

Tianneng Power International Limited

Uncertainty ahead

Bloomberg | Reuters | POEMS
 819 HK | 819.HK | 819.HK
 Industry: Lead-acid battery

Phillip Securities Research

30 August 2012

Report type: Interim Update

Rating: Neutral

Closing Price: HK\$5.01 | Target Price HK\$5.11

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).

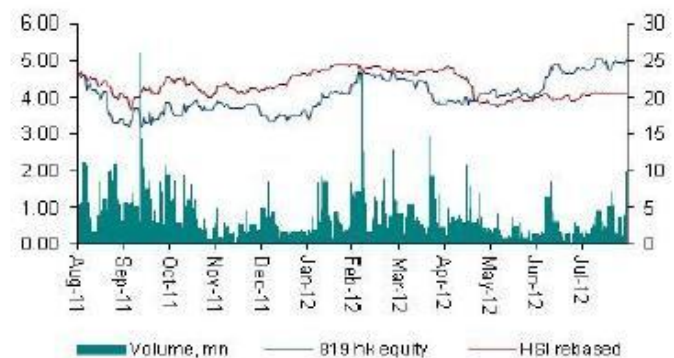
1H2012 interim results highlights

- Revenue soared 56.9% y/y to CNY 3,824.5 million.
- Gross profit margin stretched by 3.3% y/y from 22.5% to 25.8%.
- Net income surged 87.2% y/y to CNY 376.3 million.
- Basic EPS surged 85.95% y/y to CNY 34.4 cents.
- The lead recycling Zhejiang Wushan production base has started the trial production in 2Q2012. It has the annual capacities of 150,000 ton used battery collection and 100,000 ton recycled lead production respectively.

Summary

Due to the debt-laden issue and the potential impact of the 'Entry Requirements for Lead-acid Battery Industry', investment risk of Tianneng increased substantially. Beside, we are skeptical about the continuity of the current dividend policy, as Tianneng will suffer from severe capital pressure in 2H2012 and FY2013. We upgrade our leading FY2012 P/E forecast of Tianneng to 6.12x with EPS of CNY0.69. The current share price of HK\$5.01 implies a leading P/E of 6.0x and represents a 2.0 percent upside potential. We upgrade our 12-month target price of Tianneng to HK\$5.11 with a "Neutral" rating.

Rating	3.00	Neutral
- Previous Rating	2.00	Accumulate
Target Price (HKD)	5.11	
- Previous Target Price (HKD)	4.71	
Closing Price (HKD)	5.01	
Expected Capital Gains (%)	2.0%	
Expected Dividend Yield (%)	5.0%	
Expected Total Return (%)	7.0%	
Raw Beta (Past 2yrs weekly data)	-	
Market Cap. (HKD mn)	5,508	
Enterprise Value (HKD mn)	6,218	
Average Daily T/O (mn)	3.8	
52 week range (HKD)	2.71 - 5.16	



Major Shareholders	(%)
1. Zhang Tianren	37.0

Key Financial Summary

FYE	12/10	12/11	12/12F	12/13F
Revenue (CNY mn)	3,753	5,438	8,402	12,836
Net Profit, adj. (CNY mn)	346	616	763	1,217
EPS, adj. (CNY)	0.32	0.57	0.69	1.08
P/E (X), adj.	12.9	7.3	6.0	3.8
BVPS (CNY)	1.81	2.29	2.88	3.44
P/B (X)	2.3	1.8	1.4	1.2
DPS (CNY)	0.10	0.17	0.21	0.32
Div. Yield (%)	2.4%	4.1%	5.0%	7.9%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

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Consolidation of the Lead-acid Battery Industry

According to the announcement of Ministry of Environmental Protection, as at 31 July 2011, among the 1,930 lead battery enterprises being checked, over 50% of them were under suspension, self-checking or rectification while the other 30% were even banned. Meanwhile, Ministry of Industry and Information Technology and Ministry of Environmental Protection decided to implement 'Entry Requirements for Lead-acid Battery Industry' from 1 July 2012. It aims to speed up the rectification of the structure and development model of the lead-acid battery industry structure. The consolidation of the lead-acid battery industry will bolster the growth of Tianneng in three different ways.

i) An additional revenue boost. After year of development, there are approximately 1,930 lead-acid battery manufactures in China. The inter-sector competition is fierce. The closure of lead-acid battery manufactures and the increase of entry barrier will free up additional sales opportunities to market leaders. From the FY2012 interim results, revenue of electric bike motive battery from the primary market increased 27.3% y/y to CNY 1,217.4 million; while the revenue from secondary market soared 79.9% y/y to CNY 2,323.6 million. The management expects that as the consolidation of the lead-acid battery industry continue, Tianneng will be able to maintain it's robust growth momentum in coming two to three years.

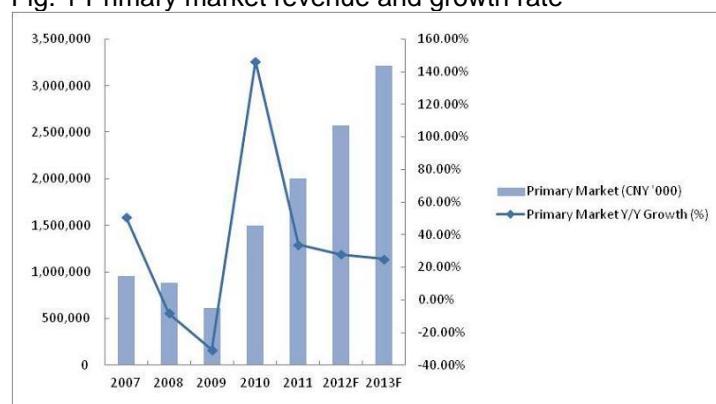
ii) Improvement in gross profit margin. In 1H2012, gross profit margin stretched by 3.3% y/y from 22.5% to 25.8%. As industry participants reduced, market leaders enjoy a stretch in profit margin as their pricing power increased. Meanwhile, the increase in entry barrier and regulation increased the operating costs and small-scale manufactures will be affected most. The management stated that there was room for further gross profit margin hike. However, Tianneng lowered it gross profit margin in order to force out small-scale players and increase it's market shares.

iii) M&A opportunities. Tianneng completed the acquisition of 100% interest in a battery company, Zhejiang Huayi Power Supply Co., Ltd., in May 2012 for a consideration of CNY 60.78 million for the purpose of expansion of production capacity. In addition, Tianneng is currently undergoing another acquisition, acquiring 70% of the registered capital of the Target Company at a consideration of CNY15.5 million in cash and contributing another CNY 31.5 million to expand the registered capital. The change in industrial landscape has already damaged the viability of small-scale manufactures and lower the M&A costs. We expect more M&A activities from Tianneng in coming two to three years, spurring the inorganic growth of the Company.

Primary Market of Electric Bike Motive Battery

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. Due to intensifying competition and saturating of the primary market, we expected the growth rate of the primary market would shrink. However, thanks to the industry consolidation of lead-aid battery starting in 2011, we expected Tianneng to expand its market shares from FY2012 – FY2014 and further boost its revenue from the primary market. Supported by the expansion of production capacity, we expected the Company will be able to maintain it's current growth momentum from FY2012 to FY2013.

Fig. 1 Primary market revenue and growth rate

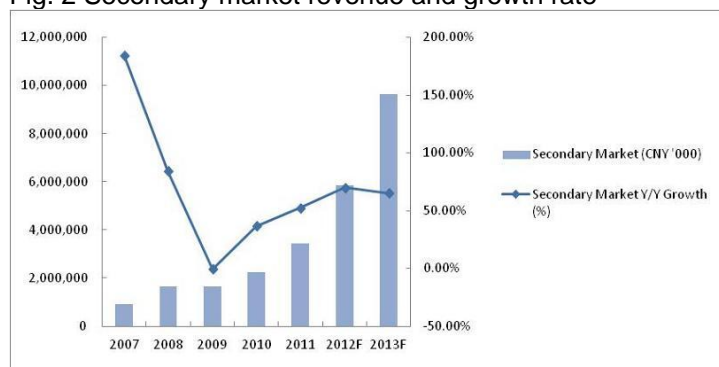


Source: Company, PSR Est

Secondary Market of Electric Bike Motive Battery

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 soared 79.9% y/y to CNY 2,323.6 million. In 1H2012. After years of robust growth of electric bike sales in China, we expected the replacement of motive battery would come to a peak, as the lifespan of a motive battery is about 2 years and the aggregate demand for battery replacement is going to be unleashed. Together with the industry consolidation of lead-aid battery starting in FY2011, we expected the growth momentum of the secondary market would remain robust from FY2012 to FY2013 and raised the growth forecast from our pervious coverage.

Fig. 2 Secondary market revenue and growth rate



Source: Company, PSR Est

Used battery recycling plant

The lead recycling Zhejiang Wushan production base has started the trial production in the second quarter of 2012. It has the annual capacities of 150,000 ton used battery collection and 100,000 ton recycled lead production respectively. Calculated with the average lead price of about CNY15,556 per metric ton in 1H2012 and an estimated net profit margin of 7% to 9%, the potential 2H2012 net income from the recycling business will be approximately CNY 68.45 million, accounting 18.19% of 1H2012 revenue.

Gross Profit Margin and Expenses

In 1H2012, gross profit margin of the Company stretched by 3.3% y/y from 22.5% to 25.8%. However, the gross profit margin actually dipped 2.4% from 28.2% to 25.8% comparing with the FY2011 results. Management stated that the drop in gross profit margin aimed to force out small-scale players and increase its market shares. We believe the Company will be able to maintain its gross profit margin level for FY2012 – FY2013.

We are also wary about the hike in selling and distribution costs and administrative expenses. In 1H2012, selling and distribution costs soared 119.9% y/y; administrative expenses surged 81.36% y/y; while revenue only 56.9% y/y. Management stated that the hike in operating expense stemmed from those under construction plants that has yet made a profit but already incurred expenses. We expect the change in costs structure will persist during the rapid expansion phase of the Company.

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; and the Company needs another CNY47 million to fund the proposed acquisition. Any further acquisitions will fuel the funding pressure of the Company. Although Management stated that the Company has already

acquired enough credit line for the 2H2012 CAPEX, we believe that debt refinancing in FY2013 is inevitable.

Impact of the '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 heavy costs. According to the requirements, production lines of lead-acid battery and its leaded components with a cadmium content exceeding 0.002% should cease operation by 31 Dec, 2013. We understand that there is merely 15% of the entire production capacity in China meets the above-mentioned requirement; while the most of the production capacity comes from the Company's major competitor. At this stage we are not able to quantify the potential impact of this requirements to Tianneng, but we believe the impact will be material.

Conclusion and Valuation

Due to the debt-laden issue and the potential impact of the 'Entry Requirements for Lead-acid Battery Industry', investment risk of Tianneng increased substantially. Beside, we are skeptical about the continuity of the current dividend policy, as Tianneng will suffer from severe capital pressure in 2H2012 and FY2013. We upgrade our leading FY2012 P/E forecast of Tianneng to 6.12x with EPS of CNY0.69. The current share price of HK\$5.01 implies a leading P/E of 6.0x and represents a 2.0 percent upside potential. We upgrade our 12-month target price of Tianneng to HK\$5.11 with a "Neutral" rating.

	12/10	12/11	12/12F	12/13F
Valuation Ratios				
P/E (X), reported	12.9	7.3	6.0	3.8
P/E (X), adj.	12.9	7.3	6.0	3.8
P/B (X)	2.3	1.8	1.4	1.2
EV/EBITDA (X), adj.	10.1	5.2	3.9	2.6
Dividend Yield (%)	2.4%	4.1%	5.0%	7.9%
Per share data (CNY)				
EPS, reported	0.32	0.57	0.69	1.08
EPS, adj.	0.32	0.57	0.69	1.08
DPS	0.10	0.17	0.21	0.32
BVPS	1.81	2.29	2.88	3.44
Growth & Margins (%)				
Growth				
Revenue	66.4%	44.9%	54.5%	52.8%
EBITDA	35.1%	94.3%	33.2%	51.5%
EBIT	36.7%	105.1%	28.1%	54.1%
Net Income, adj.	27.9%	77.9%	23.9%	59.4%
Margins				
Gross profit margin	23.2%	28.2%	26.3%	26.1%
EBITDA margin	13.5%	18.1%	15.6%	15.4%
EBIT margin	11.7%	16.6%	13.8%	13.9%
Net Profit Margin	9.2%	11.3%	9.1%	9.5%
Key Ratios				
ROE (%)	19.0%	27.6%	26.8%	34.4%
ROA (%)	13.0%	15.7%	12.6%	14.7%
Net Debt/(Cash)	704.06	1,419.49	2,860.18	4,608.84
Net Gearing (X)	0.36	0.57	0.90	1.19
Income Statement (CNY mn)				
	12/10	12/11	12/12F	12/13F
Revenue	3,752.8	5,438.3	8,402.3	12,836.4
COGs	(2,881.4)	(3,906.2)	(6,191.3)	(9,490.4)
Other revenue/(expenses)	16.7	28.2	87.1	66.6
Selling and marketing expenses	(224.7)	(261.9)	(453.7)	(693.2)
Administrative expenses	(45.5)	(118.1)	(298.3)	(455.7)
R&D expenses	(112.4)	(198.0)	(237.4)	(281.4)
EBITDA	505.5	982.4	1,308.8	1,982.3
Depreciation & Amortisation	(65.4)	(79.9)	(152.7)	(201.2)
EBIT	440.1	902.5	1,156.1	1,781.1
Net Finance (Expense)/Income	(11.4)	(72.8)	(137.9)	(157.9)
Other items	0.0	0.0	0.0	0.0
Associates & JVs	0.0	0.0	(0.3)	(0.4)
Profit Before Tax	428.8	829.7	1,017.8	1,622.8
Taxation	(82.5)	(213.7)	(254.5)	(405.7)
Profit After Tax	346.3	616.0	763.4	1,217.1
Minorities Interest	0.0	0.0	0.0	0.0
Other comprehensive income	0.0	0.0	0.0	0.0
Net Income, reported	346.3	616.0	763.4	1,217.1
Net Income, adj.	346.3	616.0	763.4	1,217.1
Dividend	105.7	183.8	229.0	365.1
Source: Company, PSR Est				

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