

ALTO CAPITAL RESEARCH

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Low cost entry in renewable energy sector

25th August 2010

CBD Energy Limited (CBD)

Speculative Buy

Price: 14.5¢
 Price Target: 30.0¢
 Mkt Cap: \$54.2m

Investment Data:

Share Price	14.5¢
Ord Shares	374.0m
Market Capitalisation	\$54.2m
Unlisted 10¢ Options (30/06/11)	7.5m
Unlisted 20¢ Options (27/11/13)	9.5m
Unlisted 25¢ Options (30/06/11)	15.0m
Market Capitalisation (diluted)	\$58.9m
12% 10¢ convertible notes	(\$5.4m)
Outstanding Loans	(\$3.9m)
Cash Balance (Jun 10)	\$4.8m
Enterprise Value	\$63.4.6m
52 week Low/High	7.8¢ / 19.5¢

Directors:

Non-Exec Chairman	The Hon Mark Vaile
Managing Director	Gerry McGowan
Non-Exec Director	James Anderson
Non-Exec Director	David Iverach

Major Shareholders:

Solon AG	18.6%
Souls Private Equity Limited	10.5%
Soul Private Equity	6.2%
Hunter Hall	5.1%

Top 20 Shareholders hold 81.4% of the issued stock

Income (\$m):	08	09	10	11F
Sales	17.8	16.8	44.3	120.0
EBITDA	(0.5)	(1.3)	6.1	17.5
Dep	(0.2)	(0.3)	(0.4)	(2.0)
EBIT	(0.7)	(1.6)	5.7	15.5
Interest	0.2	0.0	(0.9)	(0.7)
EBT	(0.5)	(1.6)	4.8	14.8
Tax	-	-	-	(3.5)
Underlying Profit	(0.5)	(1.6)	4.8	11.3
Reported NPAT	(0.5)	(3.7)	8.5	11.3
Balance Sheet (\$m):				
Cash	5.3	0.9	4.8	5.5
Intangibles	8.3	7.8	24.1	26.3
Total Assets	22.3	20.6	71.1	86.1
Total Debt	0.3	2.7	9.3	8.0
Total Liabilities	3.1	5.1	28.7	30.3
Equity	19.2	15.5	42.5	55.8



Summary:

CBD Energy Limited (CBD) is an ASX listed integrated renewable energy business, combining engineering skills, technology and services to provide renewable energy solutions to retail, industrial and government customers.

CBD energy's major strength lies in its ability to leverage its expertise in renewable power solutions across its range of business, and create a one stop shop for both residential and commercial scale renewable energy projects.

The acquisition of eco-Kinetics late last year has transformed the company into Australia's leading wholesaler and retailer of solar solutions.

We have maintained our **SPECULATIVE-BUY** recommendation; however have lowered our 12-month price target to \$0.30 per share. Our price target of 30¢ is based a price earnings multiply of 10x 2011 forecast earnings and on CBD Energy continuing to benefit from Government incentives to increase the use of renewable energy in both the residential and commercial sectors..

Key Points:

- CBD Energy can be broken down into four main renewable energy segments, 1) Solar, 2) Wind, 3) Storage, and 4) Energy Services, with each segment providing design/distribution, construction/installation, operation, and maintenance services.
- CBD yesterday announced a full year underlying profit of \$4.8m, a dramatic turnaround from the December half loss of \$3.5m. The recently acquired Eco-Kinetics was the standout performer with an operating profit (before tax) of \$9.7m.
- CBD's largest business segment is the recently acquired eco-Kinetics, which specialises in the design and installation of residential solar power systems. Eco-Kinetics is forecast to account for 65% of CBD's 2011 revenue and 70% of CBD's 2011 profit.
- CapTech, a division of CBD recently announced that it would begin manufacturing solar inverters in Australia under licence from German electronic company, Oelmaier Elektronik. CapTech plan to produce 20,000 units a year, which should contribute around \$9m in additional revenues for the 2011 year and an increase of \$1.5m in profits.
- The recent amendments to the Renewable Energy Target (RET) scheme to include the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET) has provided greater certainty for the renewable energy sector going forward, particularly the \$40 SRES REC price from January 1, 2011. This removes the uncertainty out of the REC price which has fluctuated significantly over the past year.
- An estimated \$25 - \$30 billion in addition investment is required over the next 10 years to reach the goal of a 20 per cent share of renewables in Australia's electricity mix by 2020, and will require and increase in renewable power from the current 9,500 GWh to 45,000 GWh in 2020
- CBD recently signed a strategic co-operation agreement with two of China's largest renewable energy businesses (both Fortune 500 Cos) (Tianwei Wind and China Dantang Corp) to participate in prospective new projects in Australia and China.
- License holder for the innovative graphite block energy storage technology, enabling the storage of excess energy produced via renewable energy sources.
- High quality Board and Management team in place, with extensive skills and experience in engineering, financial, treasury, and corporate management.

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Summary of Businesses

Services full spectrum of users from small retail customers through to large corporate and government projects.

CBD Energy is an integrated diversified renewable energy company, providing renewable energy solutions across the whole spectrum of end users from small retail customers through to large corporate and government projects.

CBD can be broken down into four main renewable energy segments, 1) Solar, 2) Wind, 3) Storage, and 4) Energy Services, with each segment providing design/distribution, construction/installation, operation, and maintenance services.

Solar

Eco-Kinetics

Estimated sales of \$20m for the 6 months to June.

CBD's newest subsidiary (purchase completed Jan 2010) is the group's largest revenue generator with sales for the 6 months to June 30 estimated at approx \$20m. The majority of sales are currently generated by providing solar power systems to residential clients, with a new system installed every 90 minutes. Revenue is also provided by selling and installing solar equipment to commercial and government operators.

\$6,200 upfront subsidy for the popular 1.5kw solar power system.

The most popular residential solar power system installed by eco-Kinetics is the 1.5 kilowatt product, which eco-Kinetics charges around \$9,000 per installation, however clients are eligible for the Small-scale renewable Energy Scheme (SRES), which provides an upfront subsidy of \$40 per megawatt hour of electricity produced, this equates to \$6,200 for the 1.5 kilowatt system for a household in Sydney. This upfront subsidy combined with dramatically reduced future power bills, generally means the system pays for itself within 3 to 4 years.

We believe eco-Kinetics EBITDA margin per 1.5 kilowatt system is around \$700-\$800, with current installations running around 100 – 125 per week, with 300 – 350 per week forecast for the first half of the 2010/11 financial year.

eco-Kinetics also supplies solar equipment to major corporations and governments, with, 1) a contract to supply approx \$20m worth of solar equipment over a 12 month period to the Murchison Valley Goes Solar and the Shepparton Chamber of Commerce, announced in December 2009, and 2) contract to supply solar equipment to Alice Spring with estimated sales of \$3m for 2010, announced March 2010.

Eco-Kinetics providing the majority of CBD's revenues.

eco-Kinetics is currently by far the most important and largest division of CBD Energy and is expected to account for around 65% of revenue and 70% of EBIT for CBD Energy for the 2010/11 financial year.

CBD Solar

CBD Solar was formed in mid 2007, through the business relationship between CBD Energy and SOLON AG (leading German producer of photovoltaic solar modules). SOLAN produces the largest industrial manufactured turnkey solar tracking system globally.

CBD Solar focusing on larger scale solar installations.

The main focus of CBD Solar is to provide Australian solar companies access to the high end quality products of SOLON. CBD Solar also offers a premium residential products which sells at a significant premium to the eco-Kinetics offering..

An example of CBD Solar project was the installation of six dual axis tracking solar photovoltaic systems on King Island, adding 100kW of renewable energy generation.

The acquisition of eco-Kinetics at the start of the year has cemented CBD's Solar division as Australia's leading wholesaler and retailer of solar solutions.

Wind

CBD Wind

Recently signed strategic co-operation agreement with two of China's largest renewable energy firms.

The Wind Energy division focuses on developing wind farms including sourcing projects, locating suitable sites for development, progressing regulatory approvals, acquiring wind turbines and building and operating wind farms and associated infrastructure. Income is expected to be generated from engineering and development fees, combined with longer-term operating and maintenance revenues.

CBD Wind recently signed a strategic co-operation agreement with two of China's largest renewable energy businesses, Tianwei Wind and China Datang Corporation Renewable Power Co. The agreement covers an existing CBD wind project (Adjungbilly), and the development of prospective new projects in Australia and China. We get the impression that CBD will act as the Chinese groups agent to source suitable projects, design, engineer and operate wind farms outside of China, with the Chinese providing funding and equipment.

We believe these agreements will enable CBD Wind to expand its development pipeline, and provide the group with access to both debt and equity finance in the future.

Most wind projects have long lead times, so we don't expect substantial revenues to occur until late 2011 at the earliest, however once completed projects should provide substantial re-occurring income for many years.

Summary of Businesses (cont.)

Storage

Remote Area Power Systems

Remote Area Power Systems (RAPS), is an energy solutions company that has developed a commercial size graphite energy storage system that addresses the need for storage of renewable energy (eg solar and wind) as well as providing a modular system that allows for storage optimisation.

CBD engaged international engineering firm Sinclair, Knight and Mertz to conduct due diligence on its graphite energy storage system, with SKM stating "The prototype Energy Storage Module performed in accordance with RAPS' expectations, heating losses were minimal, heat flow was satisfactory and steam recovery effective".

The first commercial use of the product will be as part of the Kings Island renewable energy project, with the first storage unit to be delivered later this year.

RAPS has recently built and commissioned a \$3m small wind project on Chatham Island N.Z. This is expected to generate around \$300k in revenues for the 2011 year.

Licence holder of initiative graphite energy storage technology.

To begin manufacturing solar invertors in July, ramping up to 20,000 units per annum.

Other

Capacitor Technologies (CapTech)

Captech is involved in developing and supplying power factor correction equipment to both the commercial and industrial sectors. Captech also manufactures a series of harmonic filters and reactors and is a supplier of capacitors, lightning and surge protection, energy monitoring and management systems and components.

In May 2010 CapTech announced that it would begin manufacturing solar invertors in Australia under licence from German electronic company, Oelmaier Elektronik in July 2010. Solar invertors take the direct current (DC) produced by solar panels and convert it to alternating current (AC) so it can be feed into the electricity grid.

CapTech plans to produce 20,000 units a year, generating around \$20m in revenues per annum, however we believe that the majority of the invertors will be sold to eco-Kinetics reducing the impact of the \$20m to CBD's revenue (internal sales not external sales). The benefit of CapTech manufacturing the invertors is likely to be two fold, 1) increased profit margin at eco-Kinetics due to lower cost of invertors, and 2) guaranteed supply of invertors to eco-Kinetics which is currently very important as there is a global shortage of invertors due to the expanding global solar industry. The production of invertors will drive this business over the next few years with all product produced being consumed by in-house customers.

CapTech will become Australia's first manufacturer of invertors, with production cost forecast to be 20% lower than current costs.

Parmac

Parmac, established in 1994, offers air conditioning installations and mechanical services, ranging from in-house designing of systems, checking of projects documented by consulting engineers, project management services and drafting services.

Parmac specialises in green field projects, institutional projects, office tenancy refurbishments and dedicated computer room and industrial air conditioning installations.

As announced in their market update, the second half of FY 2010 has seen a significant turnaround in this business with the Melbourne building construction industry recovering after the WFC.

Specialist air conditioning services provider.

Main Business Objectives

We believe CBD's strength lies in its ability to leverage its expertise in renewable power solutions across its range of business, creating a one stop shop for both residential and commercial scale renewable energy projects.

Three examples of this leverage are 1) the ability to use CapTech to produce solar invertors for use by eco-Kinetics, thereby reducing the risk that global shortages of invertors presents to the business, 2) using the well established distribution and installation expertise of eco-Kinetics to strengthen and grow the sales of the high quality SOLAN solar equipment, and 3) the ability to provide a total renewable energy solution including solar, wind and storage capabilities, as part of the current King Island renewable energy project.

Over the next 2 years eco-Kinetic is forecast to be the groups major growth engine, with sales and profits from eco-Kinetic accounting for over 70% of the CBD Energy group. However, as the company advances its various wind farm projects (and potential new projects in China) the engineering and development revenue from these projects is forecast to add significantly to the groups bottom line, however this not expected until 2012 – 2013.

Two key requirement for CBD to meet its business objectives (particularly its wind division) are 1) its ability to form and maintain key joint ventures and partnerships with third parties, 2) its ability to access funding to progress its projects forward, through either its joint ventures, equity markets or the debt markets.

The groups Chairman, Mark Vaile and MD Gerry McGowan, have secured significant relationship in the Chinese power industry, and have established a China office in Beijing to foster these relationships and provide its operating divisions a local resource to source and buy components for their systems.

Strength lies in the ability to leverage expertise across its various businesses.

Ability to form and maintain key JV and Partnerships.

Key Projects

King Island Renewable Energy Project

50/50 JV with Hydro Tasmania.

CBD Energy and Hydro Tasmania have established a 50/50 JV to greatly increase the use of renewable energy for the production of electricity on King Island, thereby reducing the reliance on power from currently installed diesel generators (goal to make King Island self reliant on renewable energy).

The King Island project is designed to produce renewable energy from both solar and wind, and to store excess power generated from both wind and solar in energy storage modules to be used when insufficient power is generated from the renewable energy sources.

Ability to showcase the various energy solutions of CBD.

King Island is considered a marquee project for CBD as it will enable to group to showcase its main commercial scale renewable energy capabilities, with particular emphasis on its graphite storage system. This will be the first use of the graphite storage system in a commercial installation and will enable the commercialisation of the system if successful.

Received a \$15.3m Federal Government grant.

The project commenced in January 2010, and is forecast to be completed in the third quarter of 2011.

The King Island project received a \$15.3m grant from the Federal Government under the Renewable Energy Demonstration Program (REDP).

Adjungbilly Wind Farm

\$85m wind farm producing 40MW, forecast to commence construction early next year

Adjungbilly is located 350km south-west of Sydney, between Yass and Gundagai. Development approval is currently being sought for a 40MW wind farm at Adjungbilly, with the Development Application (DA) lodged a couple of months ago, and final consent expected towards the end of 2010.

CBD is in the process of preparing documentation to allow China Datang to take a 60% interest in the project, with Baoding Tianwei (of China) already agreeing to provide 26 wind turbines.

The Adjungbilly wind farm is estimated to cost \$85m to develop, with construction expected to commence during the first quarter of next year (between Jan and Mar 2011).

Shannon's Flat Wind Farm

\$175m wind farm producing 70MW, forecast to submit DA by end of year

Shannon's Flat is located between Canberra and Cooma, and is expected to be one of the highest wind farms in Australia. A Development Application (DA) is expected to be lodged for a 70MW wind farm towards the end of 2010, with DA approval by the middle of next year.

Due to the size of the project (estimated project cost of \$175m) CBD plans to involve development partners, and is currently discussing the possible roles of various partners. CBD signed a non-binding term sheet with GE Energy setting out the key terms upon which GE Energy may develop the site with CBD last year.

Government Legislation

20% electricity mix by 2020 generated by renewable sources

The Australian Government set a target to achieve a 20 per cent share of renewables in Australia's electricity mix by 2020. To achieve this, the Government is supporting the deployment of renewable energy in Australia's electricity supply through the national Renewable Energy Target (RET) scheme. The RET scheme guarantees a market for additional renewable energy generation, using a mechanism of tradeable Renewable Energy Certificates known as RECs.

Legislated target increased to 45,000GWh from 9,500GWh

The Government, in cooperation with the States and Territories, is increasing the legislated target more than four times from 9,500 gigawatt-hours (GWh) to 45,000 GWh in 2020. The RET scheme expands on the existing Mandatory Renewable Energy Target (MRET) and absorbs existing and proposed State and Territory renewable energy schemes into a single national scheme.

The expanded RET scheme is expected to accelerate the uptake and prepare the electricity sector to contribute to the significant emissions reductions that will be needed to address climate change. The RET design focuses on reaching the 45,000 GWh target in 2020 at least cost and is closely based on the existing MRET scheme.

Profile of Annual Targets

Staged ramp up to 45,000 GWh over a 10 year period

The target profile (table to right) is a ramp-up of annual targets in calendar years from 2010, rising to 45,000 GWh in 2020. The target profile is to be maintained at 45,000 GWh from 2020 to 2030, at which point the RET scheme will conclude.

Year	Target (GWh)	Increase (GWh)
current	9,500	
2010	12,500	3,000
2011	14,400	1,900
2012	16,300	1,900
2013	18,200	1,900
2014	20,100	1,900
2015	22,000	1,900
2016	26,600	4,600
2017	31,200	4,600
2018	35,800	4,600
2019	40,400	4,600
2020	45,000	4,600

Recommendation and Price Target

Speculative Buy with a 30¢ price target.

We have maintained our **SPECULATIVE-BUY** recommendation; however have lowered our 12-month price target to \$0.30 per share. Our price target of 30¢ is based on a price earnings multiply of 10x 2011 forecast earnings and on CBD Energy continuing to benefit from Government incentives to increase the use of renewable energy in both the residential and commercial sectors.

The recent amendments to Renewable Energy Target (RET) scheme to include the Small-scale Renewable Energy Scheme (SRES) and the Large-scale Renewable Energy Target (LRET) has provided greater certainty for the renewable energy sector, and is likely to increase the attractiveness of CBD and similar companies to the investing public.

It must be noted that if CBD is to achieve its goals in the renewable energy sector, the company will be required to raise substantial capital going forward. Our estimate is that in order for group to advance the current projects on its books will require at least \$20 million in new equity/debt over the next two years.

Currently trading at a 55% discount to our 12-month price target.

On our valuation of 30¢ per share, CBD is trading at 50% discount to fair value, and has the potential for significant capital gains if the group's future plans come to fruition.

Final Thoughts

Despite a significant increase in cash receipts, operating cash remains negative

Despite cash receipts increasing to \$32.5m for the June half, CBD still reported an operating cash outflow of \$5.0m due to a significant increase in stock levels and accounts receivables. We expect the June quarter to be the last period of negative cash flows, with the September quarter showing a substantial turnaround in free cash flow. However if the group is unable to convert the increased sales into free cashflow the group may experience a cash crunch in the coming months.

If CBD can achieve the ambitious goals it has set for its eco Kinetics and CapTech divisions over the coming months, we believe the free cashflows generated will provide a substantial proportion of the capital required to develop its key wind and solar projects.

CBD is heavily reliant on government regulations, and any adverse change to areas of regulation effecting renewable energy targets, renewable energy trading, land access, and environmental regulation would likely have a dramatic impact on CBD Energy's business.

Little downside risk at current share price levels.

We see little downside in the current price of CBD at current levels of around 11.5¢, although we are aware that the group's cash balance is getting low and will likely need to conduct a capital raising in the near future. Our opinion is that a smallish raising (\$4 – \$5m range) would provide the best outcome as it would not dilute existing shareholders excessively, and should provide enough working capital to enable eco-Kinetics to become cashflow positive.

Directors

The Hon Mark Vaile
Non-Exec Chairman

Mr. Vaile was appointed to the board as Chairman on the 8 September 2008. Mr Vaile was Deputy Prime Minister of Australia from June 2005 to November 2007. He was elected to the Australian Parliament in 1993 and resigned in July 2008. He was Minister for Trade from July 1999 to September 2006 and was responsible for negotiating Australia's free trade agreements with the United States, Singapore and Thailand. He has held the ministerial portfolios of Transport and Regional Development (twice) and Agriculture, Fisheries and Forestry. Mr Vaile was elected leader of the National Party in June 2005.

Mr. Gerry McGowan
Managing Director

Mr. McGowan was appointed Managing Director on 8 September 2008. Mr McGowan is a former executive of TNT and Mayne Nickless. Gerry started his own company in 1982 and won the distribution of John Fairfax product nationally. He launched Impulse Airlines in 1992, and then sold to Qantas in 2001. Currently Gerry is Executive Chairman of Pacific Aviation Pty Limited and TRW Holdings Pty Limited, an investment company with exposure to the energy and aviation industries. Mr McGowan also previously served as a director under a ministerial appointment to the Board of Air Services Australia.

Mr. James Anderson
Non-Exec Director

Mr. Anderson was appointed to the board on the 29 March 2010. Mr Anderson has had a long and extensive career in chartered accounting, investment banking and funds management. Mr Anderson spent many years working for Ernst & Young in the U.S.A. and London, has held senior executive positions in structured finance with a number of investment banks, including Security Pacific Australia Ltd and Kleinwort Benson Australia Ltd, and was also a member of the Council of University of NSW.

Dr. David Iverach
Non-Exec Director

Dr David Iverach, an engineer, with a variety of management experience in government and industry, was appointed to the board on the 14 July 2010. For the past 20 years Dr Iverach has held various executive positions with Transfield Pty Ltd, including CEO of Transfield Investments, CEO Transfield Energy, CCO of Transfield Construction and Executive GM of Transfield Projects. Prior to joining Transfield Dr Iverach was Director General of Transport in NSW under the governments of Premiers Unsworth and Greiner, coming to the position after having been Principal Engineer with the NSW Department of Environment

The author of this report currently owns shares in ALG, ALGO, ATQ, CEU, NQM, RVE, RVEO, TAH, and TBR.

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