4 December 2012

Equity Focus

Lead-acid Battery Sector

Key Data

Average FY12E PE (x)	4.61
Average FY12E PB (x)	1.57

Source: Bloomberg, ABCI Securities

Net income in 1H2012 (Rmb mn)

Tianneng (819)	426.0
Chaowei (951)	322.1
Leoch (842)	71.7
Coslight Tech (1043)	22.9
Scud Group (1399)	27.1

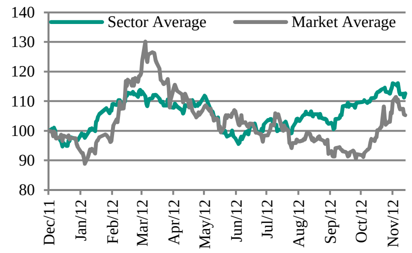
Source: Company

Average share performance (%)

	Absolute	Relative*
1-mth	(13.1)	(12.5)
3-mth	3.8	(8.6)
6-mth	(11.3)	(29.7)

**Relative to Hang Seng Index*
Source: Bloomberg

1 year price performance



Source: Bloomberg

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Government might levy 5% tax on lead-acid batteries

There is news saying that China government may levy 5% of consumption tax on lead-acid batteries. With cost plus pricing method, we expect Tianneng and Chaowei can pass on additional costs to consumers. Nevertheless, we have done a worst case scenario in which est 2013FD EPS of Tianeng and Chaowei will be lowered by 35%.

Consumption tax: According to Mr Wang Jinliang, the Vice President of China Battery Industry Association, the Administration of Taxation and the Ministry of Finance intend to levy a 5% consumption tax on lead-acid batteries. The major question to ask is whether the lead-acid batteries manufacturers can pass on the cost to consumers.

Likely to be able to pass on costs to consumers: E-bike batteries producers such as Tianneng and Chaowei adopt a cost-plus basis pricing policy and they set their ASP based on lead prices, which accounted for more than 65% of their production costs. They have therefore maintained a stable GP margin over the past few years. GP margin of Tianneng and Chaowei maintained within 20-32% during 2008-2011.

Their strong ability to pass on costs is mainly due to the lack of alternative goods. The production costs of lithium battery, which is considered as an alternative to lead-acid batteries, are more than 150% higher than production costs of lead-acid batteries. Hence, if producers have to pass on the 5% consumption tax that might be levied on lead-acid batteries, we expect the relatively small % change in price is unlikely to lead to substitution effect.

Worst case scenario: However, the market is more concerned on whether the rapid capacity expansion by the market leaders will lead to over-supply and affecting its pricing ability. If producers are unable to pass on the costs to consumers, we estimate Tianneng and Chaowei 2013 FD EPS will lower by 35% to Rmb0.4869 and Rmb0.4045 respectively. Based on 7.0x times of PER valuation, Tianneng and Chaowei TP will be set at HK$4.26 and HK$3.53 respectively (compared to our base case TP of HK$6.61 and HK$5.53).

Base case scenario: Our base case scenario assumes ASP stays the same in 2013 as compared to 2012. Our est 2013 FD EPS for Tianneng and Chaowei is Rmb0.6316 and Rmb0.7556 repectively.

Summary on selected companies in the sector

Company	Ticker	Price HK$	Ratings	TP HK$	12 PE x	13 PE x	PB x
Tianneng	819	4.76	Buy	6.61	5.8	5.0	1.37
Chaowei	951	3.80	Buy	5.53	5.2	4.8	1.42
Leoch	842	1.04	-	-	7.0	3.6	0.47
Coslight Tech	1043	2.25	-	-	-	-	0.44
Scud Group	1399	0.36	-	-	-	-	0.24

Note: Valuation is based on base case scenario; 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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