

Tianneng Power International Ltd

Take away from Corporate Presentation

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Industry: Lead-acid battery

Phillip Securities Research Pte Ltd

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Report type: Company Update

Rating: BUY

Closing Price: HK\$4.95 | Target Price HK\$6.33

Company Overview

Tianneng Power International Limited (Tianneng)'s lead-acid motive battery products are sold under its own brand name "TIANNENG" and are mainly used in electric bikes in China. Tianneng Power focuses on four major businesses, including motive battery for E-Bikes; motive battery for EV; new energy storage battery and eco-industrial park (battery recycling).

Take away from Corporate Presentation

On 4th October 2012, we are honored to invite Management from Tianneng for a corporate presentation regarding on the latest development of the Company. The following are the key take away from the presentation.

- Management stated that there are approximately 120 million units of electric bike nowadays in China and this figure may reach 300 million units by 2020.

- "Low-Speed Electric Vehicles will recreate the success of Electric Bike in China", stated by the Chairman Mr. Zhang Tianren in the FY12 interim result conference.

- Being the leader of lead-acid battery industry, Tianneng will comply with all measures of the 'Entry Requirements for Lead-acid Battery Industry'.

- The Company has no intention to fund the expansion via equity-financing as the current valuation of the Company is not reasonable.

Summary

The overall take away from the corporate presentation is positive. The Management further stated that on-the-run recycling plant would contribute an annual net income of CNY100 million and the next recycling plant will require less CAPEX as the Company gained experience from the first one (CAPEX: CNY 250 million). We believe that the growth story of low-speed electric vehicles is promising and Management's confidence in complying with the 'Entry Requirements for Lead-acid Battery Industry' has eased our concerns. However, the high debt levels of the company remains a major investment risk.

The share price of Tianneng is currently trading way below the historical P/E mean of 8.38x. We upgrade our leading FY2012 P/E forecast of Tianneng to 7.54x with EPS of CNY0.69. The current share price of HK\$4.95 implies a leading P/E of 5.9x and represents a 27.9% upside potential. We upgrade our 12-month target price of Tianneng to HK\$6.33 with a "BUY" rating.

Rating	1.00	Buy
- Previous Rating	3.00	Neutral
Target Price (HKD)	6.33	
- Previous Target Price (HKD)	5.11	
Closing Price (HKD)	4.95	
Expected Capital Gains (%)	27.9%	
Expected Dividend Yield (%)	5.1%	
Expected Total Return (%)	33.0%	
Raw Beta (Past 2yrs weekly data)	-	
Market Cap. (HKD mn)	702	
Enterprise Value (HKD mn)	914	
3M Average Daily T/O (mn)	2.6	
52 week range (HKD)	2.92 - 5.16	
Closing Price in 52 week range		



Major Shareholders	(%)
1 Mr. Zhang Tianren	36.6

Key Financial Summary				
FYE	12/10	12/11	12/12F	12/13F
Revenue (CNY mn)	3,753	5,438	8,151	10,980
Net Profit, adj. (CNY mn)	346	616	806	1,130
EPS, adj. (CNY)	0.32	0.57	0.69	0.97
P/E (X),adj.	12.7	7.2	5.9	4.2
BVPS (CNY)	1.81	2.29	2.72	3.32
P/B (X)	2.2	1.8	1.5	1.2
DPS (CNY)	0.10	0.17	0.21	0.29
Div. Yield (%)	2.4%	4.2%	5.1%	7.1%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Analyst
Phillip Research Team
+65 65311240
research@phillip.com.sg

Electric Bike Motive Battery – Boom Continues

From FY2006 to FY2011, revenue of electric bike motive battery from primary market increased from CNY 0.633 billion to CNY2.006 billion, representing a CAGR of 25.29%; while revenue from the primary market increased 27.3% y/y to CNY 1,217.4 million in 1H2012. Management stated that there are approximately 120 million units of electric bike nowadays in China and this figure may reach 300 million units by 2020. Although market remains skeptical on the future of electric bike motive battery, there is no sign of slowing down in the growth of electric bike motive battery yet. From our view, it is too optimistic to expect the same growth momentum over the next five years. However, we agree with the Management that there is still room for further boom of the primary market, but at a lower pace.

From FY2006 to FY2011, revenue of electric bike motive battery from secondary market increased from CNY 0.316 billion to CNY3.431 billion, representing a CAGR of 61.12%, while revenue from the secondary market increased by 79.9% y/y to CNY 2,323.6 million and accounted for 65.6% of total revenue from electric bike motive battery. As mentioned above, both the primary and secondary markets have yet to reach their full potential. We expect the secondary market to be the core growth driver for Tianneng over the next five years.

Low-Speed Electric Vehicles – The Missing Puzzle

In 1H12, the revenue from Energy Vehicle Motive Battery (EV Motive Battery) was approximately CNY196.4 million, soaring 76.0% y/y and accounted for approximately 5.1% of the Company's total turnover. “

“Low-Speed Electric Vehicles will recreate the success of Electric Bike in China”, stated by the Chairman Mr. Zhang Tianren in the FY12 interim result conference. When China declared in 2010 that it wanted to be the world's number one producer of electric vehicles by 2020, many assumed it meant passenger cars. The development of electric passenger cars is facing major obstacles of insufficient infrastructure and expensive production costs.

As reported, sales of low-speed electric vehicles have been booming in China's second and third tier cities. The vehicles which can reach a top speed of about 50 km per hour require less high-tech equipment and are priced lower between CNY 30,000 and CNY 50,000. According to industry statistics, 44,000 low-speed electric vehicles were produced in 1H12, representing a surge of 74.8 percent y/y. Thanks to the nature and low production costs of lead-acid battery (Approximately 25% of lithium battery), low-speed electric vehicles are able to recharge by using normal household electric plugs (Recharge Time: Approximately 8 hours) and priced at an affordable range for low-middle income group in China. Currently Shandong province is the heart of development for low-speed electric vehicles in China. Manufacturers such as Baoya and Shifeng have already launched a series of low-speed electric vehicles. Despite the bright prospect of low-speed electric vehicles,

this new industry is still facing regulatory measures that have not been resolved.

We believe that the growth story of low-speed electric vehicles will be the next investment theme of the lead-acid battery industry. The story has not been fully appreciated by the market, which explains the low stock price of Tianneng.

Fig 1. BY03 - Low-Speed Electric Vehicles from Baoya



Sources: <http://www.baoya-ev.com>

Fig 2. Parameter settings of BY03

Parameter settings	
L * W * H (no-load) (mm)	3520 * 1570 * 1480
Wheelbase (mm)	2345
Wheel tread (front / rear) (mm)	1330/1310
Vehicle curb weight (Kg)	1178
The maximum speed (km / h)	50
Gradeability (%)	≥ 20
Driving range (km)	150 -200
Minimum ground clearance (mm)	145
Charging time (h)	8
Battery type	Lead-Acid
Battery rated capacity (Ah)	210

Sources: <http://www.baoya-ev.com>

'Entry Requirements for Lead-acid Battery Industry'

Although the 'Entry Requirements for Lead-acid Battery Industry' provides Tianneng with great opportunities, it also comes with high costs. The Management explained that they understand the market concerns over the impact of the measures. Board members of the Company were members of the committee, which created the 'Entry Requirements for Lead-acid Battery Industry'. He further stated that being the leader of lead-acid battery industry, Tianneng will comply with all measures. The Company plans to upgrade its production facilities and ensure that all production lines will meet the requirements by the end of FY13. The current CAPEX budget has already included the costs associated with the upgrade. We view management's confidence as positive and believe it will partially mitigate the market concerns over the policy risks faced by Tianneng.

Debt-laden issue

In 1H2012, short-term debt of the Company soared 61.76% to CNY2.38 billion, interest expense surged 129.7% to CNY67.91 million. We are wary of the situation as the Company is currently funded by short-term debt, meaning the Company has to refinance or repay the debt within a year. Meanwhile, the estimated CAPEX for 2H2012 and FY2013 are CNY460 million and CNY800 million respectively. The Management explained that the Company has no intention to fund the expansion via equity-financing as the current valuation of the Company is not reasonable. In addition, the Company has a credit line of CNY one billion which could provide further short-term financing to the Company. However, the Management did not rule out the possibilities of debt financing such as bond issuance. We believe the rapid expansion of the Company will be vital for its future during the industry consolidation. We expect the debt level to increase further in FY12 and FY13 and remain high for a while. The contribution from new production capacity will help ease the debt problem, but we remain wary that the hike in interest expense will erode the profitability of the Company.

Conclusion and Valuation

The overall take away from the corporate is positive. Management further stated that on-the-run recycling plant would contribute an annual net income of approximately CNY100 million and the next recycling plant will require less CAPEX as the Company gained experience from the first one (CAPEX: CNY 250 million). We believe that the growth story of low-speed electric vehicles is promising and Management's confidence in complying with the 'Entry Requirements for Lead-acid Battery Industry' has eased our concerns. However, the high debt levels of the company remains a major investment risk.

Despite the robust growth of Electric Bike Motive Battery and the bright prospects of EV Motive Battery, market's limited appetite for risky asset and skepticism over the long-term future of lead-acid battery continued to weight on the valuation of the Company.

The share price of Tianneng is currently trading way below the historical P/E mean of 8.38x. We upgrade our leading FY2012 P/E forecast of Tianneng to 7.54x with EPS of CNY0.69. The current share price of HK\$4.95 implies a leading P/E of 5.9x and represents a 27.9% upside potential. We upgrade our 12-month target price of Tianneng to HK\$6.33 with a "BUY" rating.

Fig 3. P/E band of Tianneng and Hang Seng Index



Sources: Bloomberg, Company, PSR

	12/09	12/10	12/11	12/12F	12/13F
Valuation Ratios					
P/E (X), reported	16.2	12.7	7.2	5.9	4.2
P/E (X), adj.	16.2	12.7	7.2	5.9	4.2
P/B (X)	2.6	2.2	1.8	1.5	1.2
EV/EBITDA (X), adj.	2.0	1.5	0.8	0.6	0.4
Dividend Yield (%)	1.9%	2.4%	4.2%	5.1%	7.1%
Per share data (CNY)					
EPS, reported	0.25	0.32	0.57	0.69	0.97
EPS, adj.	0.25	0.32	0.57	0.69	0.97
DPS	0.08	0.10	0.17	0.21	0.29
BVPS	1.56	1.81	2.29	2.72	3.32
Growth & Margins (%)					
Growth					
Revenue	-12.8%	66.4%	44.9%	49.9%	34.7%
EBITDA	11.2%	35.1%	94.3%	25.6%	40.9%
EBIT	7.0%	36.7%	105.1%	30.5%	38.7%
Net Income, adj.	15.6%	27.9%	77.9%	30.8%	40.2%
Margins					
Gross profit margin	28.5%	23.2%	28.2%	25.5%	26.5%
EBITDA margin	16.6%	13.5%	18.1%	15.1%	15.8%
EBIT margin	14.3%	11.7%	16.6%	14.4%	14.9%
Net Profit Margin	12.0%	9.2%	11.3%	9.9%	10.3%
Key Ratios					
ROE (%)	18.5%	19.0%	27.6%	28.4%	32.0%
ROA (%)	13.8%	13.0%	15.7%	14.4%	15.9%
Net Debt/(Cash)	215.56	704.06	1,419.49	2,850.73	3,504.71
Net Gearing (X)	0.13	0.36	0.57	0.90	0.90
Receivable days	42	49	49	50	51
Payable days	76	62	59	60	62
Inventories days	106	90	91	93	95
Income Statement (CNY mn)					
	12/09	12/10	12/11	12/12F	12/13F
Revenue	2,254.9	3,752.8	5,438.3	8,151.4	10,979.7
COGs	(1,613.1)	(2,881.4)	(3,906.2)	(6,072.8)	(8,070.0)
Other revenue/(expenses)	38.2	16.7	28.2	42.3	56.9
Selling and marketing expenses	(197.1)	(224.7)	(261.9)	(397.2)	(541.2)
Administrative expenses	(43.6)	(45.5)	(118.1)	(200.7)	(306.4)
R&D expenses	(65.3)	(112.4)	(198.0)	(289.6)	(380.7)
EBITDA	374.0	505.5	982.4	1,233.4	1,738.2
Depreciation & Amortisation	(52.0)	(65.4)	(79.9)	(55.6)	(104.2)
EBIT	322.0	440.1	902.5	1,177.8	1,634.0
Net Finance (Expense)/Income	(2.4)	(11.4)	(72.8)	(103.2)	(127.2)
Other items	0.0	0.0	0.0	0.0	0.0
Associates & JVs	0.0	0.0	0.0	0.0	0.0
Profit Before Tax	319.7	428.8	829.7	1,074.6	1,506.8
Taxation	(49.0)	(82.5)	(213.7)	(268.7)	(376.7)
Profit After Tax	270.7	346.3	616.0	806.0	1,130.1
Minorities Interest	0.0	0.0	0.0	0.0	0.0
Other comprehensive income	0.0	0.0	0.0	0.0	0.0
Net Income, reported	270.7	346.3	616.0	806.0	1,130.1
Net Income, adj.	270.7	346.3	616.0	806.0	1,130.1
Dividend	83.7	105.7	183.8	241.8	339.0
Source: Company, PSR Est					

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Please contact Phillip Securities Research at [65 65311240] in respect of any matters arising from, or in connection with, this document.

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Contact Information (Singapore Research Team)

Chan Wai Chee
CEO, Research
Special Opportunities
+65 6531 1231
yebo@phillip.com.sg

Magdalene Choong, CFA
Investment Analyst
Gaming, US
+65 6531 1791
magdalenechoongss@phillip.com.sg

Ken Ang
Investment Analyst
Financials
+65 6531 1793
kenangwy@phillip.com.sg

Roy Chen
Macro Analyst
Global Macro, Asset Strategy
+65 6531 1535
roychencz@phillip.com.sg

Lee Kok Joo, CFA
Head of Research
S-Chips, Strategy
+65 6531 1685
leekj@phillip.com.sg

Go Choon Koay, Bryan
Investment Analyst
Property
+65 6531 1792
gock@phillip.com.sg

Travis Seah
Investment Analyst
REITS
+65 6531 1229
travisseahhk@phillip.com.sg

Nicholas Ong
Investment Analyst
Commodities
+65 6531 5440
nicholasonghg@phillip.com.sg

Joshua Tan
Macro Strategist
Global Macro, Asset Strategy
+65 6531 1249
joshuatan@phillip.com.sg

Derrick Heng
Investment Analyst
Transportation, Telecom.
+65 6531 1221
derrickhengch@phillip.com.sg

Ng Weiwen
Macro Analyst
Global Macro, Asset Strategy
+65 6531 1735
ngww@phillip.com.sg

Research Assistant
General Enquiries
+65 6531 1240 (Phone)
research@phillip.com.sg

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

Octa Phillip Securities Ltd
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (03) 9629 8288
Fax (03) 9629 8882
Website: www.octaphillip.com

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

Phillip Securities Japan, Ltd.
4-2 Nihonbashi Kabuto-cho Chuo-ku,
Tokyo 103-0026
Tel: (81-3) 3666-2101
Fax: (81-3) 3666-6090
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 550 Yan An East Road,
Ocean Tower Unit 2318,
Postal code 200001
Tel (86-21) 51699200
Fax (86-21) 63512940
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005