined panel sales of Rmb315m ($50m) — about a 10th of the equipment sales the listed unit made to the parent company that year. The same factories reported a combined Rmb38m loss for that year, with debts of nearly Rmb1.2bn, according to Chinese State Administration for Industry and Commerce filings.

In an interview in the company's Beijing headquarters, company executives acknowledged that Hanergy Group is now losing money on its solar panel production but said the company was a "high-tech plus energy" model whose market potential — not unlike Google or Alibaba — drives its share price. "We do not think it is strange at all," Mr Dai said about the value of its listed arm.

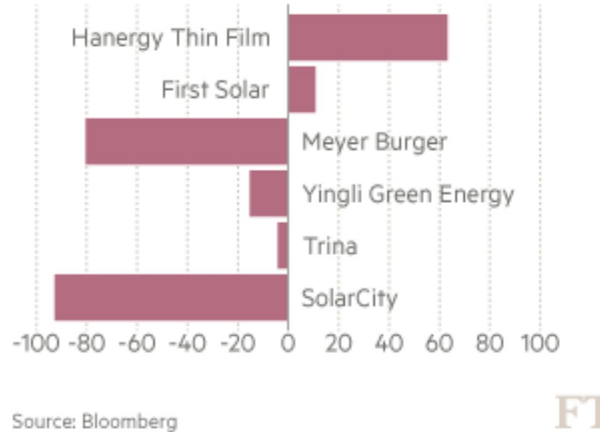
Asked about the current output of Hanergy Group, Mr Dai said that as of June 2014, the listed unit had delivered 2.4GW in production equipment — or about 1.7 per cent of all of the world's installed solar capacity. Pressed to explain, he said: "In principle their capacity has reached 2.4GW." Asked to elaborate about current output, Mr Dai said: "It's not up to 2.4GW, that's all I can say."

Company officials confirmed that Hanergy Group's manufacturing bases were operating at very low levels with only 200MW fully ramped up of the 2.4GW of equipment delivered. "At this stage, they have to be losing money," Mr Dai said about the factories. "But by the end there will be no problem. If you own a huge



Net profit/loss margin
Fiscal year 2013 (%)

house, and you have four bedrooms and need to air-condition them but are only using one bedroom, then it is totally different to using all four."



Mr Dai said the decision to invest in several factories at once, even at the cost of very low rates of production, was a "question of strategy, the company strategy". Mr Dai, who runs HTF and is also a vice-president of Hanergy Group, would not outline a timetable for increasing output; he also said that although he could not explain Mr Li's strategy, he believed scale was essential to drive down production costs.

HTF's business as equipment supplier to its parent dates from Hanergy's initial 2009 purchase of solar equipment from a Hong Kong-listed provider, Apollo Solar. Hanergy Group eventually bought majority control of Apollo Solar and renamed it Hanergy Thin Film.

In 2011, China announced a drive to develop high-tech champions and energy-saving and environmentally friendly technologies. The government announced it would pour Rmb10tn into those "strategic industries" to reduce dependence on imported oil and to tackle politically unpopular pollution. Senior leaders — including Xi Jinping in 2011 before he became head of state — have visited Hanergy facilities.

HTF's soaring share price over the past year has made Hanergy, in the words of analyst Charles Yonts of the CLSA brokerage, "too big to ignore". In December, Mr Yonts, who heads sustainable research at the Hong Kong office, focused on Hanergy by asking: "Are they really that good?" He wrote: "Working through [HTF's] businesses, we can't make them add up to the company's market cap."

Hanergy: The 10-minute trade
Mar 25, 2015 - 5:22 pm

You might not have heard of Hanergy Thin Film before, but this Hong Kong listed solar energy company is worth more than $35bn. Its share price has enjoyed a startling rate of growth in the last two years. But an FT investigation into trading in the company's stock has uncovered some curious patterns. Robin Kwong talks to Miles Johnson, FT hedge fund correspondent, about the findings.

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Mr Yonts noted on Tuesday that — were Hanergy Group producing at capacity — its panel output would "roughly be sufficient to cover one of the smaller European states" yet "nary a Hanergy panel has been seen in the wild".

Mr Dai said that the evolving solar market was "different than other industries". He said Mr Yonts had failed to consider that its glass panels could be sold as construction material, a distinction that company officials said was important in assessing where Hanergy's output might go.

Most of Hanergy's panels have gone to its own projects, of which some solar farms have been transferred to the listed company. Mr Dai declined to specify how much solar generation capacity the Hanergy parent company still owned or how much money it made.

HTF has plans, according to two company presentations, to build a 50MW farm in Henan Province, a 19MW farm in California, and an ambitious 400MW solar project in Ghana — equivalent to about a fifth of that country's entire current installed electricity capacity.

HTF in December also made a notable sale from its solar-farm inventory: it sold 180MW of solar farms developed in the far western regions of Xinjiang and Qinghai for a profit of Rmb777.6m to a previously unknown Chinese investment vehicle called Hongsheng.

Eddie Lam, finance director of the listed company, said the sale demonstrated an external demand for Hanergy products. Documents seen by the FT, however, have raised some doubts about the deal with Hongsheng, which has no website and had never been mentioned in the Chinese media before its purchase from HTF.

Company registration documents show that Hongsheng was incorporated 13 days before the deal was announced. One of the three funds that owns Hongsheng has as its legal representative the wife of Victor Wong, a former HTF board member, who stepped down from his role in May last year, eight months before the sale took place.

Mr Dai said he was unaware of the relationship until queried by the FT. "Actually we have to thank you," Mr Dai said. "Only after we received your questions did we realise this".

He said that HTF's lawyers had since informed him that Mr Wong's wife's presence in the fund, and HTF not having previously declared this, did not breach any rules for related-party transactions for Hong Kong-listed companies.

Mr Dai also said that HTF was pursuing contracts to sell solar power to corporations and western consumers, including recently signing deals to install lightweight panels at Honda and Volkswagen plants in Guangdong province, as well as a contract for charging stations for Tesla, the electric car manufacturer. It has also sold rooftop solar assemblies for home use through Ikea.

None of those outside deals is yet generating large revenues but Mr Lam said they laid a foundation for a "win-win" business model of sales of power from Hanergy panels to external customers.

"In a year or two, a lot of what you see as problems won't be problems any more," Mr Dai said. "You will be able to see it is an amazing company."

Additional reporting by Owen Guo

Rags, riches and mysteries: China's fifth-richest man

Many Chinese private entrepreneurs have a rags-to-riches story but Li Hejun, founder of Hanergy

Group, leaves mysteries in his wake, **writes Lucy Hornby in Beijing**.

He is now ranked China's fifth-richest man by Forbes, as his listed company balloons to an $18bn market cap. Hanergy's headquarters, a converted club north of Beijing's Olympic stadium, is lavishly furnished with wood from the endangered rosewood tree. Proudly displayed on the walls are photos of Mr Li ushering senior leaders around his facilities.

Fast fortunes in China are often tied to powerful patrons but Mr Li appears to come from a humble background. Like many in his home town of Heyuan in Guangdong province, he is a Hakka, a people known for their business acumen and strong community ties.

"Hanergy's luck lies in the fact that we took advantage of good timing, a time in which new energy is replacing conventional energy on a large scale," he told Chinese media last year.

After graduating from Jiao Tong University, Mr Li's first venture was an electronic components business in Beijing. He then returned to his home town to build a small hydropower dam.

By the early 2000s, Mr Li had obtained concessions to build nine more dams along the skirts of the Himalayas in Yunnan province and began promoting them to US investors.

Then misfortune struck. Powerful state-owned companies muscled in, leaving Mr Li in control of just one of those projects. That dam, Jinanqiao, is the cash cow that enabled his foray into solar power.

This article has been amended since publication in relation to Hanergy Group's solar panel production.

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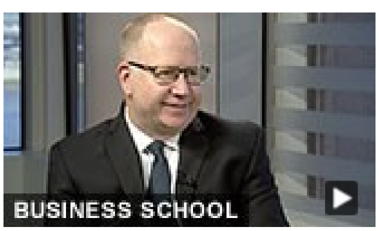

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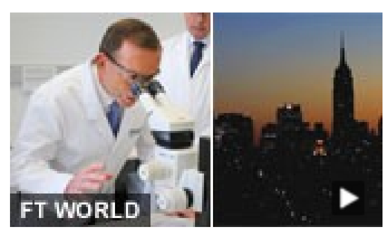

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