

# Tianneng (819.HK)

The Recycling business is expected to become a new profit growth point

Hong Kong | Automobile parts | Update Report

27 JUNE 2018

## Investment Summary

Tianneng Power is a leading enterprise in China's lead-acid power battery industry. We believe that the Company's lead-acid battery business will continue to maintain its stable growth characteristics and become the Company's "cash cow" business. Its recycle business revenue CAGR growth in future is expected to reach 50%. The company is the leader in the field of lead-acid batteries and has a sound financial position. Its new business forward plan is clear and pragmatic. We believe that a certain valuation premium should be given. We expect the company's EPS for 2018/2019 to reach 1.196/1.451 yuan and the target price of HK\$14.7, corresponding to 2018/2019 10/8.2x P/E. (Closing price as at 25 June 2018)

## Company Profile

Tianneng Power is a leading enterprise in China's lead-acid power battery industry. Founded in 1986, the Company entered the lead-acid power battery field for electric bicycles and launched the "Tianneng" brand in 1998. In 2004, it began to engage in the R&D and production of lithium batteries. After over three decades of development, the Company has become a new energy high-tech enterprise that integrates electric vehicle power battery, wind energy solar energy storage battery, and battery recycling and other businesses, establishes its mature sales channel, and steadily increases its market share. Its market share of lead-acid battery industry is 42%, and the total market share of lead-acid power battery industry of the Company and Chaowei Battery exceeds 80%, forming an industry duopoly pattern.

The Company owns eight production bases in four provinces in China, which are located in (1) Changxing Headquarters, (2) Meishan and (3) Heping in Changxing County of Zhejiang Province, (4) Shuyang County of Jiangsu Province, (5) Wuhu City and (6) Jiashou City of Anhui Province, (7) Puyang City and (8) Jiyuan City of Henan Province, respectively. The Company now has 300 thousand terminal stores and 3000 dealers.

The Company's existing business is divided into five categories, namely 1) electric bicycle lead power battery, 2) special purpose lead power battery, 3) new energy lithium battery, 4) recycling of waste batteries, and 5) smart energy. In terms of revenue, the first two categories are the Company's traditional businesses, which account for about 89% of revenue. The latter three are emerging sectors, which represent a rapid growth although occupying a relatively smaller share.

## BUY

CMP HKD: 12.18  
(Closing price as at 25 June 2018)  
TARGET HKD: 14.7 (+21%)

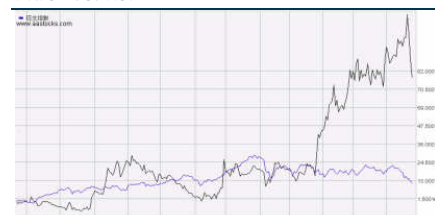
### COMPANY DATA

O/S SHARES (MN) :	1127
MARKET CAP (HKD MN) :	13721
52 - WK HI/LO (HKD):	14.34/5.98

### SHARE HOLDING PATTERN, %

Prime Leader Global Limited	36.42
Morgan stanley	4.98
Blackrock Inc	4.97

### PRICE VS. HSI



Source: Phillip Securities (HK) Research

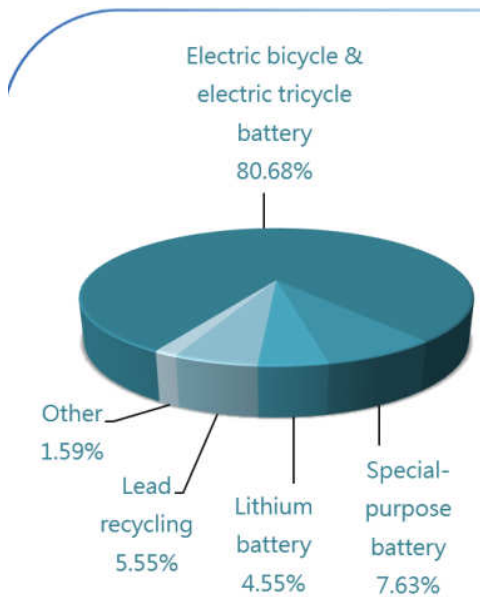
### KEY FINANCIALS

CNY mn	FY16	FY17	FY18E	FY19E
Net Sales	21511	26939	31340	34150
Net Profit	858	1179	1348	1635
EPS, CNY	0.76	1.05	1.20	1.45
P/E, x	14.3	9.7	8.2	6.8
BVPS, CNY	3.49	4.33	5.10	6.40
P/BV, x	3.1	2.3	1.9	1.5
DPS (HKD)	0.23	0.31	0.36	0.45
Div. Yield (%)	2.1%	3.1%	3.6%	4.6%

Source: Company reports, Phillip Securities Est.

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### Revenue Breakdown

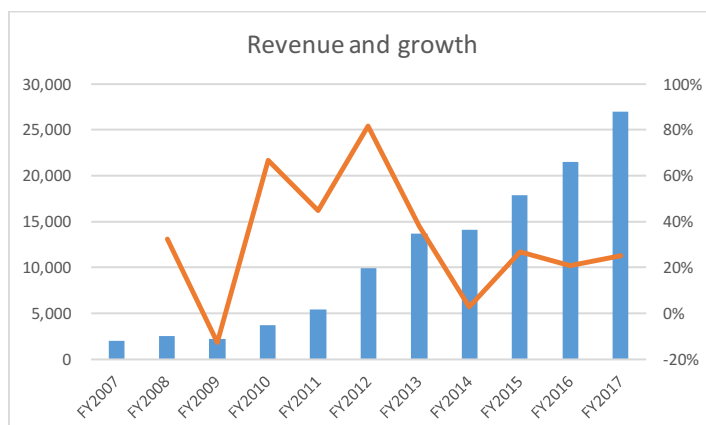


Source: Phillip Securities Hong Kong Research

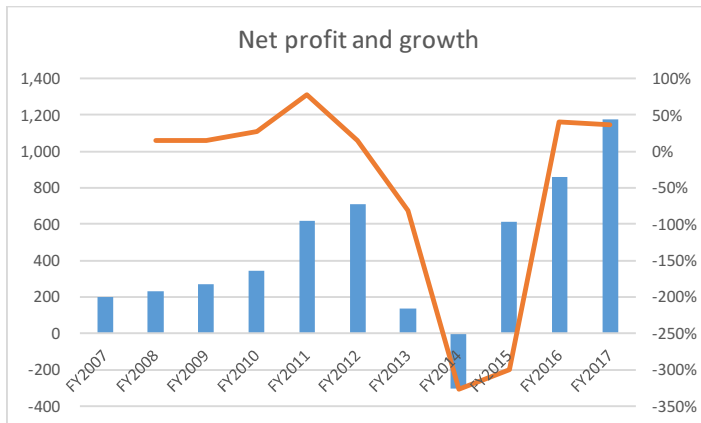
### Financial overview

Electric bicycles have been rapidly popularized in China due to their convenience, practicality, and economy. The output has grown rapidly from 300,000 electric bicycles in 2000 to 36.95 million electric bicycles in 2013. The compound annual growth rate was up to 50%. Afterwards, the output declines, but it still maintains at an annual yield of 30 million electric bicycles. Lead-acid batteries account for about 95% of the market share of electric bicycle power batteries.

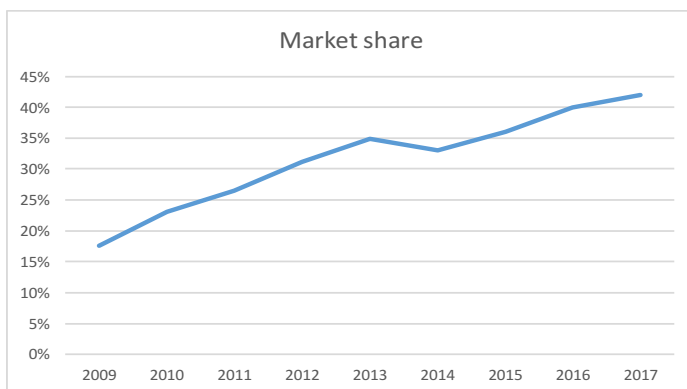
Benefited from high industrial growth, since the Company's listing in 2007, its operating revenue has reported a compound annual growth rate of 30%, and its net profit has reported a compound annual growth rate of 19.2%. There has been a decline in result only due to the government's efforts to strengthen environmental protection supervision and industry price war in 2013-2014. Due to fluctuations in lead prices and the price competition strategies of the Company, the Company's gross margin has gradually decreased from 20-30% a decade ago to 10-14%, but its market share has increased from 23% in 2010 to 42% currently.



Source: Wind, Phillip Securities Hong Kong Research



Source: Wind, Phillip Securities Hong Kong Research



Source: Phillip Securities Hong Kong Research

In 2017, the Company’s revenue reached RMB26.9 billion, up 25.2% yoy; the net profit attributable to shareholders was RMB1.178 billion, up 37.3% yoy; the diluted earnings per share were RMB1.02, and the final dividend per share was HKD0.37 with a payout ratio of 30%. The gross margin was approximately 13.04%, down 0.8% yoy, which was mainly because the price of lead (which is the main raw material for lead batteries) has increased and the utilization rate of lithium battery business was still climbing. However, the Company’s expenses are properly controlled, and the operating expense ratio decreases by approximately 0.4 pts to 4.75%. The net profit rate increases by 0.17 pts to 4.38%, the ROE increases by 3.3 pts to 26.75%, and the result is better than its peers.

The sales revenue of new energy lithium battery was approximately RMB1.223 billion, up 98.68% yoy; the sales revenue of special-purpose battery sales revenue was approximately RMB2.054 billion, up 5.10% yoy; the sales revenue of lead-acid power batteries for electric bicycles and electric tricycles was approximately RMB21.707 billion, up 26.83% yoy.

**Lead-acid part will remain steady, with its "cash cow" nature is not changed**

We believe that the Company’s lead-acid battery business will continue to maintain its stable growth characteristics and become the Company’s “cash cow” business, based on the following perspectives:

1) The economic development between China’s urban and rural areas is extremely uneven. Electric bicycles/tricycles have a vast market in terms of travel and logistics. Even if the growth rate drops, there is still a huge replace demand market. The cost-effectiveness of lead-acid batteries is enough to protect its dominant position in the mid-to-short term. At present, the proportion of new market and replace market is

about 2:8. One bicycle/tricycle needs 3-5 batteries while the battery life is about 1.5-2.5 years. According to Ipsos Business Consultancy Forecast, by 2025, the demand for electric tricycle batteries will reach RMB60 billion.

2) In recent years, the Chinese government has continued to increase its efforts to rectify environmental protection and increase supervision of the lead-acid battery industry. The price war has also led to the elimination of many small-scale lead-acid battery manufacturers. The industry concentration has continued to increase, and the possibility and necessity of price war have greatly reduced and it is expected that the battery price will maintain a relatively stable range.

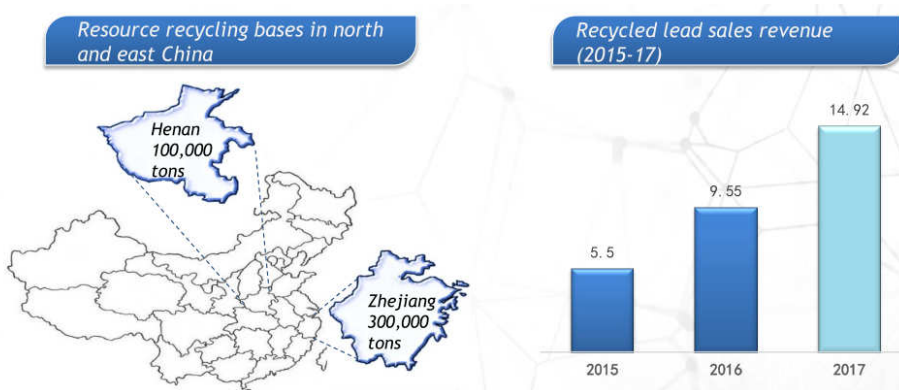
3) The Company is actively developing new lead battery utilization markets, including four-wheel low-speed electric vehicles. The tubular batteries for electric forklifts, the starter batteries for conventional automobiles, and the energy storage battery systems for wind energy solar energy are newly added. Specifically, we believe that the market potential of mini low-speed electric car is huge, and still in rapid development. The large lead-acid batteries part is worth looking forward to.

**The Recycling business is expected to become a new profit growth point**

The Company previously announced that its business focus in the next 3-5 years will be tilted toward emerging businesses such as low-speed electric vehicle lead-acid batteries, new energy lithium batteries, and battery recycling. The 3Gwh power lithium battery and 15GVAh lead-acid power battery project invested by the Company have partly been put into use.

“Client first” will be the emphasis of the Company’s lithium business. The Company’s NEV customers include Chery, Conti, Lifan, FAW, Zhongtai, Niudian, Yadea, and shared e-bicycle companies ; Tianneng’s lithium battery products have excellent performance and pipeline advantages. In the future, they will fully benefit from the increase in the penetration rate of lithium batteries. Among the mini low-speed car customers, Yujie, Shifeng, Tangjun and several other mainstream companies all use Tianneng’s products.

For recycle business, the Company has two major waste battery recovery bases in Zhejiang and Henan, with an annual processing capacity of 400,000 tons and a lead recovery rate of 99%. It is the largest harmless recycling waste battery company in China and can produce 25-28 million tons of recycled lead. Since the lead entry threshold for lead recycling industry is extremely stringent, with the growth of scrap-acid batteries, this business revenue CAGR growth in future is expected to reach 50%.



Source: Phillip Securities Hong Kong Research

## Investment Thesis

The Company's Balance sheet is strong, holding net cash as high as 3.27 billion, and the gearing ratio is only 16%. The company is the leader in the field of lead-acid batteries and has a sound financial position. Its new business forward plan is clear and pragmatic. We believe that a certain valuation premium should be given. We expect the company's EPS for 2018/2019 to reach 1.196/1.451 yuan and the target price of HK\$14.7, corresponding to 2018/2019 10/8.2x P/E.

### Forward P/E,P/B



Source: Bloomberg, Phillip Securities Hong Kong Research

## Financials

FYE DEC	FY14	FY15	FY16	FY17	FY18F	FY19F
<b>Valuation Ratios</b>						
P/E (X), adj.	(35.0)	18.7	14.3	9.7	8.2	6.8
P/B (X)	4.0	3.4	3.1	2.3	1.9	1.5
Dividend Yield (%)	0.0%	2.6%	2.1%	3.1%	3.6%	4.6%
<b>Per share data (RMB)</b>						
EPS, (Basic)	-0.27	0.54	0.76	1.05	1.20	1.45
EPS, (Diluted)	-0.27	0.53	0.74	1.02	1.17	1.43
DPS	0.00	0.27	0.23	0.31	0.36	0.45
BVPS	2.40	2.96	3.49	4.33	5.10	6.40
<b>Growth &amp; Margins (%)</b>						
<b>Growth</b>						
Revenue	12.4%	5.0%	20.7%	25.2%	16.3%	9.0%
EBIT	11.2%	12.1%	43.5%	20.1%	13.3%	21.0%
Net Income, adj.	15.8%	17.4%	40.4%	37.4%	14.3%	21.4%
<b>Margins</b>						
Gross margin	9.0%	13.6%	13.8%	13.0%	13.4%	13.9%
EBIT margin	-1.5%	4.9%	5.8%	5.6%	5.4%	6.0%
Net Profit Margin	-2.2%	3.4%	4.0%	4.4%	4.3%	4.8%
<b>Key Ratios</b>						
ROE	-10.8%	20.3%	23.5%	26.7%	25.4%	25.2%
<b>Income Statement (RMB mn)</b>						
<b>Revenue</b>	<b>14058</b>	<b>17825</b>	<b>21511</b>	<b>26939</b>	<b>31340</b>	<b>34150</b>
<b>Gross profit</b>	<b>1264</b>	<b>2428</b>	<b>2975</b>	<b>3507</b>	<b>4194</b>	<b>4741</b>
EBIT	-214	869	1247	1498	1697	2052
Profit before tax	-407	746	1145	1408	1616	1970
<b>Tax</b>	<b>-114</b>	<b>118</b>	<b>240</b>	<b>227</b>	<b>265</b>	<b>329</b>
Profit for the period	-293	628	905	1181	1351	1641
Minority interests	12	17	47	2	3	6
Total capital share	1112	1122	1134	1127	1127	1127
<b>Net profit</b>	<b>-305</b>	<b>611</b>	<b>858</b>	<b>1179</b>	<b>1348</b>	<b>1635</b>

Source: PSR

(Financial figures as at 25 June 2018)

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Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm$ 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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