



September 3, 2013
 Equity Focus
 Rating: SELL
 TP: HK\$ 3.18

Share price (HK\$) 3.01
 Est. share price return 5.65%
 Est. dividend yield 3.16%
 Est. total return 8.81%

Previous Rating & TP HOLD; HK\$ 4.45
 Previous Report Date July 25, 2013

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Key Data

52Wk H/L(HK\$)	6.17/2.77
Issued shares (mn)	1,099.4
Market cap (HK\$ mn)	3,572.8
3-mth avg daily turnover (HK\$ mn)	22.93
Major shareholder(s) (%):	
Zhang Tianren*	36.64
Pinpoint Capital Management	5.96
Deutsche Bank	5.80
JP Morgan	5.07
Credit Suisse	5.00

* Chairman of Co.
 Source(s): Company, Bloomberg

1H13 Revenue breakdown (%)

Lead-acid battery products	
Electrical Bicycle Battery	94.1
Storage Battery	0.2
Pure Electric Car Battery (Note)	3.8
Nickel hydride and lithium battery products	1.1
Electrode plates	0.3
Others	0.5
Total	100.0

Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	(19.8)	(19.6)
3-mth	(32.1)	(31.7)
6-mth	(47.6)	(46.7)

*Relative to HSI
 Source(s): Bloomberg

1-Year stock performance (HK\$)



Source(s): Bloomberg

Tianneng (819 HK)

Increased outsourcing hurt profitability. Downgrade to SELL.

- Tianneng's 1H13 net profit decreased by 77.9%YoY to RMB 83.0mn. Results did not surprise the market as Tianneng issued a profit warning in June 2013
- We expect GP margins to improve in 2H13 on the four price hikes in July. But the extent of the improvement should be limited as ASP retreated 8%-10% in Aug, and increased outsourcing to OEM would also affect margins.
- We revise Tianneng's FY13E/14E EPS down by 37%/34% to RMB0.2477/0.4363 and lower our TP from HK\$ 4.45 to HK\$ 3.18, based on 6.0x FY14 P/E. Downgrade to SELL.

Poor interim results. Tianneng reported 1H13 revenue increased by 54.8%YoY to RMB 5,919.2mn, mainly attributable to 79.9%YoY growth in sales volume of e-bike lead-acid batteries. However, 1H13 net profit decreased by 77.9% YoY to RMB 83.0mn as GP margin declined significantly on fallen ASP. The poor results did not surprise the market as Tianneng had issued a profit warning back in mid-June.

GP margin to rebound in 2H13, but improvement would be partly offset by increasing OEM. The poor results were mainly attributable to price competition since 2H12 and the increase in unit cost as a result of the increased OEM production. ASP of lead-acid motive batteries dropped to RMB 97.7/unit in 1H13 from RMB 104.4/unit in 2012. For 2H13, however, we believe GP margin will rebound after the four price hikes in July, in which ASP has surged 20%. Although ASP has come down by around 8%-10% in Aug, which is in line with our expectation that ASP declines after peak season. However, GP margin could be affected by the continuous increases in OEM production.

Increasing OEM production will reduce margins. Although management emphasized that their production plants were in compliance with environmental standards, we believe pressure from media will result in close monitoring by government and this might have driven Tianneng to outsource more production to the OEM. In terms of volume, OEM accounted for 36% of Tianneng's total production in 1H13, as opposed to 22% in 2012. Management guided that the proportion might continue to increase in 2H13. As GP margin of OEM is 2.7ppt lower than that of the self-produced batteries (11.5%), we revise down our FY13E GP margin estimate from 15% to 12.8%. While increasing OEM production may help the Group to expand market share, but its profitability could be lowered as a result.

Downgrade to SELL. According to management, 1H13 CAPEX has slowed to RMB 348mn in 1H13 (vs. RMB 462mn in 2H12) and 2H13 CAPEX will be ~RMB 350mn. Target production for 2013 was maintained at 93mn units, but the 2014 target was adjusted down by 15% to 106mn-110mn. We estimate 2H13 net profit to reach RMB 192mn in 2H13, up 131% HoH because the Group's EPS is highly sensitive to changes in ASP (1% ASP change leads to 10% EPS change). Based on the lower GP margin, however, we revise Tianneng's FY13E EPS down by 37% to RMB 0.2477 and FY14E EPS by 34% to RMB 0.4363. We lower our TP from HK\$ 4.45 to HK\$ 3.18, based on 6.0x FY14E P/E. Downgrade to SELL.

Risk factors: 1) Production risks; 2) Share price volatility; 3) Trading liquidity; 4) High ASP fluctuations caused by seasonality as demonstrated in recent price hikes.

Results and Valuation

FY ended Dec 31	2010A	2011A	2012A	2013E	2014E
Revenue (RMB mn)	3,752.8	5,438.3	9,887.6	12,750.0	15,381.3
Chg (% YoY)	66.43	44.91	81.81	28.95	20.64
Net Income (RMB mn)	346.3	615.9	708.7	275.3	484.8
EPS (RMB)	0.2993	0.5630	0.6377	0.2477	0.4363
Chg (% YoY)	23.15	88.12	13.26	(61.16)	76.13
BVPS (RMB)	1.8057	2.2944	2.8402	2.8986	3.2645
Chg (% YoY)	15.91	27.07	23.79	2.06	12.62
P/E (x)	-	-	3.72	9.59	5.44
P/B (x)	-	-	0.84	0.82	0.73
ROA (%)	12.96	15.66	12.60	3.49	4.61
ROE (%)	19.03	27.64	25.75	8.89	14.31
DPS (RMB)	0.0976	0.1690	0.1919	0.0751	0.1323
Yield (%)	-	-	8.07	3.16	5.57
Net gearing (%)	6.17	28.69	67.02	71.50	78.42

*Net gearing=Net debt/Total equity
 Source(s): Bloomberg, ABCI estimates



Exhibit 1: Tianneng's 1H13 results

P&L	1H13	2H12	1H12	HoH Chg	YoY Chg	Remarks
	RMB mn	RMB mn	RMB mn	(%)	(%)	
Revenue	5,919	6,063	3,825	(2.4)	54.8	Driven up by 79.9%YoY sales volume growth (to 57.02mn units) but partly offset by 12.5%YoY drop in ASP (to RMB 97.7)
Cost of Sales	(5,277)	(5,194)	(2,839)	1.6	85.9	
Gross Profit	642	869	986	(26.1)	(34.9)	
Gross Margin (%)	10.8	14.3	25.8	(3.5)ppt	(14.9)ppt	
Other income	82	86	44	(5.4)	86.5	
Other gains and losses	(19)	(13)	5			
S&D	(160)	(42)	(208)	276.7	(23.3)	
Admin	(173)	(164)	(138)	5.3	25.1	
Listing related expenses	0	0	0	-	-	
R&D	(154)	(174)	(119)	(11.5)	29.3	
Other expenses	(52)	(68)	(28)	-	-	
Share of loss of an associate	(0)	(0)	(0)	(30.8)	-	
EBIT	166	493	542	(66.3)	(69.4)	
EBIT Margin (%)	2.8	8.1	14.2	(5.3)ppt	(11.4)ppt	
Finance costs	(73)	(54)	(68)	34.8	8.1	
Profit before tax	93	439	474	(78.9)	(80.5)	
Tax	(9)	(106)	(98)	(91.1)	(90.3)	
Profit after tax	83	333	376	(75.1)	(77.9)	
Minority Interest	(0)	(0)	0	0.0	-	
Net profit	83	333	376	(75.1)	(77.9)	
Net profit margin (%)	1.4	5.5	9.8	(4.1)ppt	(8.4)ppt	
Sales breakdown						
Lead-acid battery products	5,809	5,925	3,760	(2.0)	54.5	
Electrical Bicycle Battery	5,570	5,691	3,541	(2.1)	57.3	
Storage Battery	14	37	22	(61.1)	(35.8)	
Pure Electric Car Battery (Note)	225	197	196	14.0	14.4	
Battery for other usage	0	0	0	-	-	
Nickel hydride and lithium battery products	65	54	44	21.2	47.1	
Electrode plates	15	70	0	(78.5)	-	
Others	30	15	20	103.4	46.8	
Total	5,919	6,063	3,825	(2.4)	54.8	
Lead-acid battery products (%)	98.1	97.7	98.3	(0.4)	0.6	
Electrical Bicycle Battery	94.1	93.9	92.6	(0.2)	(1.3)	
Storage Battery	0.2	0.6	0.6	0.4	(0.0)	
Pure Electric Car Battery (Note)	3.8	3.3	5.1	(0.5)	1.9	
Battery for other usage	0.0	0.0	0.0	0.0	0.0	
Nickel hydride and lithium battery products	1.1	0.9	1.2	(0.2)	0.3	
Electrode plates	0.3	1.2	0.0	0.9	(1.2)	
Others	0.5	0.2	0.5	(0.3)	0.3	
Total	100.0	100.0	100.0	0.0	0.0	
Balance sheet						
	Jun-13	Dec-12	Jun-12	HoH %	YoY %	Remarks
	RMB mn	RMB mn	RMB mn			
Gross debt	3,010	2,906	2,378			
Cash	981	673	768			
Net debt	2,030	2,233	1,610			
Net debt/Equity	67.3	67.0	59.4			Remained stable as CAPEX slowed.
Key indicators						
Current ratio	1.1	1.1	1.2			
Inventory turnover days	36.4	140.3	50.0			
Trade receivable turnover days	23.6	79.9	36.7			
Trade payable turnover days	48.7	90.7	52.3			

Source(S): Company, ABCI Securities



Consolidated income statement (2010A-2014E)

FY Ended Dec 31 (RMB mn)	2010A	2011A	2012A	2013E	2014E
Revenue	3,752.8	5,438.3	9,887.6	12,750.0	15,381.3
Cost of Sales	(2,881.4)	(4,003.2)	(8,032.5)	(11,195.7)	(13,229.7)
Gross Profit	871.4	1,435.1	1,855.1	1,554.3	2,151.6
Other income	74.8	91.0	129.9	165.8	200.0
S&D	0.0	11.0	(8.1)	0.0	0.0
Admin expenses	(224.7)	(164.9)	(250.3)	(331.5)	(461.4)
R&D	(112.4)	(198.0)	(293.6)	(318.8)	(384.5)
Other expenses	(55.1)	(67.5)	(95.2)	(127.5)	(153.8)
Share of associate	0.0	(0.3)	(0.4)	0.0	0.0
EBIT	443.1	908.5	1,034.9	558.6	887.2
Finance costs	(14.3)	(78.8)	(122.4)	(205.7)	(265.7)
EBT	428.8	829.6	912.5	352.9	621.6
Tax	(82.5)	(213.7)	(203.1)	(77.6)	(136.7)
MI			(0.7)	(1.0)	(1.0)
Net profit to owners of company	346.3	615.9	708.7	275.3	484.8
D&A	65.4	79.9	130.1	156.9	188.4
EBITDA	508.4	988.3	1,165.0	715.5	1,075.6
Dividends	105.7	183.8	211.0	82.6	145.4
No. of issued shares (mn)	1,083.3	1,089.8	1,099.3	1,099.3	1,099.3
No. of issuable shares					
Share options @ HK\$1.22	29.5	0.0	0.0	0.0	0.0
Share options @ HK\$3.18	44.2	4.2	11.9	11.9	11.9
Total	1,157.0	1,094.0	1,111.3	1,111.3	1,111.3
Per share value (RMB)					
DPS	0.0976	0.1690	0.1919	0.0751	0.1323
Fully-diluted EPS	0.2993	0.5630	0.6377	0.2477	0.4363
NBV	1.8057	2.2944	2.8402	2.8986	3.2645

Source(s): Company, ABCI Securities estimates

Key Ratio (2010A-2014E)

FY ended Dec 31	2010A	2011A	2012A	2013E	2014E
Profitability ratio (%)					
Gross profit margin	23.22	26.39	18.76	12.19	13.99
EBITDA margin	13.55	18.17	11.78	5.61	6.99
EBIT margin	11.81	16.70	10.47	4.38	5.77
EBT margin	11.42	15.26	9.23	2.77	4.04
Net profit margin	9.23	11.33	7.17	2.16	3.15
ROAA	12.96	15.66	12.60	3.49	4.61
ROAE	19.03	27.64	25.75	8.89	14.31
Cost ratio (%)					
S&D/revenue	-5.99	-3.03	-2.53	-2.60	-3.00
Admin expenses/revenue	-2.96	-3.64	-3.06	-3.01	-3.02
R&D/revenue	-3.00	-3.64	-2.97	-2.50	-2.50
Effective tax rate	-1.47	-1.24	-0.96	-1.00	-1.00
Leverage (x)					
Current ratio	1.77	1.33	1.12	1.00	0.99
Quick ratio	1.03	0.84	0.65	0.61	0.65
Net debt/total equity (%)	6.17	28.69	67.02	71.50	78.42
Working capital cycle (days)					
Inventory turnover days	160	123	140	140	140
Receivables turnover days	82	71	80	93	93
Payables turnover days	112	80	91	110	110

Source(s): Company, ABCI Securities estimates



Consolidated balance sheet (2010A-2014E)

As of Dec 31 (RMB mn)	2010A	2011A	2012A	2013E	2014E
PPE	981.6	1,583.5	2,383.1	2,928.7	3,442.8
Prepaid lease payments	97.3	102.2	157.5	155.0	152.5
Others	60.6	79.9	243.8	243.8	243.8
Non-current assets	1,139.5	1,765.6	2,784.4	3,327.5	3,839.1
Inventories	818.8	1,124.7	1,953.8	2,340.4	2,734.0
Held-for-trading investments	0.0	34.6	47.0	47.0	47.0
Bills, trade and other receivables	634.8	822.2	1,557.6	1,691.0	2,728.9
Prepaid lease payments	2.1	2.3	3.8	3.8	3.8
Amount due from a related company	0.0	0.0		0.0	0.0
Time deposits	0.0	110.0	160.0	160.0	160.0
Restricted bank deposits	65.0	166.1	120.3	120.3	120.3
Bank balances and cash	424.3	752.9	813.7	1,628.0	2,092.2
Others	0.0	4.5	4.5	4.5	4.5
Current assets	1,945.0	3,017.3	4,660.8	5,995.0	7,890.7
Bills, trade and other payables	545.4	710.0	1,280.5	2,093.5	3,098.6
Amount due to a related company	0.0	0.1	15.8	15.8	15.8
Taxation payable	37.9	83.9	102.3	102.3	102.3
Bank borrowings	515.0	1,470.4	2,357.8	3,357.8	4,357.8
Short-term loan notes	0.0	0.0	400.0	400.0	400.0
Current liabilities	1,098.4	2,264.3	4,156.4	5,969.4	7,974.5
Bank borrowings	30.0	0.0	70.0	70.0	70.0
Deferred tax liabilities	0.0	18.1	17.9	17.9	17.9
Long-term loan notes	0.0	0.0	78.6	78.6	78.6
Non-current liabilities	30.0	18.1	166.5	166.5	166.5
Total assets	3,084.5	4,782.9	7,445.2	9,322.5	11,729.9
Net Assets	1,956.2	2,500.5	3,122.3	3,186.6	3,588.9
Capital & reserves:					
Share capital	106.4	106.9	107.7	107.7	107.7
Reserves	1,849.8	2,393.6	2,945.2	3,009.5	3,411.7
Equity to owners			3,052.9	3,117.2	3,519.4
MI			69.4	69.4	69.4
TOTAL EQUITY	1,956.2	2,500.5	3,122.3	3,186.6	3,588.8

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2010A-2014E)

FY ended Dec 31 (RMB mn)	2010A	2011A	2012A	2013E	2014E
EBITDA	508.4	988.3	1,165.0	715.5	1,075.6
(Increase)/decrease in inventories.	(219.7)	(306.0)	(731.0)	(386.5)	(393.6)
(Increase)/decrease in trade receivables	(254.6)	(171.7)	(643.0)	(133.3)	(1,037.9)
(Increase)/decrease in bills & other receivables	89.7	125.7	394.4	813.0	1,005.1
Others	19.5	6.5	14.7	0.0	0.0
Cash (used in)/generated from operations	143.3	642.9	200.1	1,008.6	649.2
Interest paid	(14.0)	(64.6)	(108.5)	(205.7)	(265.7)
Income tax paid	(68.1)	(166.1)	(263.7)	(77.6)	(136.7)
CF from operating activities	61.2	412.2	(172.1)	725.3	246.8
Cash flows from investing activities	(341.9)	(910.2)	(906.3)	(700.0)	(700.0)
Cash flows from financing activities	344.7	826.6	1,139.3	789.0	917.4
Net (decrease)/increase in cash and cash equivalents	64.0	328.6	60.8	814.3	464.2
Cash and cash equivalents at beginning of year/period	360.3	424.3	752.9	813.7	1,628.0
Cash and cash equivalents at end of year/period	424.3	752.9	813.7	1,628.0	2,092.2

Source(s): Company, ABCI Securities estimates



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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return $- 6\% \leq$ 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

Market return: 5(year average market return rate from 2007(2011

Time horizon of share price target: 12(month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility $<$ 2.6
Medium	$1.0 \leq$ 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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