

## Huatai Research

29 March 2020

Equity | China | Auto Parts

**BUY | TP HKD12.00****Maintained**

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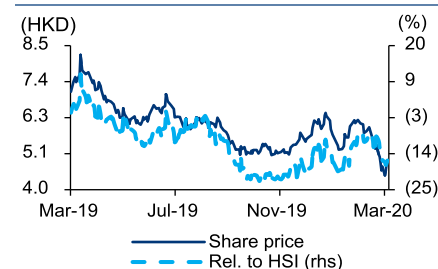
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## Key data

Target price (HKD)	12.00
Closing price (HKD as of 27 Mar)	4.83
Upside +/- (%)	148
Mkt cap (USDmn)	719
6m avg daily val (USDmn)	2.22
52wk price range (HKD)	8.21/4.45
BVPS (RMB)	5.92

## Share performance



Source: FactSet

# Margins boosted by declined lead prices in 2019

## Strong results in 2019: net profit up 29% yoy

Tianneng Power (Tianneng) reported (27 March) its 2019 financial results: total revenue increased 18% yoy to RMB40.6bn and NPAT rose 29% yoy to RMB1.68bn, beating our/Bloomberg consensus estimates by 15/22%. We attribute the strong earnings growth to the gross profit improvement of its battery manufacturing business, a result of declined lead prices in 2019. Overall, we believe Tianneng will benefit from the rising demand for lead-acid battery for electric bikes and market consolidation, given its leading position in the lead-acid battery manufacture ring industry. We raise our profit estimates by 6/3% for 2020/2021, and maintain our target price of HKD12.00.

## Battery business benefiting from declined lead prices

Lead cost made up over 70% of total production cost of lead-acid batteries in 2019, during which lead prices declined by c. 13% yoy, which led to an ASP decline in Tianneng's battery manufacturing segment. As a result, sales revenue of the battery manufacturing business declined 4% yoy to RMB30.6bn. However, Tianneng was able to benefit slightly from the lead price decline and the gross profit margin of battery manufacturing rose 2.7pps to 15.4%, a key driver for its margin improvement and net profit growth.

## Tianneng continues to benefit from market consolidation

Tianneng is China's biggest manufacturer of lead-acid batteries used for electric bikes and tricycles, according to company data. The strict regulations of lead-acid battery production in recent years to prevent environmental pollution reduced the number of competitors in the industry to c. 30-60 in 2018 from over 3,000 before 2010. Overall, we believe the tightened regulations will benefit market leaders as they have more resources to invest in production facility upgrade. We believe Tianneng will continue to dominate the market with potential to gain market share and deliver modest profit growth in coming years.

## Maintain BUY on Tianneng's strong market position

Tianneng delivered solid growth in sales and profit in 2017-2019 and generated strong cash flow. It announced a DPS of HKD0.39 for 2019, implying a dividend yield of 8.1% based on 27 March closing price. Overall, we believe Tianneng is able to generate solid shareholder returns we maintain our BUY rating. The stock trades at 3.0x 2020E PE and 0.6x 2020E PB, at attractive valuations, in our view.

## Financials

YE 31 Dec	FY18	FY19	FY20E	FY21E	FY22E
Revenue (RMBmn)	34,751	40,614	42,231	43,941	45,726
yoy%	29.2	16.9	4.0	4.0	4.1
Net profit (RMBmn)	1,301	1,682	1,716	1,773	1,829
yoy%	10.4	29.3	2.0	3.3	3.2
EPS (diluted, RMB)	1.128	1.465	1.495	1.545	1.593
PE (x)	3.9	3.0	3.0	2.9	2.8
PB (x)	0.9	0.7	0.6	0.5	0.5
EV EBITDA (x)	1.5	1.1	0.8	0.8	0.5
Dividend yield (%)	7.5	7.6	10.3	10.7	11.0
Free cashflow yield (%)	28.0	12.5	19.7	12.4	31.0

Source: Company data, Huatai HK Research estimates

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## Modest profit growth in 2020-2022E

Following the better-than-expected financial results in 2019, we raise our profit estimates by 6/3% to RMB1,716/1,773mn for 2020-2021E, and we introduce the profit estimates for 2020E.

Overall, we estimate Tianneng will deliver modest profit growth in coming years (+2/3/3% yoy in 2020E/2021E/2022E).

**Fig.1. Tianneng: changes in key assumptions and profit estimates**

(RMBmn)	2020E-old	2020E-new	Change (%)	2021E-old	2021E-new	Change (%)	2022E
<b>Revenue</b>	<b>41,085</b>	<b>42,231</b>	<b>3</b>	<b>44,349</b>	<b>43,941</b>	<b>(1)</b>	<b>45,726</b>
yoy%	8	4		8	4		4
Gross profit	4,879	4,833	(1)	5,195	5,090	(2)	5,358
GPM (%)	11.9	11.4		11.7	11.6		11.7
Selling expenses	1068	929	(13)	1153	1011	(12)	1,143
As % of sales (%)	2.6	2.2		2.6	2.3		2.5
Administrative expenses	698	676	(3)	754	703	(7)	732
As % of sales (%)	1.7	1.6		1.7	1.6		1.6
Research expenditure	1315	1182	(10)	1419	1318	(7)	1,372
As % of sales (%)	3.2	2.8		3.2	3.0		3.0
<b>Operating profit</b>	<b>2,180</b>	<b>2,397</b>	<b>10</b>	<b>2,297</b>	<b>2,430</b>	<b>6</b>	<b>2,505</b>
OPM (%)	5.3	5.7		5.2	5.5		5.5
Financing cost (net)	200	236	18	205	241	17	247
Profit before tax	1,980	2,162	9	2,092	2,189	5	2,258
<b>Net profit</b>	<b>1,623</b>	<b>1,716</b>	<b>6</b>	<b>1,715</b>	<b>1,773</b>	<b>3</b>	<b>1,829</b>
yoy%	11	2		6	3		3
NPM (%)	4.0	4.1		3.9	4.0		4.0
<b>EPS (RMB, diluted)</b>	<b>1.41</b>	<b>1.50</b>	<b>6</b>	<b>1.49</b>	<b>1.54</b>	<b>4</b>	<b>1.59</b>
DPS (RMB)	0.43	0.46	6	0.46	0.47	3	0.49

Source: Company data, Huatai HK Research estimates

**Fig.2. Tianneng: one-year forward PE bands**



Source: Company data, Huatai HK Research

## Full financials

### Income statement

YE 31 Dec (RMBmn)	FY18	FY19	FY20E	FY21E	FY22E
Revenue	34,751	40,614	42,231	43,941	45,726
Cost of goods sold	(30,665)	(35,926)	(37,397)	(38,851)	(40,368)
<b>Gross profit</b>	<b>4,086</b>	<b>4,688</b>	<b>4,833</b>	<b>5,090</b>	<b>5,358</b>
Selling and distrib cost	(890)	(897)	(929)	(1,011)	(1,143)
Admin expenses	(1,678)	(1,817)	(1,858)	(2,021)	(2,103)
Others oper inc/exp	(41)	(16)	(84)	(88)	(91)
<b>Operating profit</b>	<b>1,476</b>	<b>1,958</b>	<b>1,962</b>	<b>1,970</b>	<b>2,020</b>
Financial cost-net	(178)	(255)	(236)	(241)	(247)
Share of P&L of assoc	3	(0)	0	0	0
Others inc/exp	303	423	435	460	485
<b>Profit before tax</b>	<b>1,605</b>	<b>2,126</b>	<b>2,162</b>	<b>2,189</b>	<b>2,258</b>
Tax expense	(304)	(400)	(411)	(416)	(429)
Minority interest/other	(0)	(44)	(35)	0	0
<b>Net profit</b>	<b>1,301</b>	<b>1,682</b>	<b>1,716</b>	<b>1,773</b>	<b>1,829</b>
Depr and amortization	(470)	(481)	(526)	(575)	(681)
<b>EBITDA</b>	<b>2,252</b>	<b>2,862</b>	<b>2,923</b>	<b>3,005</b>	<b>3,186</b>
EPS (RMB basic)	1.155	1.493	1.523	1.574	1.623

### Cash flow statement

YE 31 Dec (RMBmn)	FY18	FY19	FY20E	FY21E	FY22E
EBITDA	2,252	2,862	2,923	3,005	3,186
Financing costs	(178)	(255)	(236)	(241)	(247)
Chg in working capital	306	(259)	(179)	(612)	34
Tax	(304)	(400)	(411)	(416)	(429)
Other	1	(209)	0	0	0
<b>Operating cash flow</b>	<b>2,077</b>	<b>1,739</b>	<b>2,098</b>	<b>1,736</b>	<b>2,544</b>
Capital expenditure	(685)	(1,118)	(1,118)	(1,118)	(1,000)
Other investing activ's	(1,431)	(100)	(180)	(180)	(180)
<b>Investing cash flow</b>	<b>(2,116)</b>	<b>(1,218)</b>	<b>(1,298)</b>	<b>(1,298)</b>	<b>(1,180)</b>
Increase in debt	471	(166)	264	94	100
Increase in equity	0	0	(0)	0	0
Dividends paid	(341)	(375)	(376)	(515)	(532)
Other financing activ's	(130)	433	62	103	111
<b>Financing cash flow</b>	<b>(0)</b>	<b>(108)</b>	<b>(51)</b>	<b>(318)</b>	<b>(321)</b>
Change in cash	(39)	413	750	120	1,043
Cash at start of year	3,872	3,834	4,154	4,997	5,117
Effect of forex rate chg	0	0	0	0	0
<b>Year-end cash</b>	<b>3,834</b>	<b>4,247</b>	<b>4,904</b>	<b>5,117</b>	<b>6,160</b>

### Balance sheet

YE 31 Dec (RMBmn)	FY18	FY19	FY20E	FY21E	FY22E
Inventories	3,130	3,740	3,893	3,513	3,650
Acc & bill receivable	1,250	1,514	1,736	3,612	3,758
Cash & cash equiv	3,834	4,154	4,997	5,117	6,160
Other current assets	3,157	3,357	3,359	3,359	3,359
<b>Total current assets</b>	<b>11,371</b>	<b>12,765</b>	<b>13,985</b>	<b>15,600</b>	<b>16,927</b>
Fixed assets	4,114	4,783	5,230	5,678	6,078
Intangible assets	0	0	0	0	0
Other long-term assets	1,156	1,581	1,330	1,605	1,704
<b>Total long-term assets</b>	<b>5,270</b>	<b>6,365</b>	<b>6,560</b>	<b>7,283</b>	<b>7,781</b>
<b>Total assets</b>	<b>16,641</b>	<b>19,130</b>	<b>20,545</b>	<b>22,883</b>	<b>24,709</b>
Accounts payable	6,131	6,746	6,942	7,825	8,143
Short-terms loans	1,857	1,260	1,323	1,390	1,459
Other liabilities	2,310	3,066	2,428	2,462	2,498
<b>Total current liabs</b>	<b>10,298</b>	<b>11,072</b>	<b>10,694</b>	<b>11,677</b>	<b>12,100</b>
Long-term debt	69	253	278	306	336
Other long-term liabs	501	519	850	850	850
<b>Total long-term liabs</b>	<b>570</b>	<b>771</b>	<b>1,128</b>	<b>1,156</b>	<b>1,186</b>
Equity	110	110	110	110	110
Reserves/other items	5,430	6,555	7,929	9,188	10,485
Shareholder equity	5,540	6,665	8,039	9,297	10,594
Minority interest	233	622	684	753	828
<b>Total equity</b>	<b>5,773</b>	<b>7,287</b>	<b>8,723</b>	<b>10,050</b>	<b>11,422</b>
BVPS (RMB basic)	4.92	5.92	7.14	8.25	9.40

### Valuation

YE 31 Dec (x)	FY18	FY19	FY20E	FY21E	FY22E
PE	3.9	3.0	3.0	2.9	2.8
PB	0.9	0.7	0.6	0.5	0.5
EV EBITDA	1.5	1.1	0.8	0.8	0.5
Dividend yield (%)	7.5	7.6	10.3	10.7	11.0
FCF yield (%)	28.0	12.5	19.7	12.4	31.0

### Performance

YE 31 Dec	FY18	FY19	FY20E	FY21E	FY22E
<b>Growth (%)</b>					
Revenue	29.2	16.9	4.0	4.0	4.1
Gross profit	16.5	14.7	3.1	5.3	5.3
Operating profit	6.0	32.6	0.2	0.4	2.5
Net profit	10.4	29.3	2.0	3.3	3.2
EPS	10.4	29.3	2.0	3.3	3.2
<b>Profitability ratios (%)</b>					
Gross profit	11.8	11.5	11.4	11.6	11.7
EBITDA	6.5	7.0	6.9	6.8	7.0
Net profit	3.7	4.1	4.1	4.0	4.0
ROE	25.0	27.6	23.3	20.5	18.4
ROA	8.5	9.4	8.7	8.2	7.7
<b>Solvency (x)</b>					
Net gearing ratio (%)	(33.1)	(36.2)	(38.9)	(34.0)	(38.2)
Current ratio	1.1	1.2	1.3	1.3	1.4
Quick ratio	0.8	0.8	0.9	1.0	1.1
<b>Operating capability (days)</b>					
Total assets t/o ratio (x)	2.1	2.1	2.1	1.9	1.9
Receivable	13	13	15	30	30
Payable	72	68	67	73	73
Inventory	37	37	37	33	33
Cash conversion cycle	(22)	(17)	(15)	(10)	(10)

Source: Company data, Huatai HK Research estimates

## Valuation methodology and risks statement

Our target price of HKD12.00 is an average of DCF and PE valuations.

Our DCF model values Tianneng at HKD15.60 per share. We apply a WACC of 9.5% in our DCF model, based on cost of equity of 13.2%, risk free rate of 3.0%, market risk premium of 8.0% and beta of 1.27. The after-tax cost of debt is assumed to be 3.7%, subject to a tax rate of 19% and target debt-to-equity ratio of 40.4%. We assume a terminal growth rate of 0%, to factor in the potential risks of zero growth in lead-acid battery demand. Previously our DCF model valued Tianneng at HKD17.00 per share based a WACC of 8.8%.

Tianneng has been trading at an average of around 5.1x forward PE since its IPO in 2017, substantially lower than other stocks in the manufacturing sector. The low valuation could be attributable to: 1) lead-acid batteries have lower energy density compared lithium-ion batteries, thus some people believe that lead-acid batteries will be replaced going forward, though such people disregard the low costs, high safety and high recyclability associated with lead-acid batteries; and 2) the lead-acid battery market was very fragmented before 2014, and irrational price competition led to substantial decline prices and profit margins, as well as volatility in earnings. However, the profit margins of industry leaders have recovered and stabilized since 2016.

The stock is valued at HKD8.40 using PE valuation, based on a prudent valuation multiple of 5x on 2020E PE (previous valuation of HKD7.60 based on 5x 2019E PE). Considering the intrinsic value and historical trading pattern of the stock, we derive our target price of HKD12.00, based on the average of our DCF (HKD15.60) and PE (HKD8.40) valuations.

**Fig.3. Tianneng: DCF valuation**

(RMBmn)	FY19	FY20E	FY21E	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E
EBIT	2,381	2,397	2,430	2,505	2,085	2,131	2,178	2,227	2,277	2,328
- Tax	(400)	(411)	(462)	(476)	(396)	(405)	(414)	(423)	(433)	(442)
+ D&A	481	526	575	681	729	774	814	857	895	935
- CAPEX	(1,118)	(1,118)	(1,118)	(1,000)	(1,060)	(1,124)	(1,191)	(1,262)	(1,338)	(1,419)
- Change in working capital	(259)	(179)	(612)	34	(8)	22	22	23	24	25
<b>Free cash flow</b>	<b>1,085</b>	<b>1,216</b>	<b>813</b>	<b>1,744</b>	<b>1,349</b>	<b>1,398</b>	<b>1,410</b>	<b>1,422</b>	<b>1,425</b>	<b>1,427</b>
Year		1	2	3	4	5	6	7	8	9
PV		1,111	679	1,329	939	889	819	754	690	631
Sum of PV of FCF	7,841									
Terminal growth (%)	0	Assumptions (%)								
PV of terminal value	6,660	Tax rate								
<b>Total NPV</b>	<b>14,501</b>	19.0								
+ Cash	5,446	Cost of debt								
- Debt	(3,661)	<b>Cost of debt (after tax)</b>								
- Minority interest	(622)	3.7								
<b>Equity value</b>	<b>15,663</b>	Risk free rate								
		3.0								
		Market risk premium								
		8.0								
		Beta								
		1.3								
		Equity risk premium								
		10.2								
		<b>Cost of equity</b>								
		<b>13.2</b>								
		Target debt ratio								
		40.4								
		<b>WACC</b>								
		<b>9.5</b>								
Number of shares	1,127									
Value/share (RMB)	13.90									
RMB/HKD	1.12									
<b>Value/share (HKD)</b>	<b>15.60</b>									

Source: Company data, Huatai HK Research estimates

Downside risks: 1) a significant decline in demand for electric bikes; 2) substantial increase in lead prices; and 3) weaker-than-expected profit margins.

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