

CATL (300750)

The clear market leadership implies opportunity for long term investors

25 Jun. 2018

Investment Highlights:

- ❖ **Why does CATL, whose market cap stands at Rmb150bn, now presents opportunity for long term investors?** Assuming China's NEV sales volume tallies 2.10mn units in 2020E, the NEV sector will then need c. 100Gwh of lithium battery. CATL claims a share of c. 40% in the Chinese EV battery market. Given this, coupled with its supply to overseas markets, its overall shipment is expected to hit c. 50Gwh in 2020E, equivalent to revenue of c. Rmb44bn. This and its revenue from businesses such as lithium battery materials add up to nearly Rmb50bn. Assuming CATL's reasonable profit margin is 10%, this overall revenue translates into net profit of c. Rmb5bn. Given that CATL's profit is still expected to grow by 30% post 2020E, based on PEG=1, we apply 30x PE to it and arrive at a fair market cap of Rmb150bn. CATL's market cap stands at Rmb14.46bn now. Given its small size of IPO, which is reflected in its current free float of only Rmb14.50bn, we believe CATL's last price is a prime entry point for long term investors.
- ❖ **Will CATL be able to maintain a market share of 40%+?** CATL's shipment tallied 11.9Gwh in 2017, taking up 33% of the entire Chinese EV battery market. In the same year, installation of its EV batteries in pure electric PVs and buses hit 31% and 39.4% as CATL became EV battery supplier to 50%+ of Chinese EV makers, including SAIC, Geely, BAIC, Yutong Bus, King Long, Nio etc. In terms of supplying EV batteries to new energy buses entitled to government subsidies, CATL is EV battery supplier for 17% of new energy bus models on the 5th List for 2018. If the Class A00 PVs are excluded, we expect CATL to supply EV batteries to 30%+ of models on this List. Given the huge supply of EV batteries by CATL to makers of those models, we expect CATL's overall share in China's EV battery market to exceed 40%. Besides, CATL has also inked strategic supply agreements with global clients such as Volkswagen, Daimler, BMW etc. Of which, its supply agreement with Volkswagen is order for batteries for EVs manufactured on the MEB platform. In addition, CATL has decided to put up factories in Europe and other overseas markets in a bid to wedging into the global supply chains of NEV makers.
- ❖ **Will CATL be able to maintain a reasonable profit margin of 10%?** Net margin of the EV (lithium) battery segment hit 20%+ during 2015 and 2016 on exponential growth in the demand for NEVs. CATL's recurring net margin fell to 12% in 2017 on 1) thinner subsidies, and 2) expanded supply across the segment. We view that the profit margin of the lithium battery segment will remain under downward pressure over the next two years to come along with accelerated exit of the subsidy policies for the NEV sector and clear-out of the competitive landscape in the EV battery segment. However, seen from another angle, reasonable



BUY (Reiterate)

Current price: Rmb66.55

Target price: Rmb82.60

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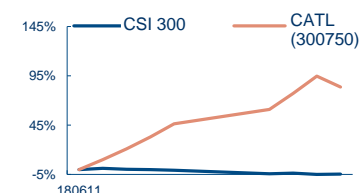
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Performance relative to the index



Source: CITICS Quantitative Investment Analysis System

Main data

CSI 300	3,608.9
Total equity/shares o/s (mn)	2,172.4/217.2
LTM High/low (Rmb)	70.54/36.2
1-month absolute gain	83.84%
6-month absolute gain	83.84%
YTD Absolute gain	83.84%
LTM Average daily turnover (Rmb mn)	984.32

profit margin of the lithium battery segment is expected to fall in the range of 10%-12%, the median of the 6%-20% range for the auto part segment as 1) lithium battery will be the one with the highest value among all parts of a NEV in future and 2) a competitive landscape, which is similar to that in the auto glass segment, is expected to finally emerge in the lithium battery segment.

- ❖ **Will CATL still deserve a PE multiple of over 30x post 2020?** China's NEV sales volume is forecast to hit 2.10bn in 2020. Of which, we assume PVs tally c. 1.60mn units and CVs c. 0.50mn units with new energy PVs taking up only c. 6% of China's total PV ownership. We view that the year of 2018 is the maiden year for solid NEV products with more and more good NEVs to roll off the production lines. Such a trend will in turn drive the auto sector into the era of "blockbuster NEV models" from the era of "Blockbuster SUV models". We expect the proportion of NEV in PVs to rise to 25% post 2025 and the EV battery segment to maintain a CAGR of 25%+. As a leading maker of EV batteries, CATL is expected to deliver above-average growth of 30%+ on its leading technologies and premium clients.
- ❖ **Potential risks:** Sales volume of the NEV sector not up to expectation, sharper than expected decline in lithium battery prices, alteration in EV battery technologies etc.
- ❖ **Earnings forecast, valuation and investment rating.** Based on cautious EV battery price forecast, we lower the Company's 2018/19/20 net profit estimates to Rmb3.09bn, Rmb4.27bn and Rmb5.51bn from Rmb3.24bn, Rmb4.64bn and Rmb6.16bn and its recurring net profit estimates to Rmb2.70bn/3.91bn/5.13bn from Rmb2.88bn/4.25bn/5.84bn. The Company, as a leading EV battery maker, stands to benefit substantially from ramp-up of the NEV sales volume. We value it at 35x 2020E PE based on PEG valuation method considering 1) CATL's prospective and proactive exposure to technologies, products and capacity and 2) increasingly stable competitive landscape in the EV battery segment post 2020E, and arrive at a target price of Rmb82.60. Retain BUY.

Item/Year	2016	2017	2018E	2019E	2020E
Turnover (Rmb mn)	14,879	19,997	25,815	40,815	51,947
Growth rate (YoY, %)	160.90%	34.40%	29.09%	58.11%	27.27%
Net profit (Rmb mn)	2,852	3,878	3,091	4,274	5,508
Growth rate (YoY, %)	206.26%	35.97%	-20.30%	38.28%	28.87%
Recurring attributable net profit (Rmb mn)	2786	2376	2699	3912	5132
Growth rate (YoY, %)	216.74%	-14.72%	13.59%	44.93%	31.19%
EPS (Rmb, basic)	1.31	1.79	1.42	1.97	2.54
Gross margin	43.70%	36.29%	30.57%	28.88%	27.51%
ROE	18.41%	15.70%	9.29%	11.58%	13.25%
PE (x)	51	37	47	34	26
PB (x)	9.2	5.5	4.1	3.6	3.2

Source: CITICS Quantitative Investment Analysis System

Note: Closing price as of 22 Jun. 2018

Income Statement (Rmb mn)

Indicator	2016	2017	2018E	2019E	2020E
Turnover	14,879	19,997	25,815	40,815	51,947
Operating cost	8,377	12,740	17,922	29,029	37,654
Gross margin	43.70%	36.29%	30.57%	28.88%	27.51%
Business tax & surcharge	109	96	124	196	249
Selling expense	632	796	981	1,551	1,974
Operating expense ratio	4.25%	3.98%	3.80%	3.80%	3.80%
Administrative expense	2,152	2,956	3,227	4,408	4,831
Administrative expense ratio	14.46%	14.78%	12.50%	10.80%	9.30%
Financial expense	80	42	130	130	131
Financial expense ratio	0.54%	0.21%	0.50%	0.32%	0.25%
Investment revenue	76	1,344	305	340	379
Operating profit	3,212	4,832	3,466	5,545	7,161
Operating profit margin	21.59%	24.16%	13.43%	13.59%	13.79%
Non-operating income	189	19	461	458	454
Non-operating expenditure	1	3	3	3	3
Total profit	3,400	4,848	3,924	5,999	7,611
Income tax	482	654	510	780	989
Income tax rate	14.17%	13.49%	13.00%	13.00%	13.00%
Minority interests	67	316	323	945	1,114
Net profit attributable to shareholders	2,852	3,878	3,091	4,274	5,508
Net margin	19.17%	19.39%	11.97%	10.47%	10.60%
Recurring attributable net profit	2,786	2,376	2,699	3,912	5,132

Cash Flow Statement (Rmb mn)

Indicator	2016	2017	2018E	2019E	2020E
Pretax profit	3,400	4,848	3,924	5,999	7,611
Income tax	-482	-654	-510	-780	-989
Depreciation & amortization	784	1,381	1,810	2,534	3,038
Change in working capital	-1,731	87	2,410	-1,189	10,869
Others	137	-3,322	-44	-72	-90
Operating cash flow	2,109	2,341	7,590	6,492	20,439
CAPEX	-2,801	-7,180	-4,937	-5,742	-4,014
Investment revenue	76	1,344	305	340	379
Others	-9,704	-1,800	-804	-885	-1,157
Investing cash flow	-12,428	-7,636	-5,435	-6,286	-4,792
Stock issuance	11,132	6,179	5,462	0	0
Change in liabilities	2,868	5,898	9,068	5,819	9,049
Dividend paid	0	0	0	-618	-855
Others	-3,029	-3,144	-130	-130	-131
Financing cash flow	10,971	8,933	14,399	5,070	8,064
Net increase in cash and equivalent	652	3,638	16,554	5,276	23,711

Source: CITICS Quantitative Investment Analysis System

Balance Sheet (Rmb mn)

Indicator	2016	2017	2018E	2019E	2020E
Cash and cash equivalent	2,457	14,081	30,635	35,911	59,622
Inventory	1,360	3,418	2,330	7,257	5,272
Accounts receivable	7,316	6,919	10,068	15,102	14,493
Other current assets	10,629	8,616	7,312	11,434	13,484
Current assets	21,761	33,033	50,345	69,704	92,870
Fixed assets	3,727	8,219	10,940	13,760	14,296
Long-term equity investment	170	791	791	791	791
Intangible assets	622	1,409	1,499	1,531	1,568
Other long-term assets	2,308	6,210	7,222	8,346	9,775
Non-current assets	6,827	16,630	20,452	24,428	26,430
Total assets	28,588	49,663	70,797	94,132	119,301
Short-term borrowing	1,227	2,245	2,245	0	0
Accounts payable	3,173	4,978	7,111	11,286	14,765
Other current liabilities	5,783	10,667	11,301	19,435	25,581
Current liabilities	10,183	17,890	20,658	30,722	40,346
long-term liabilities	302	2,129	4,129	5,129	7,129
Other long-term liabilities	2,312	3,173	10,664	18,333	26,111
Non-current liabilities	2,614	5,302	14,793	23,462	33,240
Total liabilities	12,797	23,192	35,451	54,184	73,586
Share capital	613	1,955	2,172	2,172	2,172
Capital reserve	11,609	15,355	20,599	20,599	20,599
Equity attributable to shareholders	15,489	24,701	33,254	36,910	41,563
Minority interests	302	1,770	2,093	3,038	4,152
Owner's equity	15,791	26,471	35,347	39,948	45,715
Liabilities & owner's equity	28,588	49,663	70,797	94,132	119,301

Major financial indicators

Indicator	2016	2017	2018E	2019E	2020E
Growth rate (%)					
Turnover	160.90%	34.40%	29.09%	58.11%	27.27%
Operating profit	207.05%	50.42%	-28.26%	59.97%	29.15%
Net profit	206.26%	35.97%	-20.30%	38.28%	28.87%
Margin (%)					
Gross margin	43.70%	36.29%	30.57%	28.88%	27.51%
EBIT Margin	205.51%	46.29%	-11.36%	39.28%	25.23%
EBITDA Margin	19.17%	19.39%	11.97%	10.47%	10.60%
Net margin					
Return (%)	18.41%	15.70%	9.29%	11.58%	13.25%
ROE	9.98%	7.81%	4.37%	4.54%	4.62%
ROA					
Others (%)	44.76%	46.70%	50.07%	57.56%	61.68%
Liability/asset ratio	14.17%	13.49%	13.00%	13.00%	13.00%
Income tax rate	0.00%	0.00%	20.00%	20.00%	20.00%

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