農銀國際
ABC INTERNATIONAL
ABCI SECURITIES COMPANY LIMITED

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Equity Focus

Lead-acid Battery Sector

Profit warning

We have talked to Tianneng management after Tianneng and Chaowei, market leaders of the lead-acid batteries industry, issued profit warning last week. Since the ASP recovery trend in 1Q2013 is not sustainable, we lower Tianneng EPS by 40% to Rmb0.4275 and downgrade Tianneng to Hold. We currently put Chaowei under review.

Market leaders announced profit warning: Chaowei and Tianneng announced profit warning for their 1H2013 results. They indicated that the significant decline in net profit was attributed to falling ASP which resulted from intense competition since 4Q2012. Although GP margin of Tianneng/ Chaowei rebounded to 14.7%/17.1% in 1Q2013 from historical low of 6.8%/4.0% in 4Q2012, we do not expect the upward trend to continue as both Tianneng and Chaowei are still increasing their capacity in 2013 while the continue decline in lead price provides more room for further ASP cut.

Over-supply: Chaowei and Tianneng accounted for a total of 55% market share in terms of sales revenue in 2012. Despite falling ASP, Tianneng/ Chaowei planned to increase production capacity by 20%/30%YoY to 106/120mn units in 2013. According to Tianneng management, utilization rate of the group was over 90% in 1H2013. And in addition to the 20% increase in capacity, they will continue to produce part of their batteries through OEM and we estimate that it will account for 18% of their total sales volume in 2013. In our view, the continued capacity expansion by the two largest players in the market will continue to put a pressure on ASP.

Net profit margin of both Chaowei and Tianneng were as low as 4.0%and 3.4% respectively in 1Q2013 as compared to 5.2%7.2% in 2012 and management indicated a number of smaller players were making loss. Hence, we previously assumed small inefficient players would have been forced out of the market given the historical low level of profit margin and ASP may stabilize. However, the recent decline in lead price provides room for further ASP cut, which will continue to have a negative impact on topline growth and will lead to a longer period of industry consolidation. Lead price, which accounted for over 65% of production cost, dropped 3.4% in 2Q2013 or 5.8% YTD.

Management misjudgment: We see the price war between the two major players as the result of management's over-estimation of market demand for their products. Their misjudgments has led to aggressive expansion of their production capacities. Chaowei publicly announced to expand production plant in Jiangsu on Jun 11 but unveiled profit warning on Jun 13. We doubt on the corporate governance of the group why it approved production expansion given that intense market competition has hurt its earnings. Intense market competition is a signal of supply significantly outstripping demand. Bankers may not renew and reduce credit facilities granted to them later this year in view of their poor half-year results. Credit risks of both Tianneng and Chaowei are expected to climb and risk premium on their stocks will inevitably increase subsequently.

Key Data

Average FY13E PE (x)	4.57
Average FY13E PB (x)	0.63

Source: Bloomberg, ABCI Securities

Net income in FY2012 (Rmb mn)

Tianneng (819)	709.4
Chaowei (951)	619.9
Leoch (842)	71.6
Coslight Tech (1043)	-32.3
Scud Group (1399)	-192.6

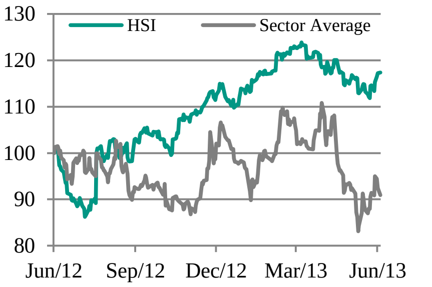
Source: Company

Average share performance (%)

	Absolute	Relative*
1-mth	(19.6)	(8.1)
3-mth	(18.8)	(5.8)
6-mth	(21.1)	(5.7)

**Relative to Hang Seng Index*
Source: Bloomberg

1 year price performance



Source: Bloomberg

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Valuation: Due to a longer period of industry consolidation, we lower Tianneng 2013 ASP by 4% and we revised our est 2013 EPS by 40% to Rmb0.4275. Based on 2013 PE valuation of 7x, we lower our TP from HK$6.22 to HK$3.75. We currently put Chaowei under review as we are still pending for their updates.

The rechargeable battery sector underperformed the market in 1, 3 & 6 mths. Market was bearish on the sector. The profit warnings of Tianneng and Chaowei re-affirm market bearish view. Moreover, Tianneng and Chaowei may cut down their upcoming interim or annual dividends. Yield investors will disappoint. Among renewable energy sector, including rechargeable battery industry, solar industry, wind industry and hydropower industry, funds may stay with the latter two as their business outlooks look better than the former two in the short to medium terms.

Summary on selected companies in the sector

Company	Ticker	Price	Ratings	TP	12 PE	13 PE	PB	Divi yld
		HK$		HK$	x	x	x	%
Tianneng	819	3.38	Hold	3.75	4.3	6.4	0.96	4.80
Chaowei	951	2.92	Review	-	4.7	4.1	1.07	5.08
Leoch	842	0.89	-	-	14.0	3.2	0.40	1.64
Coslight	1043	2.19	-	-	-	-	0.42	0.00
Scud Group	1399	0.38	-	-	-	-	0.28	0.00

Source: Bloomberg, ABCI Securities

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Definition of equity rating

Rating	Definition
Buy	Stock return ≥ Market return rate
Hold	Market return – 6% ≤ Stock return < Market return rate
Sell	Stock return < Market return – 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months
Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	2.6 ≤180 day volatility/180 day benchmark index volatility
High	1.5 ≤ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	1.0 ≤180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.
Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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