TENZING PACIFIC
INVESTMENT MANAGEMENT

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HOLDING: TPI COMPOSITE (TPIC)

Summary

TPI Composites, Inc. is manufacturer of composite wind blades. It enables wind turbine OEMs, who have relied on in-house production, to outsource the manufacturing of some of their wind blades through its manufacturing facilities. The company was founded in 1968 and is headquartered in Scottsdale, AZ. It operates primarily in the U.S., Mexico, China and Turkey

What the bulls say:

- The trend of outsourcing the component production for wind turbines will benefit TPIC as the only independent manufacturer of composite wind blades for the high-growth wind energy market. With multiple factories located in diversified geographical areas, TPIC has made itself ready to expand its operation in developing markets where onshore wind industry is forecast to grow at around 9% CAGR until 2026.
- TPI Composite's business model of shared capital investment with key clients benefit both sides of the deals that require much less initial capital investment from TPIC and also increase switching costs for clients. This will create long-term loyalty and secure future flow of revenue and income for the company. The increasing Return on Investment Capital (ROIC) from 18% in 2014 to approximately 33% in 2017 is a solid evidence for the business model's effectiveness and efficiency.
- Since its IPO in mid-2016, TPIC share price has gone upward by approximately 50% as of 19/12/2017 thanks to its impressive operating outcomes. As a leader with global foothold in the green energy industry whose best years are still ahead, TPI Composite is poised to rise further in future.

What the bears say:

- Loss of revenue from GE lines not renewed will not be fully replaced until 2019. Contracts from GE generated slightly less than 50% of TPIC in the past years, so GE's decision this year not renewing the production lines in Turkey and China and acquiring TPIC's largest competitor in April has had a negative impact that results in relatively unchanged price of TPIC's share price since April '17.
- The company's guidance for 2018 shows a drop of 26% in EBITDA compared to 2017 that will be likely to drive down its net income and profit margins. This is mainly due to the high number of production lines in transition and also pending lines under new contracts that will not be go into production until the latter half of 2018. This will likely entail uncertainty from investors whether the company is able to sustain its growth in short run.

Risks:

- TPI Composite is essentially a one-product manufacturer. While TPIC's current supply agreements with customers are sufficient to generate strong flow of revenue, estimated at $4.4 billion, in the next 5 years, its customers may cut or reduce the size of the contracts and produce the wind blades in house. If this occurs, it will siginificantly dampen the company's primary business.
- TPIC's attempt to diversify its product lines may fail if the rosy outlook of composite electric vehicles, especially the public transportation buses, does not materialize. Government funding is the primary source for public bus purchases, with a sharply

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reduced tax rate that is widely expected to generate less revenue for the government, a big cut in government spending for public transport vehicle is a major threat for TPI Composite.

4 reasons to buy/sell:

- Wind blades are the 2nd largest component of the total cost of wind turbines. TPIC's leading and innovative technology allows wind turbine producers to cut cost by outsourcing the manufacture of wind blades. The company' 5 key customers are among top 10 wind energy industry leaders who accounts for 99.8% of US onshore wind market and 45% of the global onshore market.
- TPIC's diversification strategy by entering the manufacturing field of electric vehicle bodies offers an immense growing opportunity as the market is still relatively small with huge potential. Just the North American electric bus market is forecast to grow by 95% CAGR until 2022. In 3Q17, it finalized a 5-year agreement to become the supplier of 3350 bus bodies with Proterra's catalyst zero emission electric transit buses.
- TPIC has a strong historical revenue growth of 52% CAGR in the period of 2013-2016 and estimated 25% this year. In the latest quarter, net sale were up 22.3% YoY and net income increased 10x, widening its key EBITDA margin to 12.4. The management explicitly stated that 2018 be an investment year in order to grow strongly in 2019 and 2020 as increasing cash flow allows more room for TPIC to focus on its capital investment plan in short run.
- Current agreements amassed $4.4B in revenue until 2023. The global onshore wind energy market healthy growth, while mature market only 0.8%, developing wind market 8.8% CAGR until 2026. TPIC recently announced the establishment of an advanced technology in Denmark to enhance its technical capabilities and expand its European customer base.

Recommendation:

We recommend a BUY rating on TPIC.

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