Zacks Small-Cap Research

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SunSi Energies, Inc. (SSIE-OTC)

SSIE: Upgrade rating to Neutral - stock price now sufficiently discounts revenue decline from temporary plant shutdowns.

Current Recommendation	**Neutral**
Prior Recommendation	Underperform
Date of Last Change	02/10/2012
Current Price (02/10/12)	$2.05
Six- Month Target Price	**$2.25**

OUTLOOK

The recent price decline of SunSi's stock sufficiently discounts the expected revenue decline due to the oversupply in the photovoltaic supply chain and the resultant temporarily shut down of the company's Baokai and Wendeng facilities. With polysilicon prices having rebounded from $27/kg and stabilizing in the $29/kg area, the plants are expected to resume production this month. In addition, the Chinese government is expected to promote addition polysilicon capacity through the installation of 3 gigawatts of new solar capacity in 2012. We are upgrading our rating to Neutral and adjusting our price target to $2.25.

SUMMARY DATA

52-Week High	**$4.10**
52-Week Low	**$2.01**
One-Year Return (%)	**-43.1**
Beta	**-0.14**
Average Daily Volume (shrs.)	**5,237**
Shares Outstanding (million)	**30**
Market Capitalization ($ mil.)	**$62**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**N/A**
Insider Ownership (%)	**N/A**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/M**
P/E using 2012 Estimate	**N/M**
P/E using 2013 Estimate	**N/M**
Zacks Rank	**4**

Risk Level	**Above Average**
Type of Stock	**Small - Growth**
Industry	**Chemical – Solar**
Zacks Rank in Industry	**36 of 46**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Aug)	Q2 (Nov)	Q3 (Feb)	Q4 (May)	Year (May)
2010	0.00 A	0.00 A	0.00 A	0.00 A	0.00 A
2011	0.00 A	0.00 A	4.62 A	10.46 A	15.08 A
2012	10.27 A	3.56 A	2.70 E	4.28 E	20.81 E
2013					29.00 E

Earnings per Share
(EPS is operating earnings before non recurring items)

	Q1 (Aug)	Q2 (Nov)	Q3 (Feb)	Q4 (May)	Year (May)
2010	-$0.01 A	-$0.01 A	-$0.00 A	-$0.00 A	-$0.02 A
2011	-$0.01 A	-$0.01 A	-$0.00 A	$0.00 A	-$0.02 A
2012	-$0.00 A	-$0.02 A	-$0.02 E	-$0.01 E	-$0.04 E
2013					$0.00 E

Zacks Projected EPS Growth Rate - Next 5 Years % **N/A**

2012 quarterly EPS do not equal annual EPS due to rounding.

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KEY POINTS

- SunSi's management team sought out the optimal investment opportunity in the growing solar industry. Management's objective is to become the largest trichlorosilane (TCS) producer in China through the acquisition, development and operation of a portfolio of trichlorosilane production facilities in that country.
- Management has aggressively, but with the appropriate due diligence, completed two acquisitions (**Wendeng** and **Baokai**) in the last year.
- SunSi is the only US publicly traded company to solely focus on the production of trichlorosilane, primarily for the solar industry. As such, the company is affected by the current glut of photovoltaic products and the resulting downward pressure on pricing.
- The outlook for the first half of 2012 is uncertain with spot prices for polysilicon remaining depressed (below $30 per kilogram) due to reduced solar incentives and industry overcapacity.
- We do not expect polysilicon prices to rise significantly in the near term. The polysilicon glut has driven prices below production costs for most manufacturers. The major issue in 2012 will be the process by which the industry deals with overcapacity in the photovoltaic supply chain.
- The price target for SunSi's stock is now $2.25.

OVERVIEW

A Nevada corporation with administrative offices in Brooklyn, NY, SunSi Energies (SSIE: OTCQB) focuses exclusively on the production and sales of trichlorosilane (TCS), the basic chemical ingredient used in the production of purified polysilicon[1], an essential raw material in the production of solar cells for photovoltaic (PV) panels. Having evaluated the value chain related to the production of photovoltaic solar cells, management believes that the highest profit and growth potential lies in the production of TCS. Therefore, management's objective is to acquire, develop and operate a portfolio of TCS facilities, which (with subsequent capacity expansions) will increase the company's total annual capacity to 140,000 metric tons (MT) by the end of fiscal 2012. Between December 2010 and March 2011, the company acquired majority ownership positions in two Chinese companies (90% the Zibo **Baokai**[2] trichlorosilane distribution company and 60% of the **Wendeng**[3] trichlorosilane production facility), which together now control TCS production of approximately 55,000 MT. With the acquisition of 90% of the Zibo Baokai distribution company, SunSi began to report revenue on a consolidated basis in the third fiscal quarter ending February 28, 2011. The following quarter, SunSi reported the company's first profitable quarter. However, subsequently, a glut reduced the demand for all products in the photovoltaic (PV) supply chain, from solar cells to polysilicon, and SunSi Energies reported losses in the ensuing quarters.

The company was incorporated in Nevada in January 2007 as a gold exploration company[4], but subsequently was restructured on March 24, 2009 and renamed SunSi Energies, Inc under a completely new management team. The focus of the company's business strategy became the acquisition, development and operation of trichlorosilane production facilities in China in order to serve the growing requirements of the solar photovoltaic industry worldwide. SunSi Energies owns 100% of a Hong Kong-based company, SunSi Energies Hong Kong Limited[5], through which SunSi Energies is acquiring the control of Chinese TCS production and distribution facilities.

[1] Polysilicon is properly known as polycrystalline silicon.
[2] On December 8, 2010, SunSi HK acquired a 90% equity interest in Zibo Baokai Commerce and Trade Co., Ltd.
[3] On March 18, 2011, SunSi HK acquired a 60% equity interest in Wendeng He Xie Silicon Industry Co., Ltd.
[4] Initially, the company was incorporated as Bold View Resources to explore Cupro mineral claims in the Province of British Columbia.
[5] Located at 401 Jardine House, 1 Connaught Place, Central, Hong Kong.

RECENT NEWS

Polysilicon pricing update: Polysilicon prices have rebounded from $27/kg to the range of $28/kg to $31/kg FOB (free on board) in northeast Asia.

Sichuan Yongxiang Polysilicon, based Sichuan Province, is expected to start up a polysilicon plant in September 2012 with initial production of 1,000 metric tons, ramping up to between 6,000 and 10,000 tonnes per year. In addition, Shaanxi Tianhong Silicon Industrial is expected to construct a 3,750 metric ton polysilicon project in Shaanxi province.

On January 17, 2012, SunSi Energies reported disappointing financial results for the second fiscal quarter for the period ending November 30, 2011. Revenue for the second fiscal quarter was $3.56 million. Having acquired its interests in the Baokai and Wendeng facilities within the last nine months, the company did not record any revenues in the comparable prior-year quarter; hence year-over-year comparative analysis does not assist in the evaluation of the company's financial performance. However, sequential quarterly analysis is appropriate. **Due to an oversupply of polysilicon, sales at Wendeng declined 72.8% sequentially.** Also, Baokai's revenues declined 53.3%, which contributed to the 65.3% sequential decline in overall revenues. Many polysilicon makers in China and worldwide have temporarily shut down or ceased operations. As a result, SunSi's management has closed both the Baokai and Wendeng facilities until after the Chinese New Year in mid-February, when management believes the TCS market will begin to improve in terms of volume and pricing.

Gross profit declined 94.7% sequentially to $107 thousand resulting in an overall gross margin of 3.0% with Wendeng's gross margin declining from 31.4% to 4.4% sequentially. Baokai's gross margin was stable at 2.0%. Being a distributor, Baokai's gross margin is low and consistent since current sales come from pre-existing customers (prior to the acquisition) at a locked-in 2.0% margin. In order to aid the recovery in gross margin at Wendeng, the company has negotiated with its suppliers to reduce the price of some of the raw materials required to manufacture TCS.

Management attempted to cut costs with professional fees declining 17.7% to $186,819 and general and administrative expenses sequentially declining 48.1% to $760,442. For the quarter, the company reported a loss of $538,994 or ($0.02) per diluted share.

On December 8, 2011, SunSi Energies filed a Form 8-K stating that the company has elected to **change** its **fiscal year** end from May 31 **to December 31**.

INDUSTRY OUTLOOK

A glut of solar panels and polysilicon has reduced the demand for all products in the photovoltaic (PV) supply chain, from solar cells to trichlorosilane. As a result, dramatic reductions in capacity have ensued, from the bankruptcy/insolvency of several solar companies (Solyndra LLC, Evergreen Solar, Beacon Power, SpectraWatt, Timminco Limited, Arise Germany, Solar Millennium and Solon) to shut downs of polysilicon and TCS capacity. Generally, smaller companies have reduced capacity utilization to approximately 35% while others have temporarily shut down production, including SunSi Energy. Currently, the photovoltaic chain suffers from heavy inventories and lower levels of solar cell installations.

Elsewhere in the world, polysilicon manufacturers are temporarily shutting down part of their capacity to alleviate pressure on polysilicon prices. For example, in Norway, Renewable Energy Corporation temporarily shut down 60% of the capacity at its 650MW multi-crystalline wafer facility in Heroya. The shutdown began in December 2011 and is expected to last into the first quarter of 2012.

The outlook for the first half of 2012 is uncertain with spot prices for polysilicon remaining depressed (below $30 per kg) due to reduced solar incentives and industry overcapacity. In addition, solar demand is seasonally weak in the first quarter.

For 2012, photovoltaic feed-in tariffs (FITs) have been reduced 15% in Germany, while in France, FITs will decrease by 4% to 10% for new installations connected in the first quarter 2012 compared to the fourth quarter of 2011. In Europe, financing will be more difficult due to the Eurozone debt crisis as European banks are tightening credit for funding solar investments. Therefore, European demand is expected to decrease in 2012. Also, in the US, the 1603 Treasury Program, which enables the owner of commercial solar property to receive a 30% cash grant (in lieu of taking the solar Investment Tax Credit) expired on December 31, 2011.

We do not expect polysilicon prices to rise significantly in the near term. The polysilicon glut has driven prices below production costs for most manufacturers. The major issue in 2012 will be the process by which the industry deals with overcapacity in the photovoltaic supply chain. Generally, overcapacity situations take years to resolve with the failure of weaker companies permanently reducing overall capacity. The process of temporary shut downs of capacity rarely resolve the issue of overcapacity.

Adding further uncertainty to the situation, US-based solar cell companies have alleged that Chinese companies have sold solar panels at below cost in the US market. In November 2011, the US Commerce Department opened a trade case against Chinese solar module manufacturers. In response, the China Photovoltaic Industry Alliance (CPIA), a consortium of Chinese solar cell producers, is conducting an antidumping and anti-subsidy survey on PV products imported from the US.

The Chinese government has proposed a policy to support the polysilicon industry by encouraging mergers and acquisitions of companies without economies of scale and other competitive advantages. Therefore, it is expected that large Chinese solar companies will survive and receive support from Chinese Banks.

VALUATION

Using our valuation methodology based on price-to-sales due the character of SunSi's enterprise, we expect SunSi's stock to continue trading somewhat below the middle of our estimated valuation range of 1.1 and 3.2 times normalized sales. After factoring an increase of shares outstanding, a 1.65 price-to-sales valuation projects at price target of $2.25.

The appropriate valuation methodology for SunSi Energies is based on price-to-sales (P/S) due the character of SunSi's enterprise. The valuation process for small and mid-cap companies serving the alternative energy industry is based upon profiling the potential level of a specific company's profitability through gross margin analysis, and then applying that input to a price-to-sales valuation methodology. The gross margin indicates a company's structural cost advantage based on cost of goods sold. Analyzing a company's level of profitability is often the most important aspect of equity valuation analysis. When the overcapacity issue is resolved in the photovoltaic supply chain, SunSi's overall gross margin is expected to be approximately 22%, a blend of a 2% gross margin on Baokai's distribution revenue and 32% on Wendeng's production sales.

Price-to-sales valuation incorporates a company's ability to generate cash flow and increase revenues. Management's stated business plan is to focus on solar-grade trichlorosilane, a differentiated product in an industry with high barriers to entry. Management's plans to increase the sales base by acquisitions and capacity additions has been delayed by industry conditions. We expect SunSi's stock to trade somewhat below the middle of the expected valuation range, namely around $2.25 (a 1.65 price-to-sales ratio) until an increase in demand and/or a reduction of capacity propel polysilicon prices above $30 per kilogram.

PROJECTED INCOME STATEMENT

SunSi Energies, Inc.

Consolidated Statements of Operations and Retained Earnings

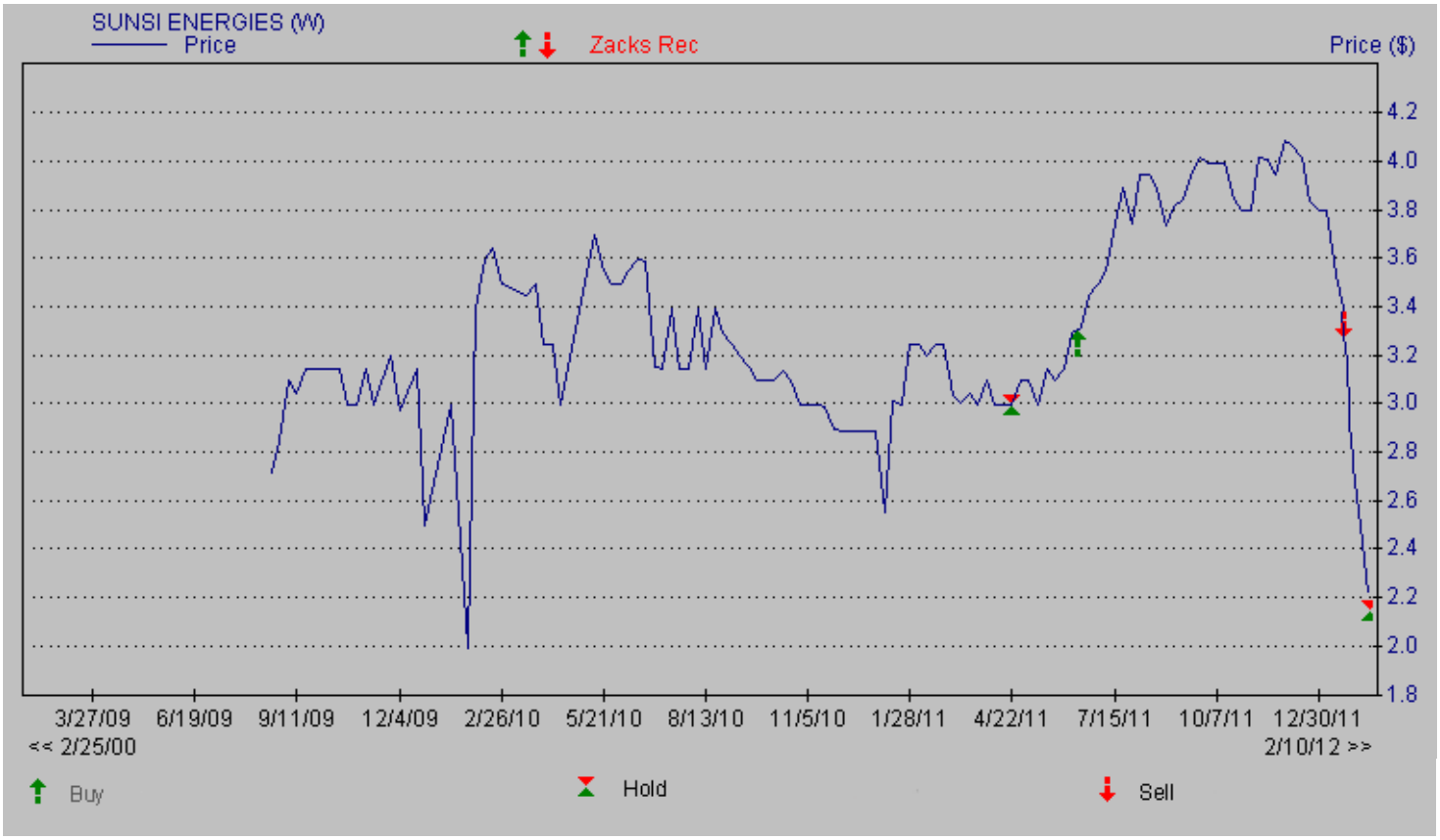
Annual Earnings Analysis

For the years ending May 31 (in $ US)	2008	2009	2010	2011	2012 E	2013 E
Revenue	**0**	**0**	**0**	**15,082,788**	**20,808,537**	**29,000,000**
Cost of sales	0	0	0	13,044,999	18,342,478	24,940,000
Gross Profit	**0**	**0**	**0**	**2,037,789**	**2,466,059**	**4,060,000**
Professional fees		124,435	545,049	618,992	673,886	687,364
General & administrative	24,937	45,420	76,586	1,315,137	3,769,307	3,400,000
Mining exploration	9,440	-	-	-	-	-
Total Expenses	**34,377**	**169,855**	**621,635**	**1,934,129**	**4,443,193**	**4,087,364**
Pre-tax profit from operations	**(34,377)**	**(169,855)**	**(621,635)**	**103,660**	**(1,977,134)**	**(27,364)**
Income (loss) before income taxes	(34,377)	(169,855)	(621,635)	103,660	(1,977,134)	(27,364)
Future income taxes	0	0	0	256,227	(377,793)	(100,000)
Net income (loss)	(34,377)	(169,855)	(621,635)	(152,567)	(1,599,340)	72,636
Net income attributable to noncontrolling	-	-	-	266,979	(193,096)	(6,020)
Net income (loss) attributable to SunSi	**(34,377)**	**(169,855)**	**(621,635)**	**(419,546)**	**(1,406,245)**	**78,656**
Net income per common share (diluted)	**(0.00)**	**(0.01)**	**(0.02)**	**(0.02)**	**(0.04)**	**0.00**
Weighted average common shares outstanding - diluted	26,760,000	26,760,000	26,972,486	27,675,252	31,306,003	33,500,000

Quarterly Earnings Analysis

	1Q (Aug) 2011	2Q (Nov) 2011	3Q (Feb) 2011	4Q (May) 2011	(May) **2011**	1Q (Aug) 2012	2Q (Nov) 2012	3Q E (Feb) 2012	4Q E (May) 2012	(May) **2012 E**
Revenue: Baokai			4,622,360	5,132,670	9,755,030	3,960,018	1,848,377	1,500,000	2,218,052	9,526,447
Revenue: Wendeng				5,327,758	5,327,758	6,306,773	1,716,053	1,200,000	2,059,264	11,282,090
Total revenues	**0**	**0**	**4,622,360**	**10,460,428**	**15,082,788**	**10,266,791**	**3,564,430**	**2,700,000**	**4,277,316**	**20,808,537**
Cost of sales: Baokai	0	0	4,528,392	5,009,669	9,538,061	3,901,763	1,811,524	1,470,000	2,173,691	9,356,978
Cost of sales: Wendeng	0	0		3,506,938	3,506,938	4,328,631	1,645,531	1,158,000	1,853,337	8,985,499
Cost of sales	0	0	4,528,392	8,516,607	13,044,999	8,230,394	3,457,055	2,628,000	4,027,029	18,342,478
Gross Profit	**0**	**0**	**93,968**	**1,943,821**	**2,037,789**	**2,036,397**	**107,375**	**72,000**	**250,287**	**2,466,059**
Professional fees	117,237	111,585	75,533	314,638	618,992	227,067	186,819	125,000	135,000	673,886
General & administrative	41,159	120,128	122,053	1,031,798	1,315,137	1,465,092	760,442	768,046	775,727	3,769,307
Mining exploration	-	-	-	-	-	-	-	-	-	-
Total Expenses	**158,396**	**231,713**	**197,585**	**1,346,435**	**1,934,129**	**1,692,159**	**947,261**	**893,046**	**910,727**	**4,443,193**
Pre-tax profit from operations	**(158,396)**	**(231,713)**	**(103,617)**	**597,386**	**103,660**	**344,238**	**(839,886)**	**(821,046)**	**(660,439)**	**(1,977,134)**
Income (loss) before income taxes	(158,396)	(231,713)	(103,617)	597,386	103,660	344,238	(839,886)	(821,046)	(660,439)	(1,977,134)
Future income taxes (benefit)			23,492	232,735	256,227	146,749	(154,171)	(205,262)	(165,110)	(377,793)
Net income (loss)	(158,396)	(231,713)	(127,109)	364,651	(152,567)	197,489	(685,715)	(615,785)	(495,330)	(1,599,340)
Net income attributable to noncontrolling			7,048	259,931	266,979	232,290	(146,721)	(102,599)	(176,065)	(193,096)
Net income (loss) attributable to SunSi	**(158,396)**	**(231,713)**	**(134,157)**	**104,720**	**(419,546)**	**(34,800)**	**(538,994)**	**(513,186)**	**(319,264)**	**(1,406,245)**
Net income per common share (diluted)	**(0.01)**	**(0.01)**	**(0.00)**	**0.00**	**(0.02)**	**(0.00)**	**(0.02)**	**(0.02)**	**(0.01)**	**(0.04)**
Weighted average common shares outstanding - diluted	27,428,995	27,483,665	27,681,750	28,965,266	27,675,252	29,665,127	29,969,628	32,769,628	32,819,628	31,306,003
Gross Margin	N/M	N/M	2.0%	18.6%	13.5%	19.8%	3.0%	2.7%	5.9%	11.9%
Gross margin: Baokai	N/M	N/M	2.0%	2.4%	2.2%	1.5%	2.0%	2.0%	2.0%	1.8%
Gross margin: Wendeng	N/M	N/M	N/M	34.2%	34.2%	31.4%	4.1%	3.5%	10.0%	20.4%

HISTORICAL ZACKS RECOMMENDATIONS



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