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Is Tianneng Power's performance surprise "enough power"?

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Tianneng Power (00819.HK) is a private company headquartered in Changxing, Zhejiang. Its main business is the production and sale of lead-acid batteries for electric bicycles and tricycles. It was listed in Hong Kong in 2007.

The company has expanded into the lithium battery business in recent years, and currently this business contributes little to the company's overall revenue. Judging from the 2015 financial report, lithium batteries accounted for only 3.1% of the turnover by product, pure electric vehicle batteries accounted for 9.8%, and electric bicycle batteries and electric tricycle batteries accounted for 82.8% of the total.

Due to overcapacity, the electric vehicle battery industry has been fiercely competitive in recent years, and Tianneng Power suffered a loss of up to 300 million yuan in 2014. But by 2015, it turned profit-making in one fell swoop, making a profit of more than 600 million yuan. Tianneng Power's explanation is "successful transformation", and the stock price has risen along the way. Is this really the case?

Industry boom

Tianneng Power is developed with the rise of China's electric bicycle industry. The lead-acid batteries it produces are supplied to many domestic electric bicycle manufacturers and after-sales markets.

China's e-bike industry has experienced a process from prosperity to recession in the past ten years: in the years 2005-2010, the sales of new e-bikes in China have maintained rapid growth every year. With the increase in ownership, the improvement of people's living standards and the strengthening of government supervision of electric bicycles, the growth of demand for electric bicycles has slowed down since 2011 and has reached an



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inflection point in 2014. Shipments of new electric bicycles fell by 15% -20% each year in 2014 and 2015, and manufacturers have dropped from more than 2,000 peaks to around 700.

Tianneng Power and Chaohong Power (00951.HK), another Hong Kong stock company listed in Zhejiang Changxing, have been the two largest battery suppliers in the domestic electric bicycle market for a long time. At the beginning of 2008, Tianneng Power was the largest supplier in the country, with a market share of about 20% for electric bicycle batteries, and Chaowei had a share of more than 10%. In the next few years, Chaowei grew faster and gradually caught up with Tianneng. By 2010, the two had more than 20% of the market share of electric bicycle batteries.

In 2011, due to the lack of environmental protection measures, the production of "blood lead" accidents occurred frequently, and many local governments, including Zhejiang, conducted a suspension check on all enterprises in the province. This move led to the rapid integration of lead-acid battery manufacturers, and many non-standard small workshops were ordered to stop production. The number of electric bicycle lead-acid battery manufacturers quickly reduced from more than 3,000 to less than 1,000. The profit of battery manufacturers It was also the highest in history in 2011 due to the short supply of products. In the first half of 2012, the Ministry of Industry and Information Technology issued the "Access Conditions for Lead Storage Battery Industry". The harsh access conditions are intended to eliminate backward production capacity and avoid the deadlock of overcapacity. However, contrary to expectations, environmental protection and the establishment of access thresholds have not reduced or controlled the production capacity of the entire industry. On the contrary, driven by short-term profits and large-scale drive, the surviving manufacturers have begun large-scale capacity expansion, of which, the capacity expansion of Tianneng and Chaowei is particularly obvious. We calculated from various industry reports and interviews that as of 2014, the production capacity of the two companies and their subsidiaries is likely to be close to 400 million units, exceeding the national demand.

In the context of overcapacity, the price wars of electric bicycle batteries have continued in recent years, and the profits of the two companies have continued to decline. The 2014 financial report showed that Tianneng Power suffered a loss of 290 million yuan for the whole year, while Chaowei Power also reported a loss of 30 million yuan. The endless capacity expansion and continued price war have also left the two companies with heavy debt burdens.

The mystery of performance reversal

However, in the 2015 performance briefing that ended not long ago, Tianneng Power provided a "surprise" answer, and the annual performance had a major reversal. Not only did all sectors, including electric bicycle batteries, record revenue growth, the net profit jumped to 630 million yuan. In the performance meeting and subsequent roadshows, the management talked about "successful transformation" and believed that the lithium batteries and lead-acid batteries provided by electric vehicles and micro electric vehicles became the company's new performance growth points.

The battery business revenue of lithium batteries and micro electric vehicles was only 560 million yuan and 1.75 billion yuan in 2015, accounting for only 3% and 10%. If calculated according to the operating profit margin of 6% of these two businesses (guidance provided by the company), the pre-tax profit contributed is only 140 million yuan.

What is the profit of the electric bicycle and tricycle battery business, which accounts for nearly 83% of its revenue, in 2015 to support the annual performance



reversal? Since the first half of 2015, Tianneng Power has actively released signals, claiming that the price war has finally come to an end after several years. The management of Tianneng Power stated that its shipment price of electric bicycles and tricycles in 2015 was significantly higher than that in 2014. But is this really the case?

We visited 12 sales managers of Tianneng and Chaowei in major regions of the country (including East China, Northeast China, and North China), of which 5 were from Chaowei and 7 were from Tianneng. One of the feedbacks from all sales managers is the same: the price war in 2015 did not stop but became more dramatic. Taking the most common 48V12AH battery as an example, the settlement price in 2015 (after subsidies in the form of rebates, oil tickets, etc.) was 30-30 yuan lower than the average price of a group of batteries in 2014. In the small peak season of early 2015, the settlement price of a group of 48V12AH battery dealers was 300-320 yuan. The price was adjusted to 280-300 yuan in April 2015. In July, the peak season did not rise, and the price dropped to 240-270 yuan. In November, it rose slightly to 260-270 yuan. In 2014, all prices in the same period were 10% -15% higher than in 2015.

A sales manager said that in 2015, the demand for new electric bicycles fell sharply, and the secondary market (that is, the after-sales market) remained basically unchanged. The overall demand fell by about 10%, and the overcapacity was very serious. Another sales manager said, "Now my agent has more than one month of inventory. The pressure is very large, and it is normally half a month." Another manager said, "An interesting phenomenon also occurred in 2015. The Changxing government has all Intervened ... But (the price war stopped) only lasted for a short time, and the two started fighting in private. "

Reviewing relevant industry reports during 2015 is also consistent with our survey results.

We infer that whether it is Tianneng or Chaowei in 2015, its electric bicycle and tricycle lead-acid battery business has not actually turned losses, but the losses continue to expand. In 2015, the actual ex-factory prices of the two companies were 10% -15% lower than in 2014, while the price of lead, which accounted for 60% -70% of production costs, fell only 5% -7% throughout the year. Several interviewees mentioned that taking the common 48V12AH battery as an example, the cost of production plus logistics is already around 270-280 yuan, not counting management, research and development, and sales. "Sometimes in 2015, the price of a group of battery terminals is only 270 yuan, and the 240-260 yuan to the agent must be losing money." A sales manager of Tianneng said.

The traditional main business has not turned losses, and the profit contribution of the "new business" deliberately emphasized by Tianneng is very limited. Why did the 2015 financial report reverse the performance?

Suspected whitewashed balance sheet and cash flow

As of the end of 2015, Tianneng Power's accounts and bills receivable totaled nearly 2.4 billion yuan. And we learned from the sales manager of Tianneng that for the after-sales battery revenue that accounts for more than half of Tianneng's sales, both Tianneng and the dealer are paid first and then delivered, and there is no billing period at all. The payback cycle for new electric bicycle batteries, miniature electric vehicle lead-acid batteries and lithium batteries is only one to two months. Calculated in this way, the company's accounts receivable and bills should not exceed 500 million yuan. We think Tianneng is likely to increase sales revenue and profits by making accounts receivable larger.

It is worth noting that Tianneng's bills payable at the end of 2015 increased significantly by 1.5 billion yuan to 1.7 billion yuan, which caused the company to generate a seemingly considerable operating cash flow in 2015, and the debt ratio also appeared to have dropped significantly. However, the creditor's rights of the bills payable in the bank are more like short-term loans. It is not known why Tianneng Power's 1.7 billion yuan bills payable were generated, when they were repaid, and how they were repaid, but what is certain is that the company's 2015 cash flow and debt ratio have not improved significantly.

In the 10 years from 2005 to 2014, Tianneng only generated a small amount of free cash flow (Free Cash Flow) in two years (2008 and 2013), and all other years were negative. In these 10 years, the company invested a total of 4.4 billion yuan in capital expenditures, and the operating cash flow generated during the period was less than 2.5 billion yuan.

The sustainability of the new business is worrying

Tianneng's lead-acid battery business and electric vehicle lithium battery business are indeed better than the main bicycle battery business at present, but the contribution of these two new businesses is still very limited, and the future sustainability is also worrying.

Let me talk about the lead-acid battery business of micro electric vehicles. Judging from the current situation, this business has limited room for future growth. Customers of micro electric vehicles are mainly internal vehicles that do not require licenses, such as patrol vehicles, logistics vehicles, and golf carts. From the perspective of government and policy, regardless of past, present, and future, this part of low-speed electric vehicles will not be encouraged and allowed, and lead acid is not the direction of policy encouragement. Therefore, its market capacity is very limited.

As for the lithium battery business that Tianneng has high hopes, compared with its strong competitors in this field, Tianneng has no advantages in terms of technology, capital and scale. In 2016, Samsung, LG and many domestic manufacturers have been put into production, and Tianneng's profit on lithium batteries in 2015 may be difficult to maintain.

In summary, we believe that Tianneng's profitability in 2015 is doubtful. With a very optimistic estimate, Tianneng's real profit will not exceed 200 million yuan per year in 2016 and the next few years. If a 10-fold valuation is given, the enterprise value corresponding to Tianneng will be no more than 2 billion yuan, minus the net debt of 2.5 billion yuan (including 1.7 billion yuan bills payable), and the equity value is minimal. At present, the market value of Tianneng's stock once exceeded 9 billion Hong Kong dollars, far exceeding its actual value.

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