

Leoch International

1H in line; expecting more in 2H

to summarize...

- Revenue and net profit increment in 1H generally in line with our estimation
- Peers on suspension opens opportunities in motive battery and SLI segment
- Expansion is on the fast track since 2H this year to 1H 2013, in our view
- Our profit forecast for coming 3 years largely remains the same
- Reference TP remained at HK\$4.32 for now

Interim results encouraging. Leoch announced interim results on Tuesday. Revenue increased 64% YoY to RMB1,548m for 1H FY12/11A, of which reserve power batteries contributed 83.5% revenue, followed by SLI batteries and motive power batteries at 11.5% and 4.1% respectively. Revenue and gross profit were generally in line with our estimates. As discussed in our previous report, we believe Leoch has established reasonable price linkage mechanism that tends to maintain a stable per tonne gross profit. While there were other income and gains at RMB27m largely related to government grants for the period, actual net profit of RMB182m was 17% higher than our previous estimates. Table 1 shows 1H FY12/11A financial performance compared to 1H and 2H 2010. Table 2 shows actual figures for 1H FY12/11A and our previous estimates. Note that there was interim dividend of HK\$0.033 per share.

Table 1. Interim results overview

	1H FY12/10A	2H FY12/10A	1H FY12/11A	YoY
Revenue	944	1,172	1,548	64%
Gross profit	237	289	361	53%
EBIT	160	162	233	46%
EBT	150	150	214	43%
Net profit	127	131	182	44%

Table 2. Actual figures for 1H FY12/11A and previous estimates

	1H FY12/11A	Our estimates	Deviation
Revenue	1,548	1,548	0%
Gross profit	361	354	2%
Other income and gains	27	5	396%
Net profit	182	156	17%
EPS (RMB)	0.137	0.117	17%

Source: Leoch, SBI E2-Capital

Industry and company outlook. Leoch invested in environmental measures long before wave of suspensions within lead acid battery industry. While a good number of lead acid motive batteries producers are still on suspension, Leoch is expanding quickly especially in motive batteries and SLI batteries. For 1H 2011, gross profit from SLI segment and motive power segment increased substantially to RMB38.0m and RMB17.8m respectively, up from RMB16.9m and RMB2.5m. In fact, the management expects particular growth drivers to be: 1) UPS for 2011; 2) motive and SLI batteries for 2012; 3) pure lead batteries and renewable batteries for 2013. As gross profit per tonne would stay relatively stable, volume increment would continue to be major driving force, in our view. Our assumptions on capacity, shipment and gross profit per tonne largely remain the same, and so do profit forecasts. Reference target price remained at HK\$4.32.

Ticker	0842 HK
Rating	Not Rated
Price (HK\$)	3.61
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	2.95-5.36
Market cap. (US\$m)	621.1
Daily t/o (US\$m)	0.75
Free float (%)	25.0

Financial summary

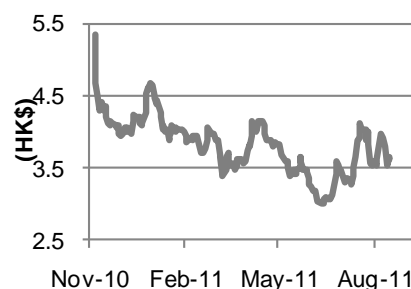
Year to Dec	09A	10A	11F	12F	13F
Turnover (RMBm)	1,392	2,117	3,870	6,940	9,188
Net Profit (RMBm)	145	258	468	749	973
EPS (RMB)	0.11	0.19	0.35	0.56	0.73
P/E (x)	25.3	14.3	8.5	5.3	4.1
P/B (x)	8.6	2.9	1.7	1.4	1.1
EV/EBITDA (x)	19.5	8.9	5.8	3.6	2.6
Yield (%)	0.0	0.0	2.8	4.5	5.9
ROE (%)	34.0	20.0	20.4	26.5	27.3
ROCE (%)	27.6	20.7	24.2	32.6	38.4
N. Gear. (%)	49%	cash	12%	cash	cash

Source: SBI

	11F	12F	13F
Consensus EPS (RMB)	0.350	0.490	0.660
Previous earnings (RMBm)	479	753	977
Previous EPS (RMB)	0.359	0.565	0.732

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	13.7	21.5	n.a.
Actual price changes (%)	(1.4)	4.0	n.a.



Source: Bloomberg

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Sales breakdown at a glance. Table 3 shows sales breakdown for various product types for 1H FY12/11A and Table 4 shows sales destination breakdown in the last two full financial years and first half of the current financial year. While UPS remained to be the largest segment, SLI batteries, motive batteries and products for renewable energy rose quickly to contribute meaningful portions. Of the new capacity in progress, 25 lines go to SLI batteries and another 25 lines go to motive power batteries. Going forward, SLI batteries and motive power batteries would be major volume driver for the company. For instance, Leoch passed the accreditation of Haojue Group, the largest motorcycle manufacturer in China to become one of its certified suppliers to supply SLI battery to Haojue Group for its Haojue and Suzuki brand of motorcycle.

Table 3. Sales breakdown for Leoch products

RMBm	Turnover	Gross profit	Gross margin
UPS	712	152	21.3%
Telecom	337	88.6	26.3%
Other consumables	209	45.0	21.5%
SLI batteries	178	38.0	21.4%
Motive power batteries	63.5	17.8	28.1%
Renewable energy	32.5	18.6	57.2%
Others	15.5	1.5	9.5%
Total	1,548	361	23.3%

Table 4. Sales destination breakdown

RMBm	FY12/09A	FY12/010A	1H FY12/11A
China	625	878	720
EU	248	409	293
US	256	344	215
Other Asian countries	202	399	258
Others	59	86	62
Total	1,392	2,117	1,548

Source: SBI E2-Capital

Pricing mechanism, assumptions and profit forecast. Leoch has prudent pricing mechanism. Upon receiving purchase order, the company quote product price on a dollar-plus-cost basis to customers after getting lead price quotes. While revenue largely depends on lead price, we strongly suggest investors to look at gross profit in dollar terms. Table 5 shows our key assumptions in connection to operations. Table 6 and Table 7 show our P&L forecast for FY12/11F, FY12/12F and FY12/13F respectively. For full year results, gross profit is estimated at RMB945m and RMB1,528m while net profit is estimated at RMB468m and RMB749m for FY12/11F and FY12/12F.

Table 5. Expansion riding on industry consolidation with slight squeeze in margin

	FY12/09A	FY12/10A	FY12/11F	FY12/12F	FY12/13F
Effective capacity in kWh m	3.5	5.9	9.6	16.5	23.0
Effective capacity in tonne	84,000	141,600	230,400	396,000	552,000
Utilization	84%	71%	78%	81%	80%
Shipment in tonne	70,250	100,000	180,000	321,600	441,600
Shipment growth rate	28%	42%	80%	79%	37%
Gross profit per tonne RMB	4,120	5,256	5,250	4,750	4,750

Table 6. Profit and loss forecast (Full-year)

RMB m	FY12/09A	FY12/10A	FY12/11F	FY12/12F	FY12/13F
Revenue	1,392	2,117	3,870	6,940	9,188
Cost of goods sold	(1,102)	(1,591)	(2,925)	(5,413)	(7,091)
Gross profit	289	526	945	1,528	2,098
Other income and gains	21	22	27	0	0
Selling and marketing expenses	(57)	(76)	(117)	(209)	(287)
Administrative expenses	(70)	(119)	(198)	(354)	(486)
Other operating expenses	(13)	(30)	(33)	(0)	(0)
Operating profit	169	322	624	965	1,325
Finance costs	(10)	(22)	(39)	(29)	(28)
Profit before tax	160	300	585	936	1,297
Income tax expense	(15)	(42)	(117)	(187)	(324)
Net profit	145	258	468	749	973
Reported EPS (RMB)	n.a.	0.243	0.351	0.562	0.729

Source: SBI E2-Capital

Table 7. Profit and loss forecast (Half-year)

RMB m	1H FY12/10A	2H FY12/11A	1H FY12/11A	1H FY12/11F
Revenue	944	1,172	1,548	2,322
Cost of goods sold	(708)	(884)	(1,186)	(1,739)
Gross profit	237	289	361	584
Other income and gains	5	17	27	0
Selling and marketing expenses	(27)	(49)	(43)	(74)
Administrative expenses	(55)	(65)	(79)	(119)
Other operating expenses	(1)	(29)	(33)	(0)
Operating profit	160	162	233	391
Finance costs	(10)	(13)	(20)	(20)
Profit before tax	150	150	214	371
Income tax expense	(23)	(19)	(31)	(86)
Net profit	127	131	182	285

Source: SBI E2-Capital

Our view and reference target price. The counter is currently trading at 8.5x and 5.3x P/E for FY12/11F and FY12/12F based on our revised forecast, which represents a slight premium in over peers in connection to Leoch's wide range of products. We initiate our reference target price at HK\$4.32 last month and the counter rose 9% as of yesterday close. We continue to remain positive towards fundamental especially after first post-listing interim results were released. We expect shipment to increase significantly and product price to remain strong for 2H 2011 and afterwards. Reference target price was maintained at HK\$4.32.

Table 8. Peers valuation statistics

Company name	Ticker	Fiscal year	Mkt cap (US\$m)	His P/E (x)	1-Yr P/E (x)	2-Yr P/E (x)	PB (x)	ROE (%)
LEOCH INT'L	842 HK Equity	12/2010	621.1	11.8	8.6	5.8	1.9	20.0
TIANNENG POWER	819 HK Equity	12/2010	608.9	11.1	7.9	6.0	2.0	19.0
CHAOWEI POWER	951 HK Equity	12/2010	529.2	10.8	7.3	5.3	2.5	26.1
COSLIGHT TECH	1043 HK Equity	12/2010	132.8	107.3	7.5	4.8	0.6	0.6
				avg:	7.8	5.5		
CAMEL GROUP CO-A	601311 CH Equity	12/2010	1,553.6	23.0	29.7	23.0	9.2	33.1
FENGFAN CO-A	600482 CH Equity	12/2010	1,061.7	149.3	76.4	47.9	6.4	4.5
ZHEJIANG NARAD-A	300068 CH Equity	12/2010	782.1	59.6	74.5	35.7	2.1	5.3
				avg:	60.2	35.5		

Source: Bloomberg

Table 9. Major shareholders

	Shareholding
Chairman Dong Li	75%
Public	25%
Total	100%

Source: HKEx

Table 10. Balance sheet items

RMB m	FY12/08A	FY12/09A	FY12/10A	FY12/11F	FY12/12F
Non-current assets	382	445	638	1,298	1,331
Property, plant and equipment	301	368	521	1,154	1,173
Prepaid land lease payments	40	42	58	115	117
Other non-current assets	41	35	59	29	40
Current assets	411	646	2,446	2,441	3,682
Inventories	99	181	688	915	1,235
Trade and bills receivables	230	340	585	952	1,330
Prepayments, deposits and other receivables	13	29	175	196	469
Time deposit with terms over 3 months	0	0	721	0	0
Pledged deposits	15	19	67	108	193
Cash and cash equivalents	36	43	179	270	455
Other current assets	20	35	31	0	0
Non-current liabilities	0	1	0	0	0
Current liabilities	437	593	1,004	1,271	1,878
Trade and bills payables	142	163	345	456	953
Other payables and accruals	118	131	161	239	502
Bank borrowings	64	173	417	526	373
Other current liabilities	114	126	81	50	50
EQUITY	356	497	2,080	2,496	3,151

Source: SBI E2-Capital

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SELL : absolute downside of >10% over the next six months

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