



Chaowei Power Holdings Limited

Share Data

|                       |           |
|-----------------------|-----------|
| Price (06/10/2011)    | HK\$3.27  |
| 52 wk high/low (HK\$) | 5.02/2.16 |
| Stock code            | 951       |
| Issued shares (mn)    | 1,005.29  |
| Market cap (HK\$ mn)  | 3,287.30  |
| Free-float            | 36.39%    |
| 30-day avg vol (mn)   | 0.26      |
| Auditors              | Deloitte  |

Major shareholders:

|                   |        |
|-------------------|--------|
| Zhou Ming Ming*   | 41.48% |
| Hony Capital Fund | 14.92% |
| Zhou Longrui#     | 7.20%  |

\* Chairman of Co., Executive Director of Co.



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Chaowei Power (951) - BUY

The lead-acid battery industry caught our attention due to their relatively high ROAA of 12-13%, compared with 8-12% of solar companies and 2-8% of wind power companies. We had a meeting with CFO of Chaowei Power Holdings Limited ("Chaowei"), a market leader of China lead-acid battery industry, and noted that with falling lead price and upward revision of ASP in the Q3 2011, GP margin of Chaowei fetched to 40% in Sep. We recommend BUY the stocks with the following reasons.

Investment Themes

- Chaowei sets to gain market share during industry consolidation.
- Government policies lift up entry barrier and trigger industry consolidation.
- Gross profit margin in 2H FY2011 will widen due to increase in ASP and decline in lead cost.
- Favorable industry policies as catalysts to expand primary market demand for lead-acid battery in the electric bikes (e-bikes) market.
- Replacement demand for lead-acid battery keeps rising in the secondary market.
- We predict FY2011 EPS to be Rmb0.4574/share, up 47.6% YoY. The counter is trading at est. FY2011 PER of 5.86x and P/B of 1.59x with expected FY2011 ROAA of 34% and ROAE of 54%.
- We set 1-year target price at HK\$4.78, representing FY2012 PER of 10x. BUY.

Results & Forecasts

| FY ended Dec 31     | 2009    | 2010    | 2011E   | 2012E   |
|---------------------|---------|---------|---------|---------|
| Revenue (Rmb mn)    | 2,433.9 | 3,224.8 | 4,912.2 | 5,763.6 |
| Chg (%YoY)          | 5.05%   | 32.49%  | 52.33%  | 17.33%  |
| Net profit (Rmb mn) | 201.9   | 268.2   | 459.8   | 394.4   |
| Chg (%YoY)          | 57.61%  | 32.83%  | 71.44%  | -14.22% |
| Basic EPS (Rmb)     | 0.2700  | 0.3100  | 0.4574  | 0.3923  |
| Chg (%YoY)          | 58.82%  | 14.81%  | 47.54%  | -14.22% |
| PER (x)             | -       | 8.65    | 5.86    | 6.83    |
| DPS (Rmb)           | -       | 0.080   | 0.137   | 0.118   |
| Yield               | -       | 2.98%   | 5.12%   | 4.39%   |
| NBV (Rmb/share)     | 0.9069  | 1.3662  | 1.6864  | 1.9610  |
| P/B (x)             | -       | 1.96    | 1.59    | 1.37    |

@Rmb0.8200/HK\$

Source: ABCI Securities estimates; Company reports

Report date: 6 Oct, 2011

Analyst:

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## Highlights

- **Set to gain market share during industry consolidation:** A total of 1,930 of lead-acid battery production, assembly and recycling plants had been inspected as of the end of Jul, as part of the nationwide investigation into the lead-acid battery industry, which was jointly initiated by nine government departments, including the National Development and Reform Commission and the Ministry of Environmental Protection (MEP), in Mar 2011. Of the 1,930 plants inspected, 583 are forced to close down because of failing to meet the required environmental standards, 1015 of plants were suspended while 252 were given permission to continue operation. Those closed down and suspended factories accounted for 30-40% of total production capacity in the lead-acid batteries industry.

As a result, there has been a shortage of supply in lead-acid motive batteries since beginning of this year. Chaowei, a market leader in the lead-acid motive batteries for e-bikes, which are excluded from the inspection list, benefit the most from the current situation. In 2010, Chaowei and Tianeng (819) are the largest producers of motive lead-acid batteries for e-bikes, each accounted for 20% of the market shares in the industry, while the third largest producer, Chisen, accounted for 8.4% of total market shares.

According to Tianeng announcement, 3 of its plants which accounted for 54% of its production capacity in 2010 has been suspended but has all resumed production in Aug. Meanwhile, it is estimated 50% of Chisen production capacity has been suspended. With its efforts in maintaining a high environmental standards, Chaowei, is in a very good position to expand its market share given current market condition.

- **Rising ASP, falling lead cost, widening GP margin:** Due to a shortage in supply, ASP of Chaowei's lead acid motive batteries increased 13% YoY in 1H2011 and ASP were revised upwards in beginning of Jul by 8-10% and another 8-10% in mid-Aug to ~Rmb120/unit. The price rises in Jul and Aug this year is the very first time adjusted not in accordance to the movement in lead price, which accounted for over 70% of total cost of sales. As a result, we expect GP margin of Chaowei will shoot up to 33.4% in 2011, compared with 26.3% in 2010. In terms of profitability, we expect Chaowei to achieve ROAA of 34.2% in 2011 and 22.5% in 2012; ROAE of 54.2% in 2011 and 29.8% in 2012.
- **Government policy lifting up entry barrier:** In order to carry out a stricter environmental control, the approval process for entering into the market has extended from local government level to the province level. Moreover, a production capacity of 3mn units of lead-acid motive batteries, which required approx Rmb 100mn of initial investment, has become the minimum requirement of entering the market. The longer approval process and higher initial investment cost have raised the entry barrier to the industry, which will in turn speed up the process of industry consolidation.



**Chaowei Power Holdings Limited**

- **Favorable policies on electric bikes (e-bikes):** In Mar 2010, e-bike is added to the catalogues of the Home Appliance Subsidy Program in Rural area. The addition allows each household in 10 specified provinces to enjoy a maximum subsidy of Rmb260 per purchase or approx 13-26% discount to retail price of e-bike, which ranged from Rmb 1,000-3,000. In other words, buying an e-bike can cost as low as Rmb740. We believe the program can spur demand in the primary market of lead-acid motive batteries and more importantly, increase the demand for secondary market in 2 years time.
- **Rising replacement demand in secondary market:** Since lead-acid motive batteries has an average life of 2 years and each e-bike typically carry 3-4 units of lead-acid motive batteries, the growth of secondary market has exceeded the primary market in 2009. It is expected the demand from secondary market to grow by 14.3% YoY to 105.6mn units of batteries in 2011 whereas primary market is estimated to grow at 8.0% YoY to 86.4mn units in 2011. Due to industry consolidation and expansion in production capacity, we believe Chaowei's sales volume growth to exceed market average. We expect Chaowei's sales volume to reach 42mn in 2011 and 56mn in 2012, representing YoY of 26.1% and 33.3% respectively.
- **Valuation:** With major assumptions set out below, we estimated 2011 EPS to be Rmb0.4574/share; 2012 EPS to be Rmb0.3923/share. With 2012 PE of 10x, we value the stock at Rmb3.923/share (or HK\$4.78).

| Major Assumptions                  | 2009    | 2010   | 2011   | 2012    | Explanations  |
|------------------------------------|---------|--------|--------|---------|---|
| Sales volume (mn)                  | 26.2    | 33.3   | 42.0   | 56.0    | - Year end production capacity is 56 mn at the end of 2011  |
| Growth                             | 34.5%   | 27.3%  | 26.1%  | 33.3%   |   |
| ASP (Rmb/unit)                     | 89.5    | 90.6   | 117.0  | 105.3   | - Av ASP was Rmb107 in 1H2011. ASP est in 2011 is based on 2 price hikes of 8-10% each in Jul and Aug 2011.<br>- Assume temporary imbalance in supply and demand continues till 1H2012 but effect will fade out when existing players expand their capacity and suspended manufacturers resume production. Batteries price are expected to revise down in accordance to lead price. |
| Growth                             | -15.57% | 1.26%  | 29.05% | -10.00% |   |
| Av lead price (Rmb/tonne)          | 13,816  | 16,108 | 16,500 | 15,000  | - Av lead purchase price was Rmb16,900/ton in 1H11 but lead price dropped >15% during Jul to Sep to less than Rmb15,000/ton.  |
| Consumption rate of lead (kg/unit) | 3.8     | 3.7    | 3.8    | 3.8     | - Increase every year with inflation.   |
| Av unit cost - lead (Rmb/unit)     | 52.1    | 59.2   | 60.8   | 57.0    |   |
| Av unit cost - non-lead (Rmb/unit) | 11.4    | 10.3   | 11.4   | 12.3    |   |
| Total unit cost (Rmb/unit)         | 63.5    | 69.5   | 75.95  | 73.06   |   |
| GP margin                          | 25.7%   | 27.9%  | 35.1%  | 29.0%   |   |



**Risk factors:**

- **Policy risks** – Driving licenses are not required for e-bikes in China. For safety concerns, e-bikes are prohibited in some of the cities including Guangzhou and Zhuhai. In Jul 2011, Shenzhen has also banned the use of e-bike in main downtown areas, effective till Dec 2011. Although we have mentioned e-bikes are encouraged in rural areas, increasing usage of e-bikes in some of the first and second tier cities in China remain a downside risks to the demand for lead-batteries.
- **Regulation risks** – In Jun 2011, the Ministry of Industry Information and Information Technology urges local authorities to use the existing e-bikes standards that were published in 1999 to regulate the manufacture and use of e-bikes. Under those requirements, e-bikes can weigh no more than 40kg with a speed limit of 20km/hour. However, the bulk of the estimated 120mn e-bikes in China has designed capacity of 30-40km/hour and typically carry four batteries, which by themselves weigh at least 16-28kg. The tightening management in existing standards may phase out many of the existing e-bikes, affecting the demand for lead-acid motive batteries.
- **Substitution risks** –Currently, the cost of producing lithium battery is 3 times more than producing a lead-acid battery. The increase in the price of lead-acid battery will lead to an increase in the substitution risks to lithium batteries. Apart from cost, stability issue is a major concern for limited use of lithium-ion batteries in e-bikes, but a technical breakthrough may lead to obsolesce of lead-acid batteries.
- **Share price risks**  
Chaowei is classified under HS Composite Consumer Goods Index – automobiles industry. Its price performance is therefore affected by the sector performance in some extent.

Chaowei’s 30-day volatility is 2.06 times of HSI and 1.54 times of Consumer Goods Index, indicating a higher-than-market share price risks.

|                                   | 30-day volatility (%) | 60-day volatility (%) |
|-----------------------------------|-----------------------|-----------------------|
| HSI                               | 35.74                 | 32.84                 |
| HS Composite Consumer Goods Index | 47.94                 | 38.31                 |
| <b>Chaowei (951)</b>              | <b>73.66</b>          | <b>80.21</b>          |

Source: Bloomberg



Financial Analysis

P&L

| For the yr ended 31 Dec (Rmb mn)       | 2009          | 2010          | 2011E          | 2012E          |
|--|---------------|---------------|----------------|----------------|
| Revenue                                | 2,433.9       | 3,224.8       | 4,912.2        | 5,763.6        |
| CoS                                    | (1,729.9)     | (2,377.0)     | (3,269.9)      | (4,091.5)      |
| <b>Gross profit</b>                    | <b>704.0</b>  | <b>847.7</b>  | <b>1,642.3</b> | <b>1,672.1</b> |
| Other income                           | 13.7          | 53.6          | 24.6           | 34.6           |
| D&S                                    | (321.9)       | (309.3)       | (491.2)        | (576.4)        |
| Admin                                  | (83.7)        | (116.8)       | (196.5)        | (230.5)        |
| R&D                                    | (15.8)        | (51.4)        | (157.2)        | (184.4)        |
| Other expenses                         | (4.2)         | (33.1)        | (49.1)         | (46.1)         |
| Gain on disposal                       | 3.2           | 0.0           | 0.0            | 0.0            |
| Share of associate                     | (2.2)         | 0.0           | 0.0            | 0.0            |
| <b>EBIT</b>                            | <b>293.3</b>  | <b>390.7</b>  | <b>772.9</b>   | <b>669.3</b>   |
| Finance costs                          | (9.6)         | (20.8)        | (36.0)         | (37.2)         |
| <b>EBT</b>                             | <b>283.7</b>  | <b>369.9</b>  | <b>736.9</b>   | <b>632.1</b>   |
| Tax                                    | (57.7)        | (66.8)        | (162.1)        | (139.1)        |
| <b>Net profit</b>                      | <b>226.0</b>  | <b>303.1</b>  | <b>574.8</b>   | <b>493.0</b>   |
| MI                                     | (24.1)        | (34.9)        | (115.0)        | (98.6)         |
| <b>Net profit to owners of company</b> | <b>201.9</b>  | <b>268.2</b>  | <b>459.8</b>   | <b>394.4</b>   |
| Chg (YoY)                              | 57.61%        | 32.83%        | 71.44%         | -14.22%        |
| D&A                                    | 30.2          | 42.2          | 70.9           | 99.3           |
| EBITDA                                 | 323.5         | 432.9         | 843.7          | 768.6          |
| <b>DPS (Rmb)</b>                       | -             | <b>0.080</b>  | <b>0.137</b>   | <b>0.118</b>   |
| <b>Basic EPS (Rmb)</b>                 | <b>0.2700</b> | <b>0.3100</b> | <b>0.4574</b>  | <b>0.3923</b>  |
| <b>NBV (Rmb/share)</b>                 | <b>0.9069</b> | <b>1.3662</b> | <b>1.6864</b>  | <b>1.9610</b>  |
| No. of issued shares (mn)              | 750.0         | 1,005.3       | 1,005.3        | 1,005.3        |

Source: ABCI Securities estimates; Company reports

Major Financial Ratios

| For the yr ended 30 Jun (Rmb mn)         | 2009   | 2010   | 2011E  | 2012E  |
|--|--------|--------|--------|--------|
| <b>Profitability</b>                     |        |        |        |        |
| GP Margin                                | 28.93% | 26.29% | 33.43% | 29.01% |
| EBITDA Margin                            | 13.29% | 13.42% | 17.18% | 13.33% |
| EBIT Margin                              | 12.05% | 12.12% | 15.73% | 11.61% |
| EBT Margin                               | 11.66% | 11.47% | 15.00% | 10.97% |
| NP Margin                                | 9.29%  | 9.40%  | 11.70% | 8.55%  |
| ROAA                                     | 15.56% | 13.08% | 34.23% | 22.48% |
| ROAE                                     | 19.66% | 39.05% | 54.24% | 29.75% |
| <b>Working capital management</b>        |        |        |        |        |
| Avg. inventories/COGS (days)             | 73.6   | 84.2   | 68.0   | 73.0   |
| Avg. trade receivables/turnover (days)   | 4.2    | 4.6    | 6.0    | 6.0    |
| Avg. bill receivables/turnover (days)    | 25.4   | 43.6   | 55.0   | 50.0   |
| Avg. trade payables/COGS (days)          | 40.0   | 44.0   | 44.0   | 44.0   |
| Avg. bill and other payables/COGS (days) | 28.0   | 31.5   | 33.0   | 33.0   |
| <b>Liquidity</b>                         |        |        |        |        |
| Current ratio                            | 1.79   | 2.05   | 1.84   | 1.73   |
| Quick ratio                              | 0.87   | 1.38   | 1.36   | 0.97   |
| Equity/ Assets                           | 48.11% | 51.12% | 48.31% | 48.88% |
| Net Debt/ Total Equity                   | 7.69%  | -2.49% | 12.18% | 14.21% |

Source: ABCI Securities estimates; Company reports



Chaowei Power Holdings Limited

Balance Sheet

| As at 31 Dec (Rmb mn)                  | 2009           | 2010           | 2011E          | 2012E          |
|--|----------------|----------------|----------------|----------------|
| PPE                                    | 364.4          | 613.7          | 1,039.0        | 1,442.0        |
| Prepaid lease payments                 | 64.9           | 67.3           | 84.4           | 82.8           |
| Goodwill                               | 15.0           | 15.0           | 25.1           | 25.1           |
| Others                                 | 54.1           | 71.7           | 101.6          | 100.9          |
| <b>Non-current assets</b>              | <b>498.4</b>   | <b>767.7</b>   | <b>1,250.2</b> | <b>1,650.8</b> |
| Inventories                            | 470.7          | 626.6          | 591.8          | 1,044.8        |
| Trade receivables                      | 19.4           | 61.9           | 99.5           | 89.9           |
| Bills receivable                       | 176.3          | 593.2          | 887.1          | 691.9          |
| Prepayments and other receivables      | 84.6           | 157.6          | 165.4          | 213.6          |
| Amounts due from related parties       | 4.4            | 0.3            | 0.1            | 0.1            |
| Prepaid lease payments-current portion | 1.5            | 1.5            | 1.6            | 1.6            |
| Restricted bank deposits               | 7.9            | 0.2            | 0.2            | 0.2            |
| Bank balances and cash                 | 150.8          | 477.8          | 513.3          | 339.7          |
| <b>Current assets</b>                  | <b>915.6</b>   | <b>1,919.1</b> | <b>2,259.1</b> | <b>2,381.8</b> |
| <b>Total assets</b>                    | <b>1,414.0</b> | <b>2,686.8</b> | <b>3,509.3</b> | <b>4,132.7</b> |
| Trade payables                         | 220.2          | 353.6          | 434.8          | 551.6          |
| Bills payable                          | 7.1            | 0.0            | 1.8            | 0.5            |
| Other payables                         | 140.0          | 269.8          | 321.5          | 418.4          |
| Amounts due to related parties         | 2.1            | 0.0            | 10.0           | 10.0           |
| Income tax payable                     | 29.0           | 33.7           | 0.0            | 0.0            |
| Dividend payable                       | 0.0            | 32.5           | 0.0            | 0.0            |
| Provision                              | 57.5           | 80.0           | 110.9          | 147.2          |
| Bank borrowings-due within one year    | 55.0           | 167.8          | 350.0          | 350.0          |
| Other borrowings                       | 0.0            | 0.0            | 0.0            | 0.0            |
| <b>Current liabilities</b>             | <b>510.9</b>   | <b>937.2</b>   | <b>1,228.9</b> | <b>1,477.7</b> |
| Deferred income                        | 17.2           | 16.8           | 16.8           | 16.8           |
| Deferred tax liabilities               | 2.1            | 0.7            | 0.7            | 0.7            |
| Bank borrowings – due after one year   | 156.0          | 276.0          | 370.0          | 370.0          |
| <b>Non-current liabilities</b>         | <b>175.3</b>   | <b>293.6</b>   | <b>387.6</b>   | <b>387.6</b>   |
| <b>Total liabilities</b>               | <b>686.2</b>   | <b>1,230.8</b> | <b>1,616.5</b> | <b>1,865.3</b> |
| <b>Net assets</b>                      | <b>727.7</b>   | <b>1,455.9</b> | <b>1,892.8</b> | <b>2,267.5</b> |
| <b>Capital &amp; reserves:</b>         |                |                |                |                |
| Paid-in capital/Share capital          | 210.0          | 68.1           | 68.1           | 68.1           |
| Reserves                               | 470.2          | 1,305.3        | 1,627.2        | 1,903.2        |
| MI                                     | 47.6           | 82.5           | 197.4          | 296.0          |
| <b>Total equity</b>                    | <b>727.7</b>   | <b>1,455.9</b> | <b>1,892.7</b> | <b>2,267.4</b> |

Source: ABCI Securities estimates; Company reports

Cash Flow

| For the yr ended 30 Jun (Rmb mn)                | 2009          | 2010           | 2011E          | 2012E          |
|---|---------------|----------------|----------------|----------------|
| <b>EBITDA</b>                                   | <b>323.5</b>  | <b>432.9</b>   | <b>843.7</b>   | <b>768.6</b>   |
| Change in inventories.                          | (221.6)       | (158.8)        | 34.8           | (453.0)        |
| Change in trade receivables                     | 2.3           | (521.1)        | (339.3)        | 156.6          |
| Change in bills and other receivables           | (54.0)        | 255.7          | 68.5           | 212.4          |
| Change in trade payables                        | (54.0)        | 255.7          | 68.5           | 212.4          |
| Others  | 65.6          | (222.5)        | (39.2)         | (214.9)        |
| <b>Cash (used in)/generated from operations</b> | <b>61.8</b>   | <b>41.8</b>    | <b>637.1</b>   | <b>682.1</b>   |
| Income tax paid                                 | (47.9)        | (83.2)         | (162.1)        | (139.1)        |
| <b>CF from operating activities</b>             | <b>13.9</b>   | <b>(41.3)</b>  | <b>475.0</b>   | <b>543.1</b>   |
| <b>Cash flows from investing activities</b>     | <b>14.8</b>   | <b>(301.9)</b> | <b>(541.7)</b> | <b>(498.4)</b> |
| <b>Cash flows from financing activities</b>     | <b>(54.0)</b> | <b>670.2</b>   | <b>102.3</b>   | <b>(118.3)</b> |
| Change in cash and cash equivalents             |               |                |                |                |
| Cash and cash equivalents at beg of year        | (25.3)        | 326.9          | 35.6           | (73.7)         |
| Effect of foreign exchange rates, net           | 177.1         | 150.8          | 477.8          | 513.3          |
| Cash and cash equivalents at end of year        | 151.8         | 477.8          | 513.3          | 439.7          |

Source: ABCI Securities estimates; Company reports



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