China EV/ESS battery

Fundamentals hold; 2Q earnings are the key

Equities
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- Recent share price weakness has diverged from resilient fundamentals. 2Q earnings should be next key catalyst
- Second half of the upcycle is where earnings quality and next growth driver visibility matter more than beta exposure
- CATL (H/A Buy/Buy; TP HKD790/RMB547) is our preferred pick in the battery sector

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What happened? Price correction has outpaced fundamental changes. The battery sector has materially underperformed despite resilient operating fundamentals. Over the past two months, the China battery index has declined 13%, while CATL A-shares have fallen 17%. In contrast, industry demand has remained robust, with China's battery sales (including exports) growing 43% YoY in both April and May. Production schedules for June and July continue to point to sequential growth, while lithium carbonate prices have stabilised within the RMB150k–200k/t range rather than moving into another extreme cycle. We therefore believe the recent correction reflects profit-taking after the sector's strong rally in the first five months (+21% vs. CSI300 +4% in the first five months of the year) and market rotation, rather than weakening fundamentals. Against a backdrop of resilient demand and stabilising costs, we see the recent sell-off as excessive.

Where are we? The upcycle remains intact, but stock selection matters more. The sector is entering the second half of the current upcycle. As the cyclical recovery becomes increasingly priced in, investors are shifting their focus towards earnings sustainability and the visibility of the next leg of growth. We expect share price performance to become increasingly differentiated, with companies offering superior profitability, stronger execution and clearer structural growth drivers outperforming the broader sector.

What's next? 2Q earnings should be the next major catalyst. The upcoming 2Q earnings season could serve as the next key catalyst for the sector. Given the low base and, in many cases, losses in 2Q25, we expect most battery companies to deliver a meaningful YoY earnings recovery in 2Q26. Positive earnings pre-announcements and reported results should help improve sector sentiment. Beyond the earnings season, however, we believe market attention will increasingly shift from the magnitude of earnings recovery to the quality and sustainability of profits.

What will drive the next leg? Three variables will shape sector performance. Demand, costs and technology are becoming the key differentiators. Demand remains supported by both EVs and ESS, while ESS's weight is rising and AI-driven power consumption is creating a new medium-term growth narrative through AIDC energy storage deployment (see our *China EV/ESS battery: From EVs to AI data centres: The next wave of energy storage demand*, 11 June 2026]). Meanwhile, lithium price volatility is increasing the value of scale, diversified customer exposure and pricing power, favouring industry leaders that can protect margins through raw material cycles. Finally, technological leadership - including sodium-ion batteries, solid-state batteries and ultra-fast charging - is becoming an increasingly important source of competitive differentiation as commercialisation gradually accelerates. Against this backdrop, **CATL remains our preferred sector exposure**, supported by its unmatched scale, diversified end-market exposure and industry-leading R&D capabilities.

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Disclosures & Disclaimer

This report must be read with the disclosures and the analyst certifications in the Disclosure appendix, and with the Disclaimer, which forms part of it.

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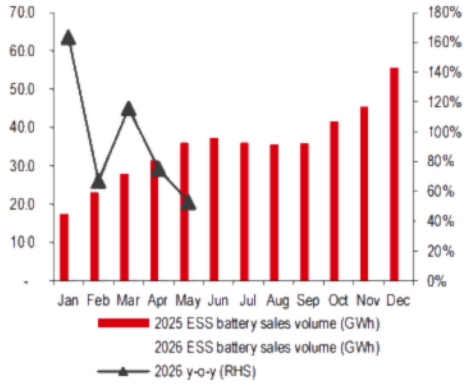
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Battery production schedules remain healthy

Battery demand remains robust. China's battery sales (including exports) reached 783GWh during 5M26, up 47% YoY, comprising 528GWh of EV batteries (+45% YoY) and 256GWh of energy storage batteries (+88% YoY). Energy storage has become the primary incremental growth driver for the battery industry.

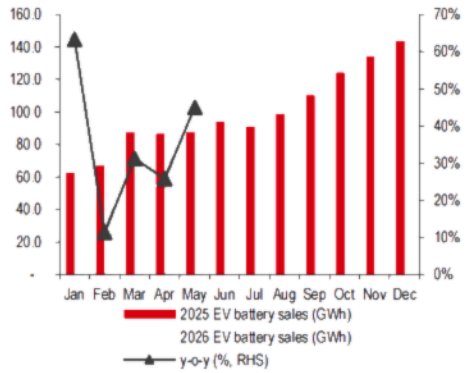
Despite the slowdown in domestic EV sales, China's EV battery installations were up 7% y-o-y in 5M26, mainly contributed by rising battery capacity per vehicle and a surging commercial EV penetration rate.

Exhibit 1. China ESS battery sales volumes (incl. exports) booked +53% y-o-y in May



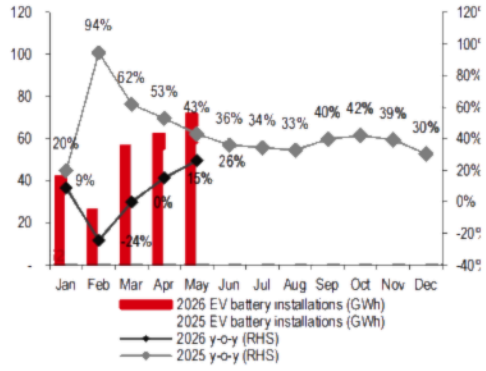
Source: CABIA, HSBC

Exhibit 2. China EV battery sales volumes (incl. exports) booked 45% y-o-y in May



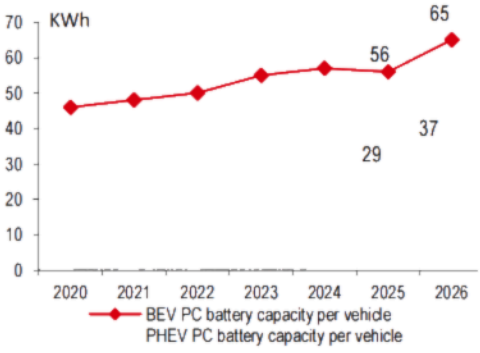
Source: CABIA, HSBC

Exhibit 3. China's EV battery installations up 7% y-o-y in 5M26



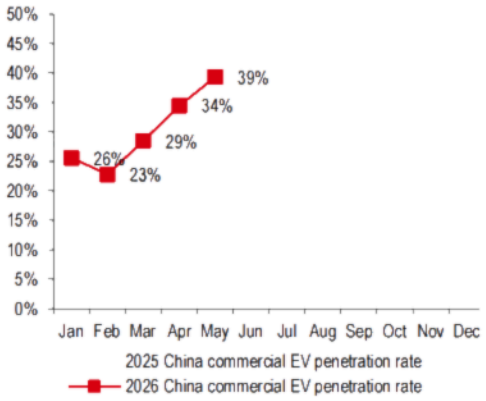
Source: CABIA, HSBC

Exhibit 4. Domestic battery capacity per vehicle grew 16% and 28% y-o-y for BEV and PHEV PC, respectively



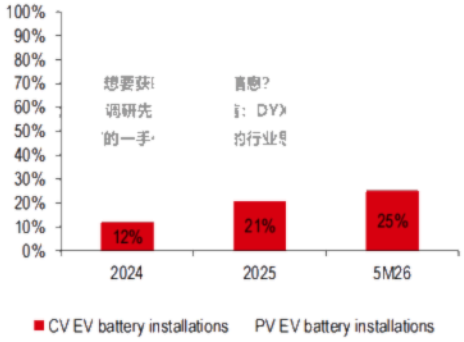
Source: CABIA, HSBC

Exhibit 5. China commercial EV penetration rate rose to 39% in May 2026



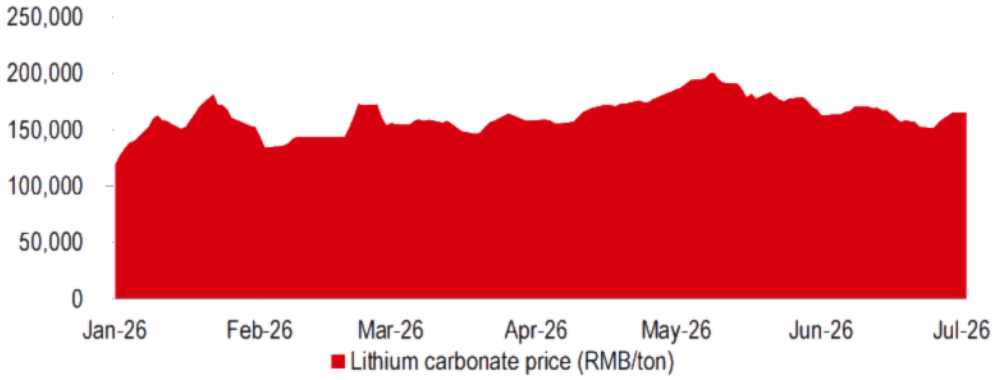
Source: CAAM, HSBC

Exhibit 6. Commercial vehicle EV battery installed volumes increased to 25% of total EV battery installed in 5M25



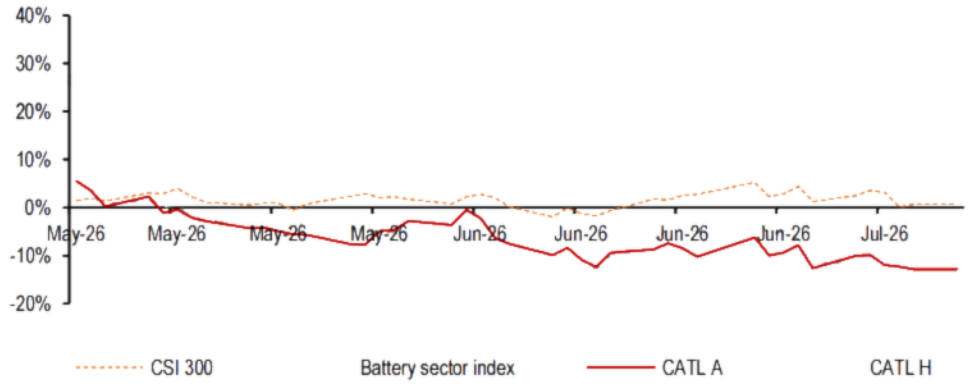
Source: CABIA, HSBC

Exhibit 7. Lithium carbonate prices have relatively stabilised within the RMB150k–200k/t range in 2Q



Source: Wind, HSBC

Exhibit 8. Battery sector underperformed since May, against resilient operating fundamentals, which we see as overcorrected



Source: Wind, HSBC

		Valuation	Risks
CATL **300750 CH** **3750 HK** **A/H: Buy/Buy**	Current price: RMB380.00 HKD675.50 Target price: RMB547.00 HKD790.00 Upside: +44%/+17%	We continue to use a DCF model to value CATL shares. With our key assumptions, including a risk-free rate of 4.25% (unchanged), a China stock market premium of 4.75% (unchanged), a WACC of 5.8% (unchanged), and a perpetual growth rate of 2.5% (unchanged), we arrive at our A-share target price of RMB547.00 (unchanged). Our target price implies c44% upside from current levels; accordingly, we maintain our Buy rating on the stock. By applying an end-2026 RMB-HKD FX rate of 1.16 (unchanged) and an H-to-A-share premium of 44% (its H-to-A share average premium since the H-shares listed, unchanged), we arrive at our H-share target price of HKD790.00 (unchanged). Our H-share target price implies c17% upside from current levels. Given we are constructive on CATL's strong earnings visibility and continued share gain potential, we maintain our Buy rating on the stock.	**Downside risks:** (1) Worse-than-expected raw materials price hike and pass-through; (2) ASP and margin pressure after the launch of the rebate programme; (3) potentially less favourable regulatory environment in overseas markets; (4) worse-than-expected execution in overseas expansion and unfavourable overseas tariff policy; (5) lower-than-expected EV/ESS market growth and market share wins; (6) potential quality/IP disputes (especially in the global market).

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Note: Priced at close of 3 July 2026. **Employed by a non-US affiliate of HSBC Securities (USA) Inc. and is not registered/qualified pursuant to FINRA regulations.*

Source: Bloomberg, HSBC Qianhai Securities estimates, HSBC

