

TCL COMMUNICATION

2618 HK

BUY

TARGET PRICE HKD10.32
CLOSE HKD8.63
UP/DOWNSIDE +19.6%

HOW WE DIFFER FROM CONSENSUS		MARKET RECS	
TARGET PRICE (%)	2.4	POSITIVE	13
EPS 2014 (%)	8.7	NEUTRAL	4
EPS 2015 (%)	14.5	NEGATIVE	0

A rising Chinese smartphone brand

■ Improving fundamentals

Increasing smartphone shipments and better product mix helped TCL Communications (TCLC) turn around in 2013. We forecast continued earnings growth in 2014 on steadily improving margins and sales. We forecast smartphone shipments of 30m in 2014 (+68% y-y).

■ Margin improvement to come

With a rising smartphone contribution and less competition in the feature phone space, TCLC's margins have been rising since 2013. We expect its OPM to reach 4.1% in 2014 and 4.5% in 2015 with earnings growth of 212% in 2014 and 29% in 2015.

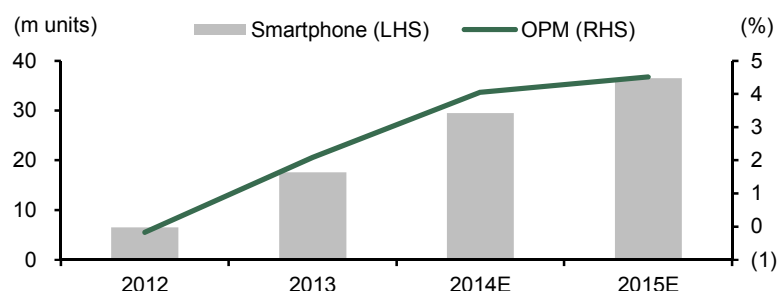
■ A Chinese LTE market beneficiary

TCLC should benefit from the LTE boom in China as operators aggressively push 4G LTE services. TCLC expects 4G products to account for 60% of its shipments in 2014. We expect this to lead to higher ASPs and margins.

■ We initiate at BUY with a HKD10.32 TP

With its improving fundamentals, we expect TCLC's share price to continue outperforming despite its strong rally last year. We initiate at BUY with a HKD10.32 TP based on 12x 2014E EPS.

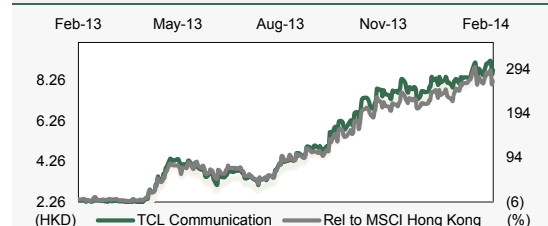
TCLC's smartphone shipments and OPM trend (2012-2015)



Sources: Company data; BNP Paribas estimates

KEY STOCK DATA

YE Dec (HKD m)	2012A	2013E	2014E	2015E
Revenue	12,031	19,362	26,718	30,399
Rec. net profit	(220)	316	1,003	1,297
Recurring EPS (HKD)	(0.20)	0.28	0.86	1.12
EPS growth (%)	na	na	212.3	29.3
Recurring P/E (x)	neg	31.2	10.0	7.7
Dividend yield (%)	0.0	1.1	4.0	5.2
EV/EBITDA (x)	13.4	7.3	2.3	1.6
Price/book (x)	4.2	3.4	2.3	1.6
Net debt/Equity (%)	48.7	58.9	(3.9)	(37.9)
ROE (%)	(8.8)	12.1	27.7	24.8



Share price performance	1 Month	3 Month	12 Month
Absolute (%)	6.9	17.6	280.2
Relative to country (%)	3.9	19.0	277.5

Next results	May 2014
Mkt cap (USD m)	1,293
3m avg daily turnover (USD m)	6.4
Free float (%)	68
Major shareholder	TCL Corp (50%)
12m high/low (HKD)	9.18/2.18
3m historic vol. (%)	47.3
ADR ticker	-
ADR closing price (USD)	-
Issued shares (m)	1,162

Sources: Bloomberg consensus; BNP Paribas estimates



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BNP PARIBAS | The bank for a changing world

Investment thesis

TCLC turned profitable in 2013 thanks to its increasing smartphone shipments and market share gains overseas. We expect this increasing scale to bring cost efficiencies, and forecast 212% earnings growth in 2014 (OPM: 4.1%) and 29% in 2015 (OPM: 4.5%).

We think its overseas exposure is better than its Chinese peers' because of Alcatel's brand recognition and relationships with telco operators. We expect TCLC to benefit from growth momentum in emerging markets where a relatively low percentage of total handsets are smartphones.

Despite the share price rally last year, we think TCLC's improving fundamentals will mean the shares continue to outperform the market in 2014. We initiate with a BUY rating and a HKD10.32 TP based on 12x 2014E EPS. This target PE multiple is at the high-end of its historical mid-range but lower than its peer group average of 15.8x (Exhibit 3).

Catalysts

We expect China 4G take-off to be the next catalyst for TCLC's shares. Management also expects its domestic China business to turnaround, with 4G products accounting for 60% of its total smartphone shipments in 2014. This should lead to higher margins.

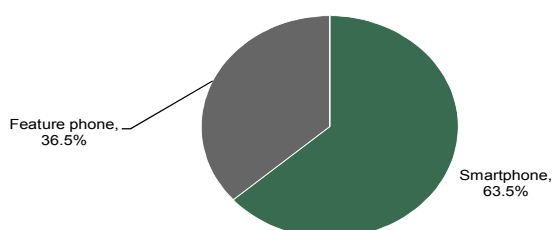
Risks to our call

Key risks are worse-than-expected smartphone shipment growth from slower-than-expected share gain in key regions. This would lead to smaller scale and put margin improvement at risk.

Company background

TCL Communication (TCLC) is a member of TCL Corp and manufactures mobile phones and accessories. In 2004, TCLC listed on the Hong Kong Stock Exchange and formed a joint venture with Alcatel. TCLC later fully acquired the JV with the right to use Alcatel's logo. TCLC promotes products under two brands – TCL (in China) and Alcatel OneTouch (in EMEA, the Americas, and APAC including Hong Kong). It is a global top-10 player in terms of mobile handset shipments.

Principal activities (revenue, 2013)



Key executives

	Title
Guo Aiping "George"	CEO
Wong Kwok Chung "Albert"	Exec VP/General Manager
Liu Yuk Tung "Thomas"	CFO

<http://www.tclcom.com>

Key assumptions

	2013	2014E	2015E
Smartphone (m units)	17.6	29.5	36.5
GM (%)	19.0	19.9	20.6
OPM (%)	2.1	4.1	4.5

Source: BNP Paribas estimates

Earnings sensitivity

	--- Base ---		--- Best ---		--- Worst ---	
	2013	2014	2013	2014	2013	2014
Sales (HKD b)	19.4	26.7	19.6	27.4	19.1	26.0
Change (%)			1.2	2.7	(1.2)	(2.7)
Smartphone spmt growth (%)	169.2	68.0	179.2	78.0	159.2	58.0
Change (%)			10.0	10.0	(10.0)	(10.0)
OPM (%)	2.1	4.1	3.1	5.1	1.1	3.1
Change (%)			1.0	1.0	(1.0)	(1.0)
EPS (HKD)	0.28	0.86	0.46	1.12	0.10	0.62
Change (%)			66.7	29.9	(65.2)	(28.5)

Source: BNP Paribas estimates

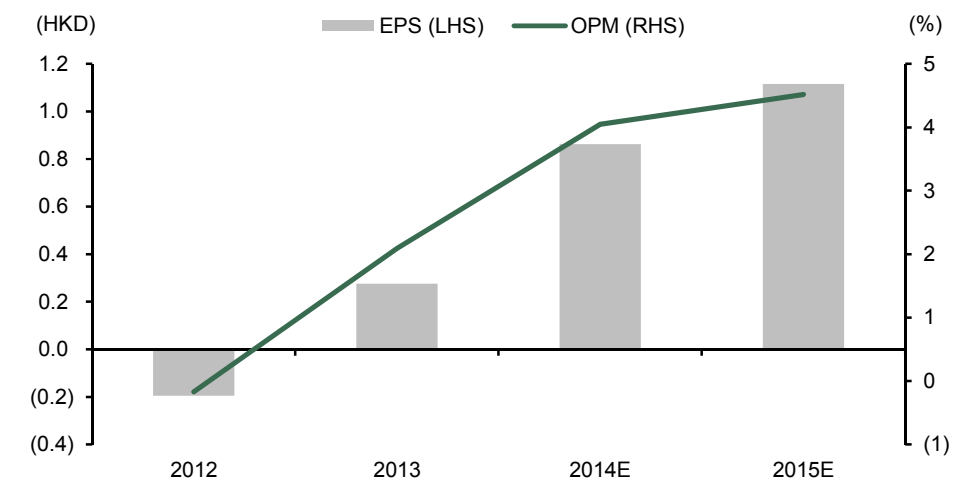
- Key earnings driver are smartphone shipments and operating margins. We estimate a 10% increase in smartphone shipments increases EPS by 1.6%/2.9% and sales by 1.2%/2.7% in 2013/14.
- Changes in OPM have a greater impact on EPS. We estimate a 1% increase in OPM, all else being equal, increases EPS by 64.3%/26.3% in 2013/14.

A rising Chinese smartphone brand

We initiate on TCL Communications (TCLC) with a BUY rating and HKD10.32 TP. Thanks to its increasing smartphone shipments and market share gains overseas, the company finally turned profitable in 2013. While TCLC's share price has rallied more than 200% in the past year, we think there is more to come. We expect TCLC's earnings recovery momentum to continue thanks to: 1) steady product innovation; 2) increasing LTE product shipments; and 3) upside in its domestic market.

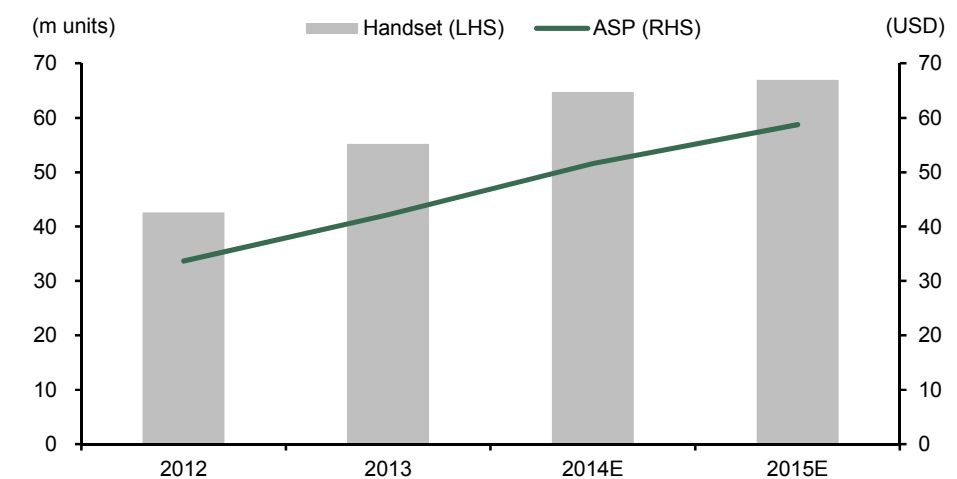
We estimate TCLC's sales and OP will trend up on the back of its improving product mix and better supply chain management. We are looking for 212.3% and 29.3% earnings growth in 2014 and 2015 with OPM sustained at 4.1% and 4.5%. Despite fierce competition from peers, we think TCLC's upside remains intact thanks to it having better exposure in overseas market than its local competitors. In addition, its more attractive pricing strategy with decent product design has helped TCLC gain share from international tier-one brands. Thanks to its steady expansion in the smartphone market and developments in tablets and wearable products, management guides for 35% y-y sales growth in 2014.

EXHIBIT 1: TCLC's earnings and OPM trend



Sources: TCL Communication; BNP Paribas estimates

EXHIBIT 2: TCLC's handset shipment and ASP trends



Sources: TCL Communication; BNP Paribas estimates

Undemanding valuation, Buy with a TP HKD10.32

TCLC is trading at 10.0x our 2014 EPS forecast vs its peer average of 15.8x. Given TCLC's robust earnings growth outlook, we think its current valuation remains compelling. We initiate on the stock with a Buy and TP HKD10.32 based on 12x of our 2014 EPS forecast. We also reference a DCF-based valuation of HKD10.53 based on a 1.5% perpetual growth rate and 16.5% WACC.

EXHIBIT 3: Valuation table

Name	BBG code	Price	P/E		EPS		P/BV		Yield		ROE		EPS growth	Mkt cap
			'13	'14	'13	'14	'13	'14	'13	'14	'13	'14	'13-14	
		(LC)	(x)	(x)	(LC)	(LC)	(x)	(x)	(%)	(%)	(%)	(%)	(%)	(USD m)
Handset components														
FIH MOBILE *	2038 HK	3.8	50.4	21.8	0.01	0.02	1	0.9	-	-	2	4.5	131.2	3,671
AAC TECH *	2018 HK	34.0	12.6	12.9	2.12	2.07	3.7	2.9	2.4	2.3	35	25.3	-2.3	5,371
BYD E	285 HK	4.3	14.3	14.7	0.3	0.3	1.1	1.0	0.7	0.5	6.7	6.9	(3.0)	1,254
SUNNY OPTICAL *	2382 HK	6.5	13.1	12.5	0.39	0.41	1.6	1.4	1.9	2.2	15.0	13.1	5.3	921
MEDIATEK *	2454 TT	445.5	21.7	16.7	20.50	26.65	2.8	2.6	2.2	3.8	14.9	17.8	30.0	23,055
LARGAN *	3008 TT	1,235.0	17.9	15.3	68.86	80.74	5.6	4.6	2.4	2.9	36.6	35.6	17.2	5,459
MERRY ELEC	2439 TT	166.0	19.6	12.6	8.5	13.2	4.7	4.0	2.8	4.4	28.3	30.3	55.7	963
FOXCONN TECH	2354 TT	68.0	12.3	11.7	5.5	5.8	1.1	1.0	1.4	1.5	9.9	9.4	5.3	2,927
CATCHER *	2474 TT	220.0	11.9	11.9	18.54	18.43	2.3	2.1	2.8	3.6	21.1	18.5	(0.6)	5,442
CHENG UEI	2392 TT	65.1	12.6	10.8	5.2	6.0	1.3	1.2	4.2	5.0	10.2	11.3	16.7	1,062
Handset brands														
HTC CORP *	2498 TT	132.0	NM	NM	(1.58)	(1.72)	1.7	1.8	-	-	(1.8)	(2.2)	NM	3,664
TCL COMMUNICATION*	2618 HK	8.5	30.9	9.9	0.28	0.86	3.4	2.5	1.1	3.9	12.1	29.4	212.3	3,664
ZTE	763 HK	15.9	35.5	21.0	0.4	0.8	2.2	2.0	1.2	1.5	10.4	10.9	68.6	7,292
COOLPAD	2369 HK	4.5	22.8	14.7	0.2	0.3	2.9	2.5	1.5	1.9	21.9	23.0	55.6	1,219
NOKIA	NOK US	7.6	28.4	22.2	0.3	0.3	2.6	2.3	0.3	0.3	9.6	10.5	28.2	28,537
APPLE	AAPL US	527.6	12.3	11.4	42.9	46.3	4.7	4.0	2.4	2.6	28.8	28.2	8.0	470,569
BLACKBERRY	BBRY US	9.8	NM	NM	(1.8)	(1.3)	1.1	1.0	-	-	(44.9)	(19.8)	NM	5,173

Priced at 25 Feb for Asia stocks, 24 Feb for US stocks

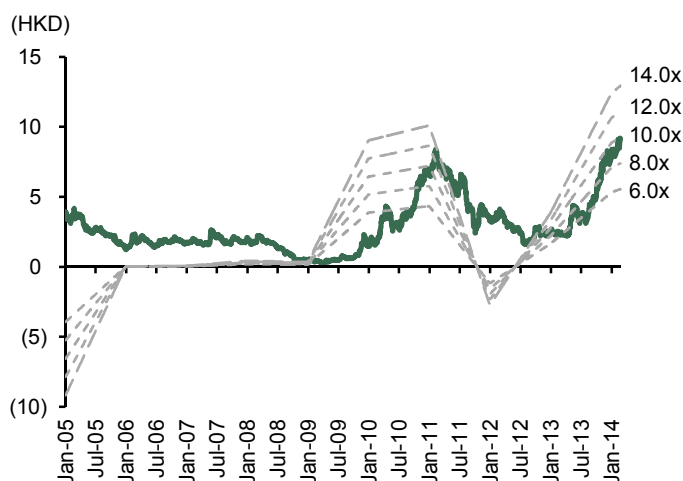
Sources: * for BNP Paribas estimate; others from Bloomberg

EXHIBIT 4: DCF summary

WACC calculation	(%)	Enterprise value	(HKD m)
Target Capital Structure		Present value of Free Cash Flow	6,781
Debt to Total Capitalization	25.8	Terminal growth rate (%)	1.5
Equity to Total Capitalization	74.2	Terminal Value	20,883
Debt to Equity Ratio	34.9	Discount Factor	0.3
		Present Value of Terminal Value	5,293
Cost of Debt (after tax)	3.8	% of Enterprise Value	44
Cost of Debt (before tax)	4.5		
Taxes	16.0	Enterprise value	12,073
		Less: Total debt	3,277
Cost of Equity	20.9	Plus: Cash and Cash Equiv.	3,447
Risk-free rate	4.5	Net Debt	(169)
Market risk Premium	15.0		
Unlevered Beta	0.9	Implied Equity Value	12,243
Levered Beta	1.1	Outstanding shares	1,162
		Implied share price	10.53
WACC	16.5	Share price with PE method (HKD)	10.32

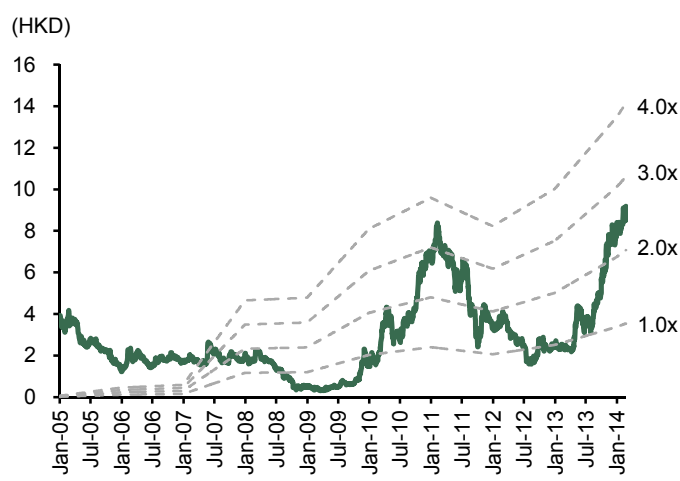
Sources: TCL Communication; Bloomberg; BNP Paribas estimates

EXHIBIT 5: 12-month forward P/E



Sources: TEJ; BNP Paribas estimates

EXHIBIT 6: 12-month forward P/BV



Sources: TEJ; BNP Paribas estimates

Demand from emerging markets to sustain growth

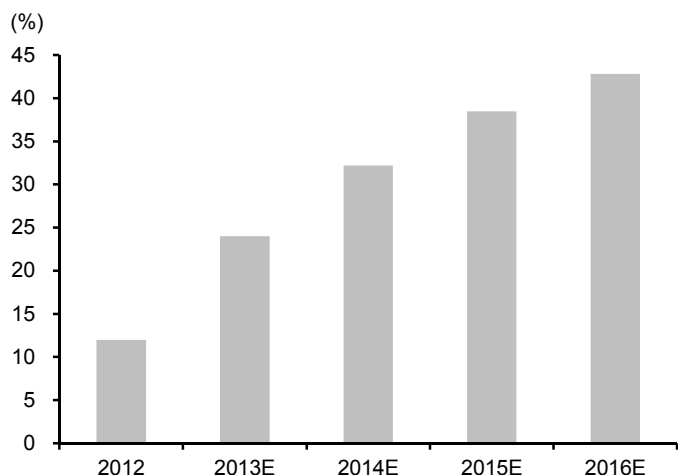
With over 70% of its smartphone shipments from emerging markets including China, emerging Asia, Latin America, Eastern Europe, Middle East and Africa, TCLC has benefited from the growth momentum of the markets in past quarters. TCLC's *fast fashion* approach started to bear fruit in 2013, when its total smartphone shipments grew over 200% y-y. It is the sixth biggest smartphone player in terms of shipments in Latin America in 2013.

In the emerging markets, smartphones account for a relatively low percentage of total handsets (32% in 2014 and 39% in 2015, according to Gartner, vs 70%+ in most developed markets. This suggests a strong shipment growth opportunity and, compared to other Chinese smartphone vendors with overseas penetration, TCLC benefits from the brand image and channel relationships established by Alcatel in the times of the feature phone. IP protection via Alcatel should also support TCLC's expansion in new markets (for more detail see page 7 our accompanying Greater China sector report "China beneficiaries of 4G smartphones", 28 Feb 2014).

Strong momentum in North America and Latin America

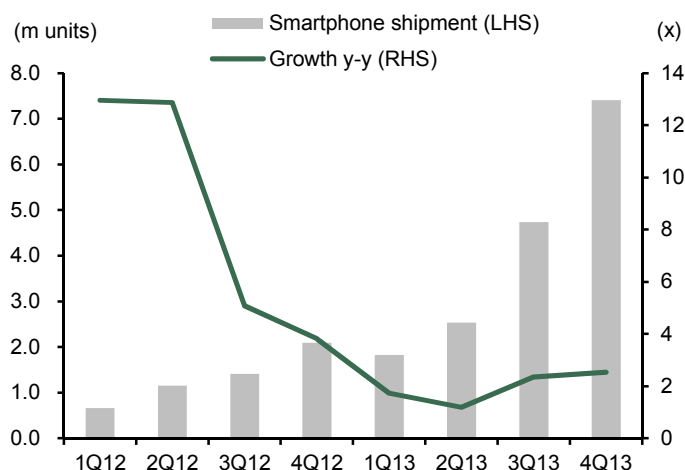
Smartphones accounted for 64% of TCLC's revenue in 2013 (vs 43% in 2012). By region, the Americas is the biggest revenue contributor (45% of sales in 2013), followed by EMEA (41%), APAC (7%) and China (7%). For smartphone revenues, contribution from the Americas and EMEA rose significantly to 53% and 39% in 4Q13 (from 29% and 21% in 1Q12). Smartphone revenue from China dropped due to stagnant shipment growth, fierce pricing competition among local peers and TCLC's reduced focus on its domestic market. Nevertheless, with 4G LTE set to take off, we see upside potential for TCLC in China.

EXHIBIT 7: Smartphones/total handset shipments in EMs



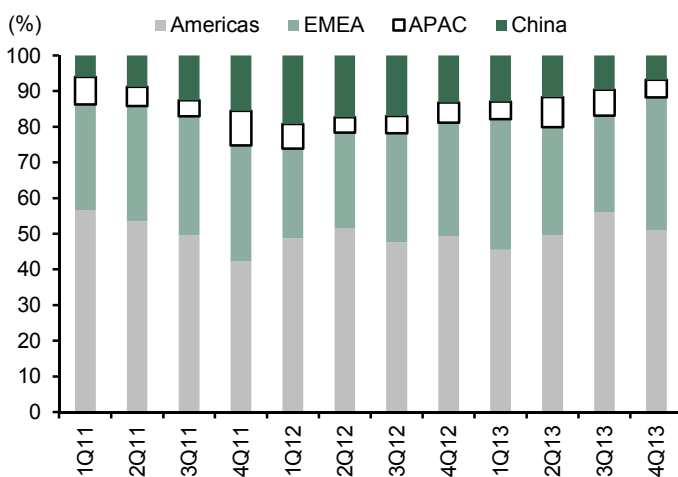
Emerging markets include China, Emerging Asia (India, Thailand, Philippines, Malaysia and South East Asia), Latin America, Eastern Europe, Middle East and Africa;
Source: Gartner

EXHIBIT 8: TCLC smartphone shipment growth



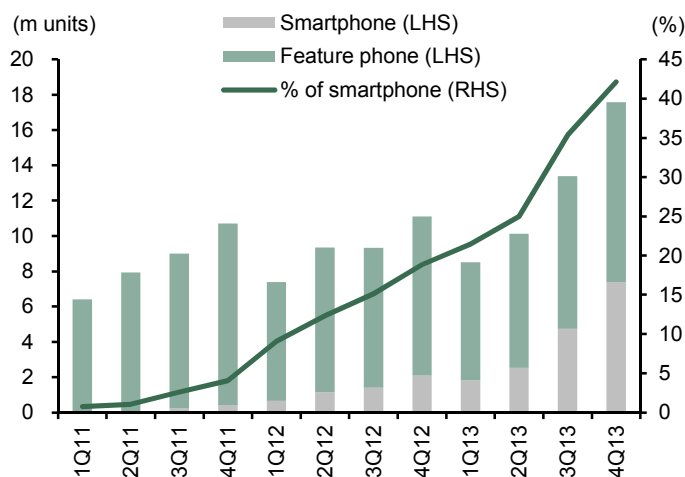
Source: Gartner

EXHIBIT 9: TCLC handset shipments by regions



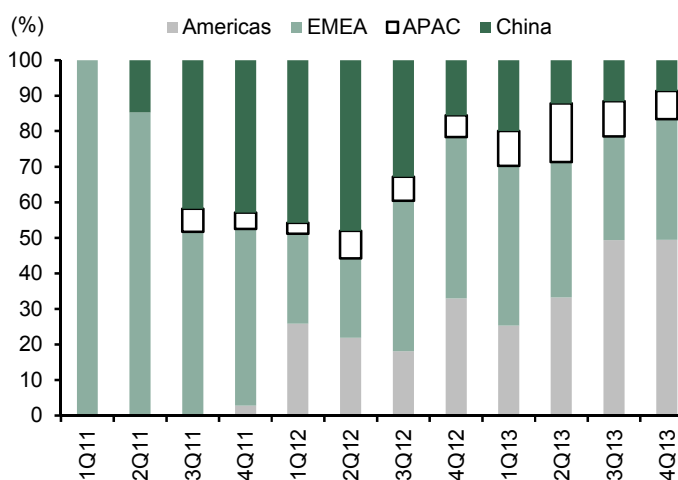
Source: Gartner

EXHIBIT 10: TCLC handset shipments by device type and % of smartphone to its total handset shipment



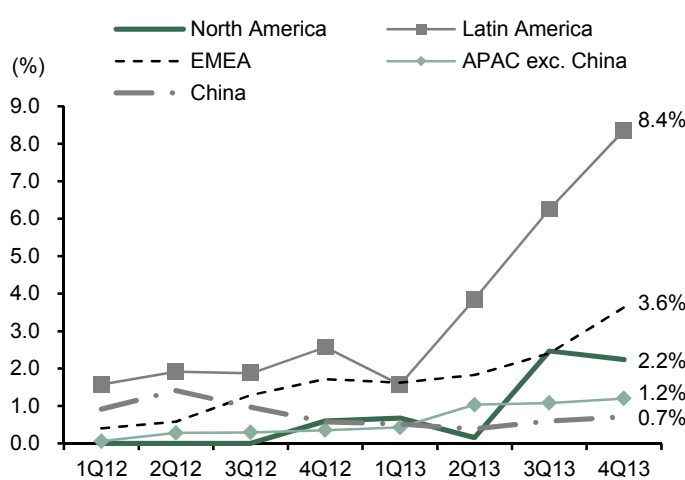
Source: Gartner

EXHIBIT 11: TCLC smartphone shipments by region



Source: Gartner

EXHIBIT 12: TCLC smartphone market share trend by region



Source: Gartner

Chinese 4G take-off as a new catalyst

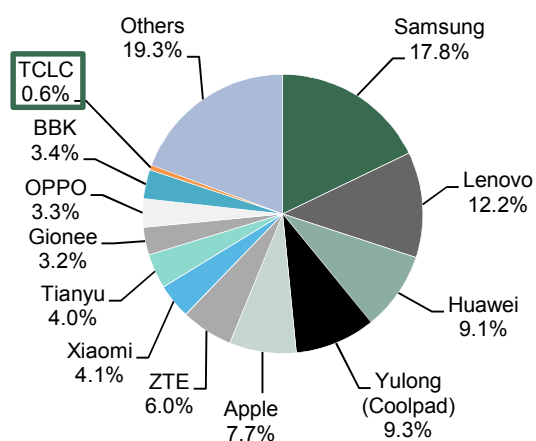
Smartphones already account for a relatively large share of China's total handset shipments (over 80% in 4Q13). We believe the next catalyst will be replacement demand, in particular for 4G LTE smartphones. On 4 Dec 2013, MIIT issued TD-LTE 4G licences to the three operators – China Mobile (941 HK), China Telecom (728 HK), and China Unicom (762 HK). It has also already approved the FDD-LTE application for mixed network experiments and will issue FDD-LTE licences later in 2H14.

According to IDC estimates, China's smartphone shipments in 2014 will exceed 450m, including 120m 4G-ready smartphones. While China Mobile is aiming for 100m units for its TD-LTE smartphone in 2014, we think initial volumes may not be big in 1H14 but will pick up in 2H14/2015 thanks to higher hardware solution readiness.

Many Chinese local brands are hoping to have a share of the pie, especially for mid-to-entry level 4G smartphones (priced around RMB1,000) where most international brands will have no offering. Coolpad has been one of the most aggressive vendors in these initial stages. It has released several competitively priced products and aims to ship 40m LTE phones in 2014. Huawei (Not listed), ZTE (763 HK), Lenovo (992 HK), TCLC (2618 HK), Hisense (Hisense Electric Co, 6000060 SHA), Tianyu (Not listed) and other local vendors are also joining the game.

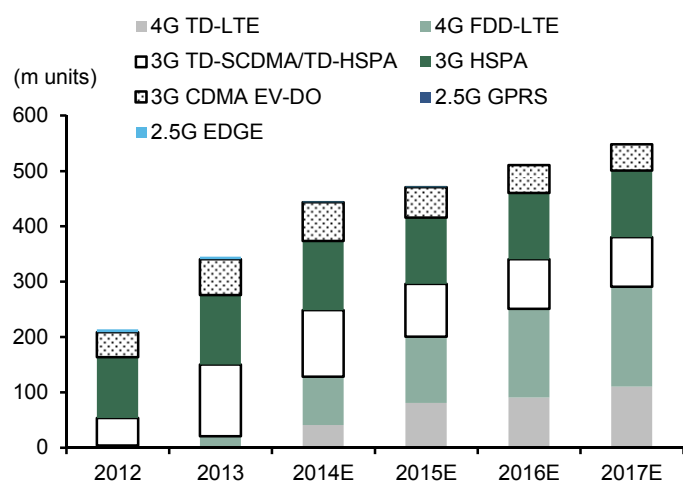
Aiming for a strong comeback in China, TCLC plans to introduce five TD-LTE smartphone models with China Mobile in 1Q14 and RMB1,000 models in 2Q14. Following China Mobile's 4G rollout, China Telecom started its 4G commercial roll out in February with wireless network cards and other network devices. While it has not given a detailed timetable for its 4G smartphone service rollout, China Telecom has started sampling and TCLC is one of the few vendors approved in the first round. With only 0.6% shipment market share in China in 2013, TCLC is hoping to turn around its domestic China business in 2014 with the 4G opportunity. Management estimates 4G products will account for 60% of its total smartphone shipments in 2014.

EXHIBIT 13: China smartphone market share by shipments (2013)



Samsung (009530 KR), Lenovo (992 HK), Huawei (not listed), Coolpad (2369 HK), Apple (APPL US), ZTE (763 HK), Xiaomi (Not listed), Tianyu (Not listed), Gionee (Not listed), BBK (Not listed), TCLC (2618 HK)
Source: Gartner

EXHIBIT 14: Chinese smartphone shipment forecast by air interface



Source: IDC

EXHIBIT 15: TCLC recent smartphone specs



Product	One Touch Idol X+	One Touch Hero	One Touch Idol α	One Touch Idol S	One Touch Idol Mini	One Touch Idol X
CPU	Octa-core, MT6592, 2GHz	Quad-core, MT6589, 1.5GHz	Quad-core, MT6589, 1.5GHz	Dual-core, Qualcomm MSM8930 AA, 1.2GHz	Dual-core, MT6572, 1.3GHz	Quad-core, MT6589+, 1.5GHz
OS	Android 4.2	Android 4.2	Android 4.2	Android 4.2	Android 4.2	Android 4.2
Display	5" FHD IPS	6" FHD TFT	4.7" HD IPS	4.7" HD IPS	4.3" IPS	5" FHD IPS
Memory	2GB RAM, 16/32GB ROM (micro SD up to 32GB)	2GB RAM, 8/16GB ROM (micro SD up to 32GB)	1GB RAM, 16GB ROM (micro SD up to 32GB)	1GB RAM, 4GB ROM (micro SD up to 32GB)	512MB RAM, 8GB ROM	2GB RAM, 16GB ROM (micro SD up to 32GB)
Camera	13.1MP rear, 2.1MP rear	13MP rear, 2.1MP rear	13MP rear, 1.3MP rear	8MP rear, 1.3MP rear	5MP rear	13.1MP rear, 2.1MP rear
Connectivity	HSDPA/GSM, Wi-Fi 802.11 a/b/g/n, dual-band, Wi-Fi Direct, Wi-Fi hotspot	HSDPA/GSM, Wi-Fi 802.11 a/b/g/n, dual-band, Wi-Fi Direct, Wi-Fi hotspot	HSDPA/GSM, Wi-Fi 802.11 a/b/g/n, dual-band, Wi-Fi Direct, Wi-Fi hotspot	LTE/HSDPA/GSM, Wi-Fi 802.11 a/b/g/n, dual-band, Wi-Fi Direct, Wi-Fi hotspot	HSDPA/GSM, Wi-Fi 802.11 a/b/g/n, Wi-Fi Direct, Wi-Fi hotspot	HSDPA/GSM, Wi-Fi 802.11 a/b/g/n, dual-band, Wi-Fi Direct, Wi-Fi hotspot
Battery	2500mAh	3400mAh	2000mAh	2000mAh	1700mAh	2000mAh
Price (RMB)	1999	1999	na	1829	1119	1699
Available	Feb-14	Jan-14	Jan-14	Dec-13	Dec-13	Jul-13

Source: TCL Communication

EXHIBIT 16: TCLC's new products announced in MWC - expanding into tablets and wearable products



Device type	Tablet	Tablet	Wearable smartphone	Smartphone	Smartphone	Smartphone	Smartphone	Smartphone	Smartphone	Smartphone
Product	Pop 7S	Fire 7	One Touch Pop Fit	One Touch Idol 2 (S)	One Touch Idol 2 Mini (S)	One Touch Pop S3	One Touch Pop S7	One Touch Pop S9	One Touch Fire C/E	One Touch Fire S
CPU	Quad-core, 1.2GHz	Dual-core, 1.2GHz	Dual-core, Mediatek CPU, 1GHz	Quad-core, 1.2-1.3GHz	Quad-core, 1.2GHz	Quad-core, Qualcomm MSM8926, 1.2GHz	Quad-core, Mediatek CPU, 1.3GHz	Quad-core, Qualcomm MSM8926, 1.2GHz	C/E: Dual-core, 0.5GHz/1.2 GHz	Quad-core, 1.2GHz
OS	Android 4.4	Firefox OS	Android 4.2	Android 4.3 (upgradable to 4.4)	Android 4.3 (upgradable to 4.4)	Android 4.3	Android 4.4	Android 4.3	Firefox OS 1.3	Firefox OS 1.3
Display	7", 1024x600	7", 960x540	2.8", 240x320	5", 960x540	4.5", 960x540	4", 400x800	5", 960x540	5.9", 1280x720	C: 3.5", 480x320 E: 4.5", 960x540	4.5", 960x540
Camera	3MP rear VGA front	VGA rear VGA front	2MP	8MP rear 1.3MP front	8MP rear 2MP front	5MP rear 0.3MP front	5MP rear 0.3MP front	8MP rear 2MP front	C: 0.3 MP E: 5MP rear, 0.3MP front	8MP rear, 2MP front
Storage	na	4GB	16GB /32 GB	8 GB	4GB	4GB	4GB	8 GB	4GB	na
Memory	na	2GB RAM	512MB RAM	1GB RAM	1GB RAM	1GB RAM	1GB RAM	1GB RAM	512MB RAM	na
Connectivity	FDD-LTE, GSM, UMTS	Wifi only	GSM, UMTS	(FDD-LTE), GSM, UMTS	(FDD-LTE), GSM, UMTS	FDD-LTE, GSM, UMTS	FDD-LTE, GSM, UMTS	FDD-LTE, GSM, UMTS	GSM, UMTS	FDD-LTE, GSM, UMTS
Battery	na	na	1000mAh	2000 mAh	1700 mAh	2000 mAh	3000mAh	3400mAh	1300/1700	na
Price (EUR)	na	108	89/120	199 (3G)/ 249 (4G)	169 (3G)/ 209 (4G)	149	189	219	na	na

Note: "S" symbols smartphones with LTE connectivity

Source: TCL Communication

Competitive landscape: strong overseas, more domestic upside

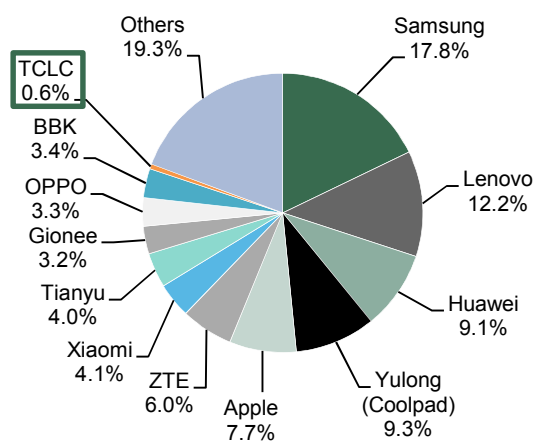
Key Chinese smartphone players such as Lenovo, Huawei, ZTE, Coolpad and Xiaomi have seen promising shipment momentum thanks to the Chinese smartphone market boom since 2011. Smartphones already account for a relatively high percentage of all Chinese handset shipments (over 80% in 4Q13). As such, we expect Chinese vendors to turn more aggressive overseas. Of those Chinese smartphone makers, TCLC had 89% of its shipments to overseas markets in 2013; ZTE had 48%; Huawei had 36%; and the others were mainly in the domestic market.

Huawei and ZTE both design and manufacture Internet network devices and servers with contracts from major telco operators. While they have relatively strong telco operator relationships, their brand awareness and consumer recognition are not strong.

For Lenovo, the market may be worried how its merger with Motorola will hurt TCLC/Alcatel's shares in the US and Latin America. However, we think the price/performance advantage of TCLC/Alcatel will help them sustain momentum. In addition, we think Lenovo/Motorola will focus on streamlining and cost cutting first, such that there will be little impact on TCLC initially.

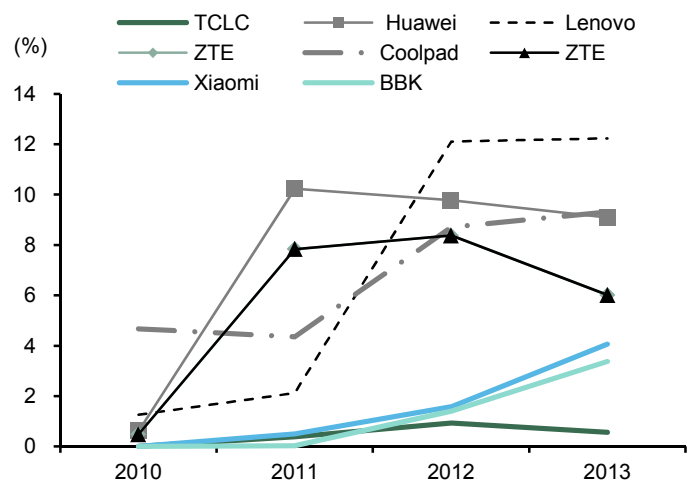
We are less worried about the threat from Coolpad and Xiaomi to TCLC overseas as we think it will take time for them to penetrate non-Chinese markets. They might find it hard to build up: 1) distribution channels either in the open market or in e-commerce; and 2) relationships with telco operators. TCLC, with Alcatel's brand recognition, is already better positioned overseas. Despite its shipments in China having been relatively weak, we expect the Chinese 4G market to be the catalyst TCLC needs to gain domestic share. We think Alcatel's support will give it a sustainable advantage over local peers in other emerging countries and overseas thanks to its relationships with global operators, well-established distribution channels and brand strength.

EXHIBIT 17: Chinese smartphone market share (2013)



Source: Gartner

EXHIBIT 18: Chinese smartphone market share trend



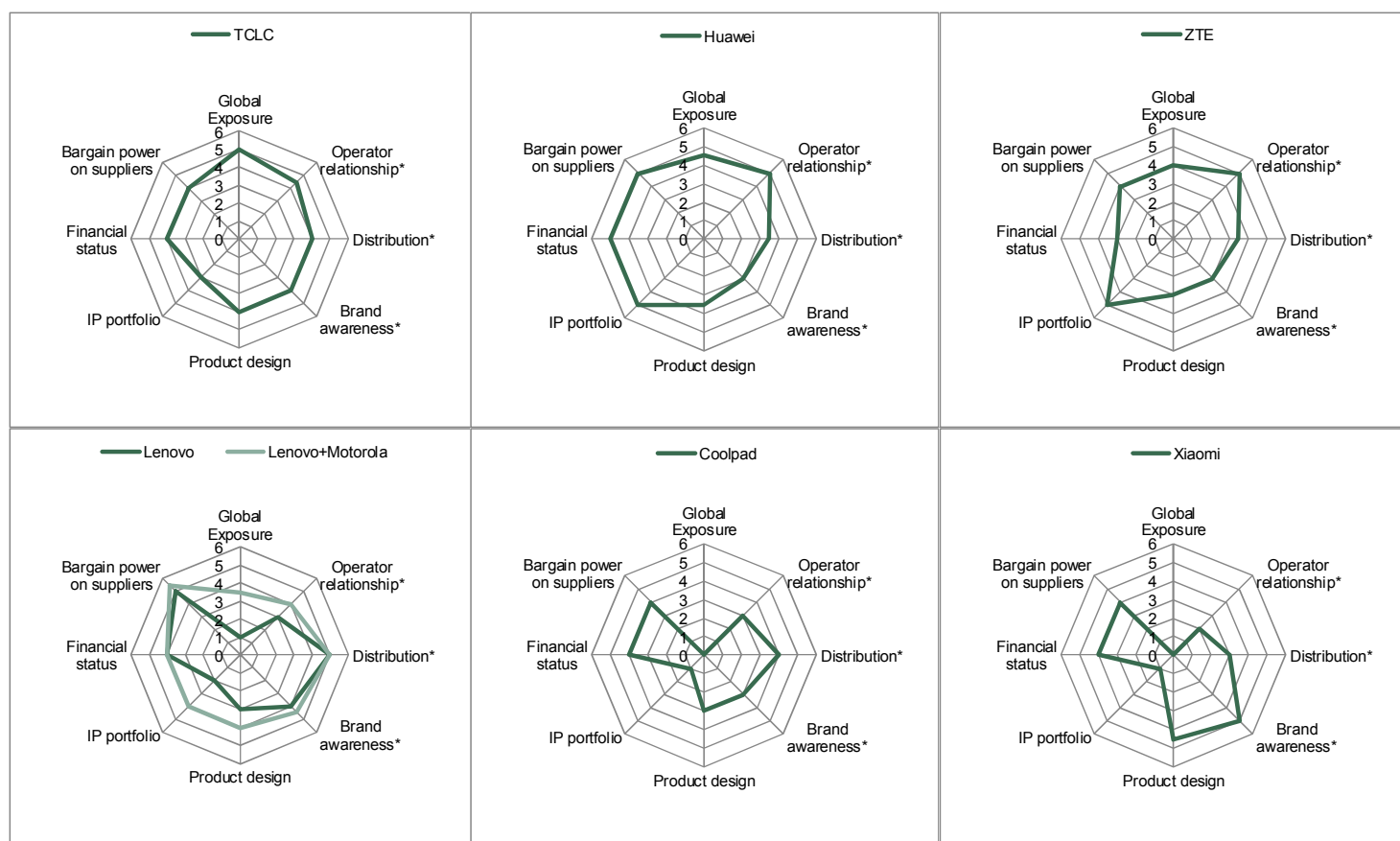
Source: Gartner

EXHIBIT 19: Major Chinese smartphone makers' overseas market share (2013)

Region	Company	Shipment (k)	Market share (%)
APAC excl. China	Lenovo	2,030	1.2
	Coolpad	880	0.5
	Huawei	2,474	1.4
	ZTE	2,982	1.7
	Gionee	592	0.3
	TCL Communication	1,667	0.9
	Subtotal	10,625	6.0
EMEA	Huawei	7,208	3.1
	ZTE	2,858	1.2
	TCL Communication	5,977	2.6
	Lenovo	1,048	0.5
	OPPO	102	0.0
	Gionee	261	0.1
	Subtotal	17,454	7.6
Latin America	TCL Communication	4,907	5.3
	Huawei	3,246	3.5
	ZTE	5,843	6.3
	Lenovo	343	0.4
	Subtotal	14,339	15.4
North America	ZTE	6,300	4.6
	Huawei	3,638	2.6
	TCL Communication	2,010	1.5
	Coolpad	112	0.1
	Subtotal	12,059	8.7

Source: Gartner

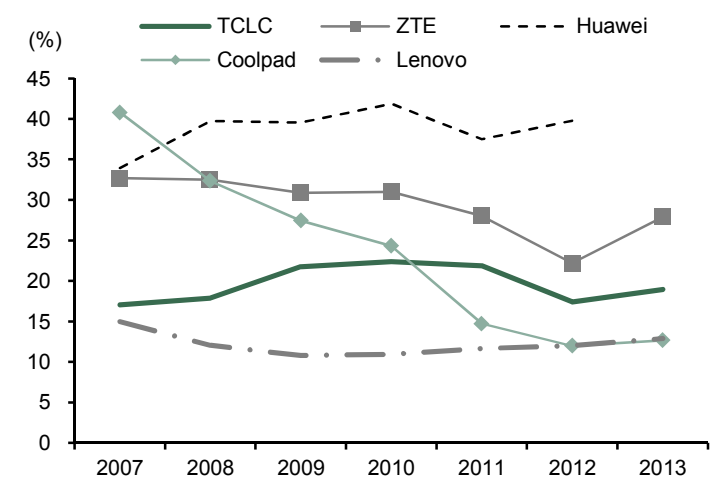
EXHIBIT 20: Chinese smartphone vendors key comparison



* Condition based in China

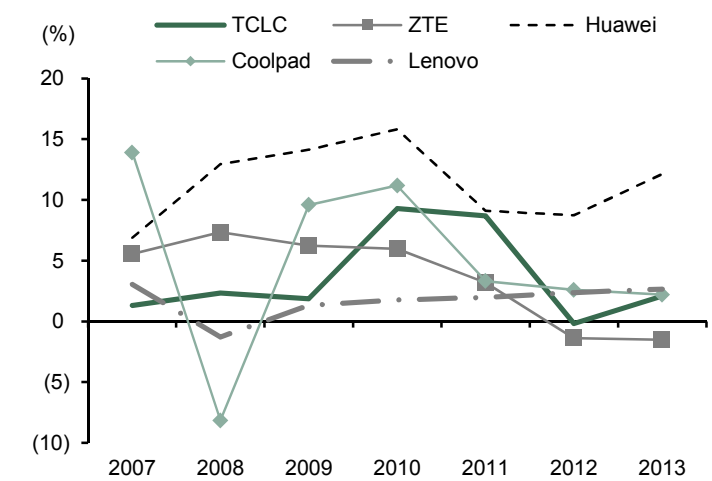
Sources: Company data; BNP Paribas estimates

EXHIBIT 21: Chinese vendors' GM trend



Sources: Companies; Bloomberg consensus for ZTE and Coolpad's 2013 GM

EXHIBIT 22: Chinese vendors' OPM trend



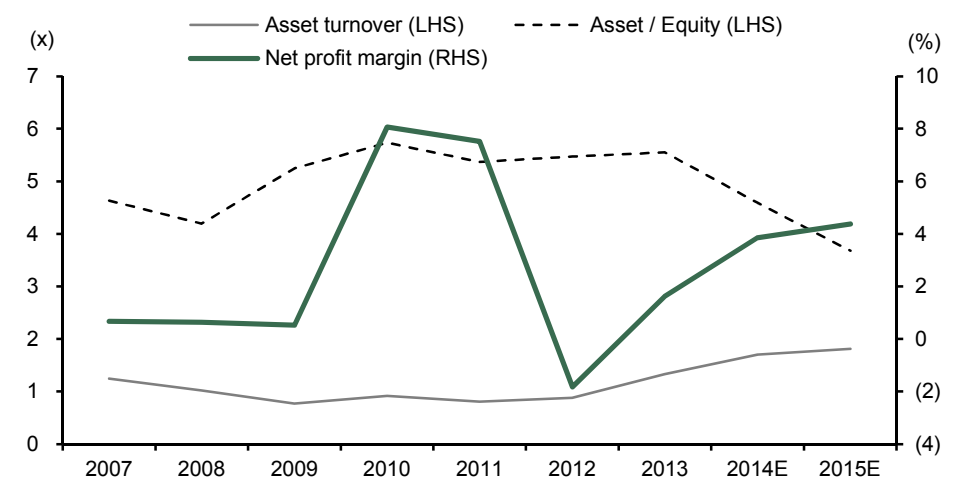
Sources: Companies; Bloomberg consensus for ZTE and Coolpad's 2013 GM

Financial analysis

Dupont analysis

TCLC's ROE tends to fluctuate, along with its net margins, on macro factors and industry competition. In 2010-2011, net margins were relatively high, at 8%, due to the recovery of the global economy and TCLC's success in market expansion. However, in 2012, the European debt crisis led to insufficient demand for handsets, so the company was running at below optimum scale. Meanwhile, its smartphone business was facing fiercer competition and pricing pressure. As a result, in 2012 the company reported a net loss for the first time since 2005. In 2013, it started exploring growing markets again, and increased the revenue contribution from smartphones. With its improving scale and product mix, we expect earnings recovery to drive OPM back to 4%-plus.

EXHIBIT 23: DuPont analysis

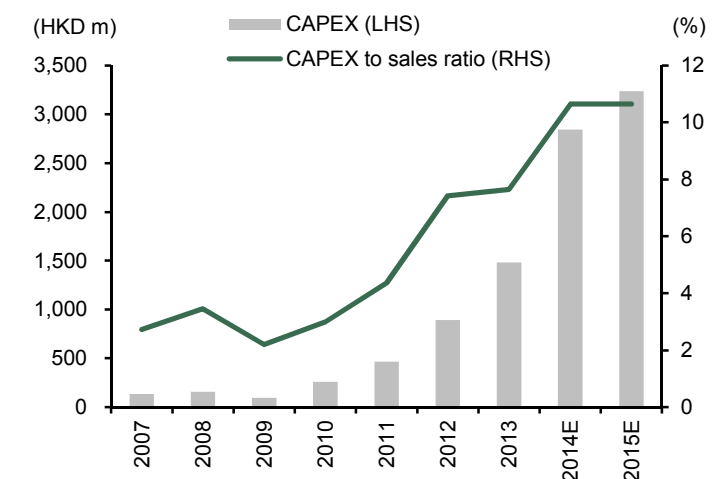


Sources: TCL Communication; BNP Paribas estimates

Capex and cash flow

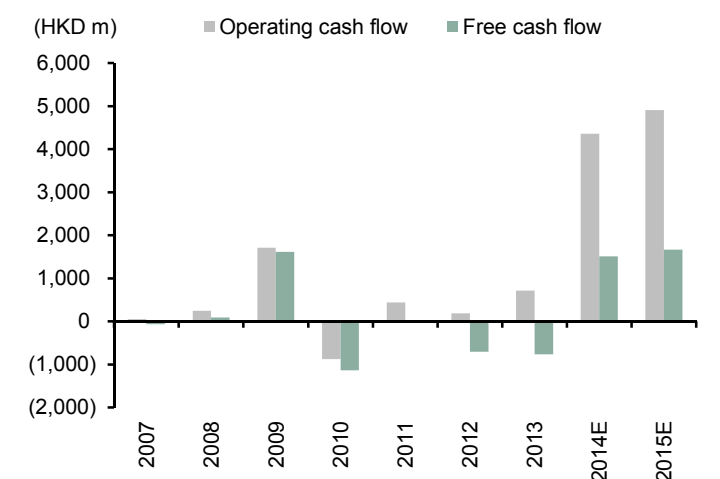
TCLC's capex level was stable at 3-4% of sales until the major expansion in 2012. This was a three-phase manufacturing and R&D expansion for its Huizhou Plant, costing around HKD1.3b. Phase one of the smartphone factory commenced operations in Sep 2013 (taking overall capacity to 100m-120m units per year) with phase two to be completed in June 2014. We expect production efficiency to increase as the older factories were designed mainly for feature phones. We also believe the higher ASP brought by smartphone sales will fuel top-line growth.

EXHIBIT 24: Capex and capex-to-sales ratio



Sources: TCL Communication; BNP Paribas estimates

EXHIBIT 25: Operating cash flow and free cash flow



Sources: TCL Communication; BNP Paribas estimates

Balance sheet

TCLC had an equity-to-asset ratio at around 18% during 2010-2013. It had nearly no long-term debt until 2012, when it increased due to the expansion plan, but it is still at a low level. While most of its debt financing is short-term, the company is managing its current and acid ratios at healthy levels. The gearing ratio, computed by dividing its net debt-to-equity, remained net cash until 2011, when debts increased on larger business scale and capex expansion. We expect TCLC to continue improving its financing ability with margin and earnings recovery starting from 2013.

EXHIBIT 26: Balance sheet summary

	2010	2011	2012	2013	2014E	2015E
	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)
Cash and cash equivalents	7,718	7,428	5,337	1,933	3,447	5,340
Current assets	11,619	12,254	11,212	11,866	14,134	17,874
Current liabilities	10,014	11,315	10,606	11,221	11,394	12,524
Working capital	1,605	939	606	645	2,740	5,350
Short-term debt	6,519	7,532	6,159	3,453	3,101	2,852
Long-term debt	-	-	310	196	176	162
Net-debt/Equity (%)	(53.9)	3.9	48.7	58.9	(3.9)	(37.9)
Equity/Asset (%)	18.1	19.1	17.4	18.5	27.0	32.4
Current ratio (x)	1.2	1.1	1.1	1.1	1.2	1.4
Acid ratio (x)	1.1	1.0	0.9	0.8	1.0	1.1

Sources: TCL Communication; BNP Paribas estimates

EXHIBIT 27: TCLC quarterly P&L

	1Q13	2Q13	3Q13	4Q13	1Q14E	2Q14E	3Q14E	4Q14E	2013E	2014E	2015E
	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)	(HKD m)
Sales	2,449	3,958	5,454	7,501	5,876	6,217	6,554	8,071	19,362	26,718	30,399
Gross Profit	402	727	1,071	1,473	1,123	1,215	1,318	1,663	3,672	5,319	6,253
Operating Profit	(205)	39	241	330	232	231	253	366	405	1,082	1,372
Pretax Profit	(241)	14	220	306	215	215	237	349	296	1,016	1,314
Net Profit	(247)	38	223	302	212	212	234	345	316	1,003	1,297
EPS (HKD)	(0.22)	0.04	0.20	0.26	0.18	0.18	0.20	0.30	0.28	0.86	1.12
Margins (%)											
GM	16.4	18.4	19.6	19.6	19.1	19.5	20.1	20.6	19.0	19.9	20.6
OPM	(8.4)	1.0	4.4	4.4	4.0	3.7	3.9	4.5	2.1	4.1	4.5
Pretax margin	(9.9)	0.4	4.0	4.1	3.7	3.5	3.6	4.3	1.5	3.8	4.3
NM	(10.1)	1.0	4.1	4.0	3.6	3.4	3.6	4.3	1.6	3.8	4.3
Growth (y-y %)											
Sales	16	32	79	93	140	57	20	8	61	38	14
Gross Profit	(4)	29	110	144	179	67	23	13	75	45	18
Operating Profit	nm	(69)	nm	nm	nm	494	5	11	nm	167	27
Pretax Profit	nm	(83)	nm	nm	nm	1442	8	14	nm	240	29
Net Profit	nm	(50)	nm	nm	nm	452	5	14	nm	217	29
Growth (q-q %)											
Sales	(37)	62	38	38	(22)	6	5	23			
Gross Profit	(33)	81	47	38	(24)	8	8	26			
Operating Profit	nm	nm	521	37	(30)	(1)	10	45			
Pretax Profit	nm	nm	1477	39	(30)	0	10	48			
Net Profit	nm	nm	481	36	(30)	0	10	48			

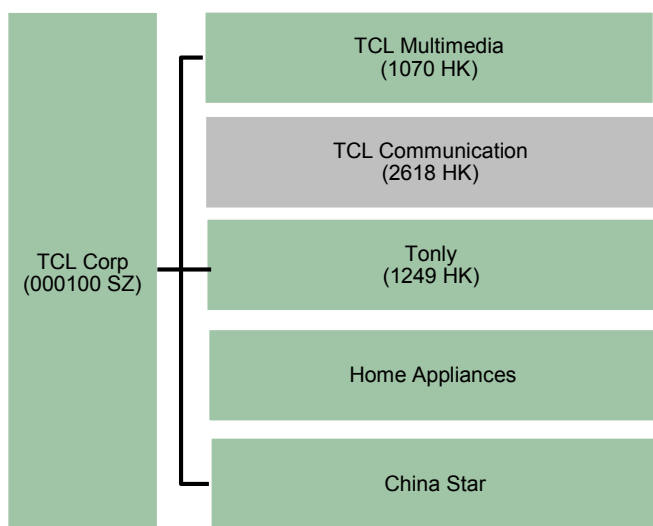
Sources: TCL Communication; BNP Paribas estimates

Company background

TCL Communication is a member of TCL Corp (000100 SZ) since 1999, as the mobile phone development and production arm. In 2004, TCL Communication was officially separated from TCL Multimedia Technology Holdings and listed on the Hong Kong Stock Exchange. In the same year, the company formed a 55% owned joint venture with Alcatel (ALU EN) and then acquired the remaining stake from Alcatel in the next year. By then TCLC was granted the right to use Alcatel's brand and logo for 20 years. TCLC mainly engages in R&D, manufacturing, and global sales of WMDs (Worldwide Mobile Devices, including smartphones and feature phones) and SCDs (Smart Connectivity Devices, including tablets, mobile broadband, and accessories). It promotes its products under two brands – TCL (in China) and ALCATEL ONETOUCH (in EMEA, the Americas, and APAC including Hong Kong).

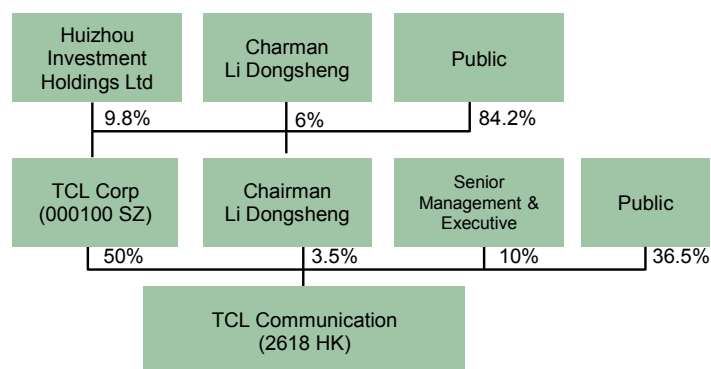
Headquartered in Shenzhen, China, the company has a global presence across over 160 countries with 115 repair centres, over 100 offices, and over 11,000 employees. Its global research facilities are located in Shanghai, Ningbo, Huizhou, Shenzhen, and Chengdu. Its global factory is located in Huizhou, China and it completed phase one of its expansion in August 2013. With 30 SMT lines, 29 assembly lines, and 46 customization/packing lines, it has capacity of 100m-120m units per year. Phase two construction will be completed in June 2014, and together with phase one, will comprise a three-storey manufacturing block and a three-storey dining hall complex. The third and last phase of construction will consist of a six-storey building for office and R&D use.

EXHIBIT 28: TCL Corp and its subsidiaries



Source: TCL Communication

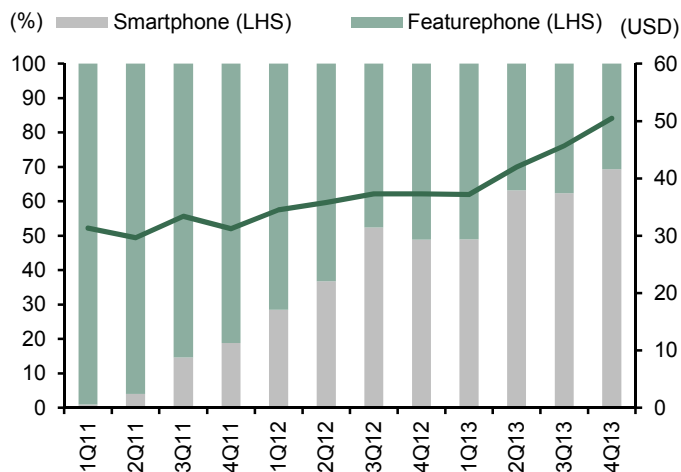
EXHIBIT 29: TCL Communication shareholder structure



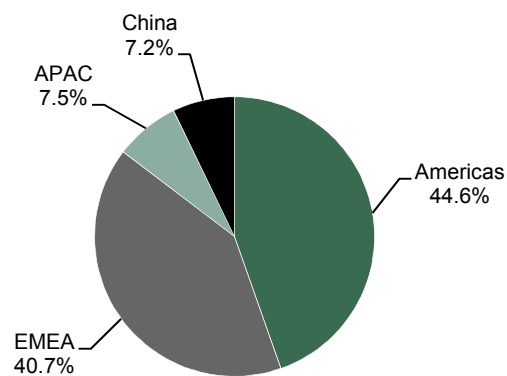
Source: TCL Communication

Revenue contribution from Americas and EMEA rises

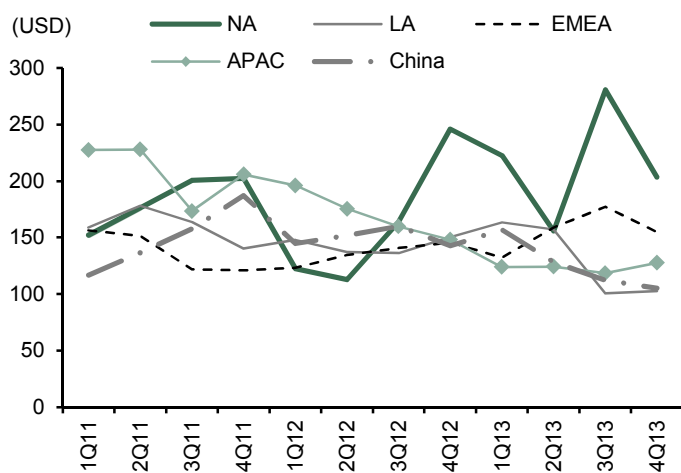
TCLC got 64% of its revenue from smartphones during 2013. Region-wise, the Americas are the biggest revenue contributors, at 45% of sales in 2013, followed by EMEA (41%), APAC (7%), and China (7%). For smartphone revenues, the contribution from the Americas and EMEA rose significantly, to 53% and 39% in 4Q13 (from 29% and 21% in 1Q12). Smartphone revenue from China dropped due to stagnant shipment growth and fiercer pricing competition. According to IDC, TCLC's smartphones enjoy higher ASPs in EMEA and North America thanks to a better product mix.

EXHIBIT 30: TCLC handset revenue breakdown and ASP trend

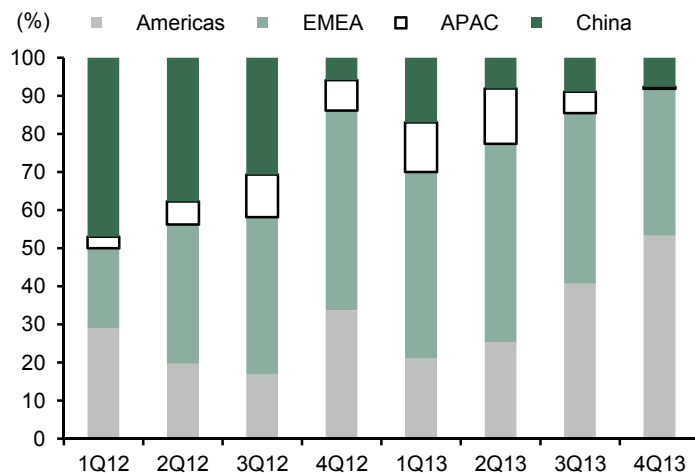
Source: TCL Communication

EXHIBIT 31: TCLC revenue contribution by regions (2013)

Source: TCL Communication

EXHIBIT 32: TCLC smartphone ASP trend by region

Source: IDC

EXHIBIT 33: TCLC smartphone revenue contribution by region

Source: TCL Communication

EXHIBIT 34: TCLC global presence

Source: TCL Communication

EXHIBIT 35: TCLC global operation and distribution partners



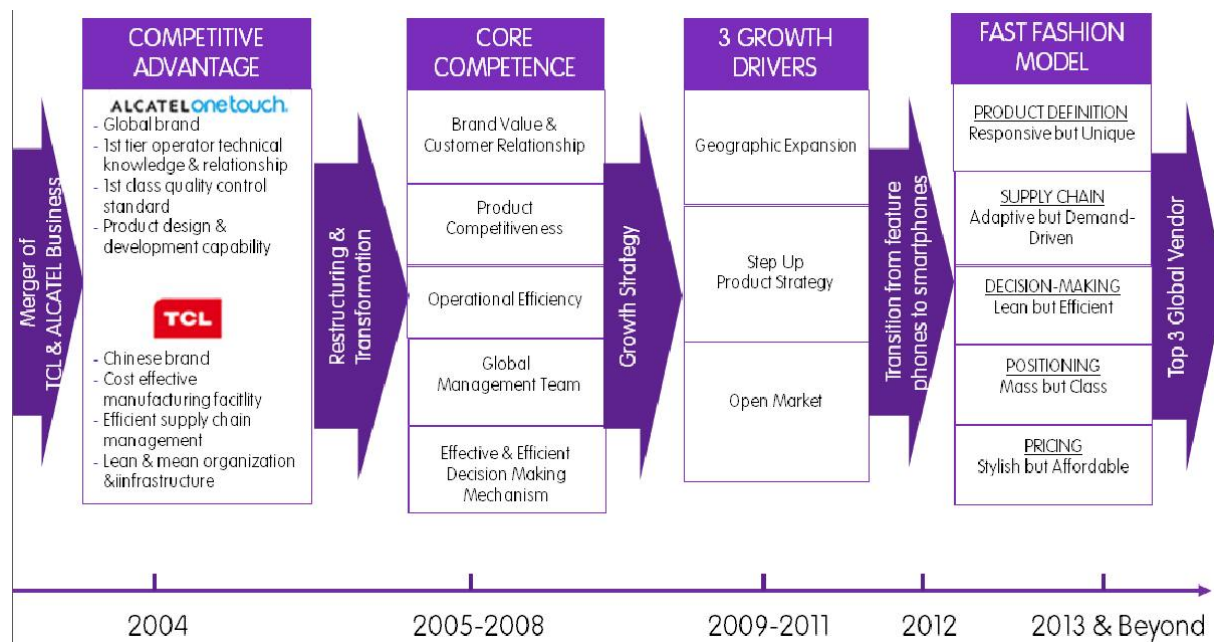
Source: TCL Communication

Business Strategy

Ever since the merger of the TCLC and Alcatel mobile phone businesses, TCLC has been combining the brand/channel/R&D ability of Alcatel with the cost-efficient operations of TCLC. Its two-brand strategy has helped TCLC penetrate overseas without a brand image and the government scrutiny faced by other Chinese handset vendors.

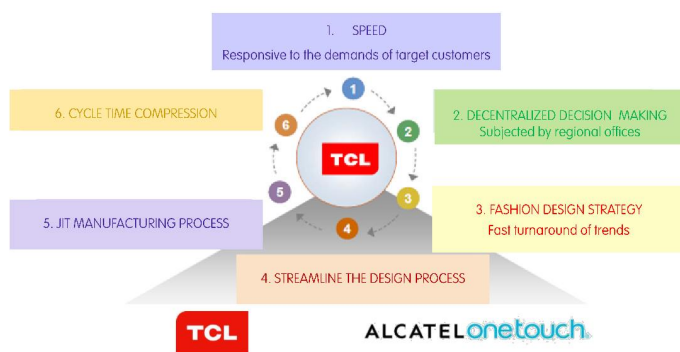
TCLC adopted the so called “Fast Fashion Model” from the apparel industry as it transformed its business focus on smartphones in 2012. The company acts promptly and precisely to the demands of target customers, submitted by different regions. Its production plants are able to manufacture just-in-time to avoid obsolescence and over-supply. It is also able to provide affordable and competitive prices for customers who pursue fashion with a limited budget, as smartphone specs and design age quickly, just as designs in the apparel industry do. With strong execution and relationships with major telco operators, TCLC is able to compress the lead time for selling smartphones, and this results in shorter inventory days compared to other Chinese smartphone vendors with overseas sales (TCLC: 40-60 days vs. peers of around 90 days on average).

EXHIBIT 36: TCLC's business strategy evolution



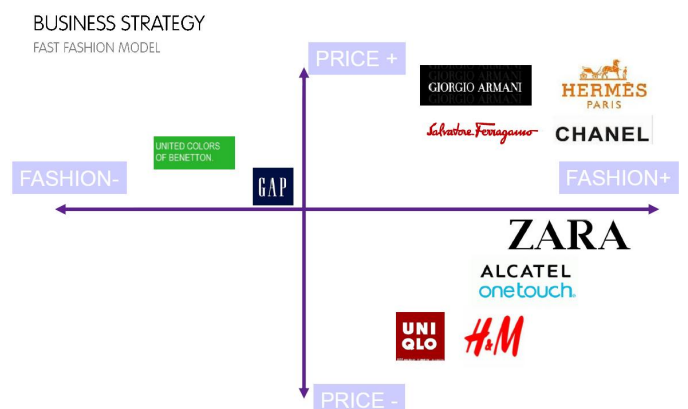
Source: TCL Communication

EXHIBIT 37: Business strategy – Fast Fashion Model



Source: TCL Communication

EXHIBIT 38: Business strategy – Fast Fashion Model



Sources: TCL Communication

EXHIBIT 39: Management team

Name	Title	
Mr. Li Dongsheng	Chairman	* Founder of TCL Corp * About 30 years in various aspects of the electronics industry
Dr. Guo Aiping (George)	CEO	* Senior VP of TCL Corp * 20 years+ in the worldwide wireless industry * Doctor's degree in Management Science at Stanford
Mr. Liu Yuk Tung (Thomas)	CFO & SVP, Business Strategy	* CPA of HKICPA, Chartered Accountant of ICAEW and fellow member of ACCA * Master degree in Accounting and MBA degree
Mr. Wang Jiyang	COO, Executive Director and GM (China)	* VP of TCL Corp * Extensive experience in R&D and management in electronics industry * PhD in Electrocircuit & System and MBA degree
Mr. Wong Kwok Chung (Albert)	EVP & GM (APAC)	* 15 years+ in computer and electronics industry * Graduated Master's degree in electrical and electronics engineering
Mr. Yves Morel	SVP & GM (EMEA)	* 28 years+ sales and marketing experience in telecommunication industries * Former sales director of ALCATEL mobile phones
Mr. Nicolas Zibell	SVP & GM (Americas)	* 22 years+ of experience in sales, marketing, product strategy and management in automotive and telecommunications industries in Europe and Americas * MBA degree

Source: TCL Communication

Financial statements

TCL Communication

Profit and Loss (HKD m) Year Ending Dec	2011A	2012A	2013E	2014E	2015E
Revenue	10,653	12,031	19,362	26,718	30,399
Cost of sales ex depreciation	(8,048)	(9,142)	(14,552)	(17,846)	(20,103)
Gross profit ex depreciation	2,605	2,889	4,810	8,873	10,297
Other operating income	508	543	513	560	566
Operating costs	(1,912)	(2,660)	(3,780)	(4,797)	(5,446)
Operating EBITDA	1,201	772	1,543	4,636	5,416
Depreciation	(276)	(793)	(1,138)	(3,554)	(4,044)
Goodwill amortisation	0	0	0	0	0
Operating EBIT	925	(21)	405	1,082	1,372
Net financing costs	(140)	(166)	(105)	(66)	(59)
Associates	(1)	(2)	(2)	0	0
Recurring non operating income	0	0	0	0	0
Non recurring items	(1)	12	(3)	0	0
Profit before tax	783	(176)	296	1,016	1,314
Tax	17	(32)	18	(13)	(17)
Profit after tax	800	(208)	313	1,003	1,297
Minority interests	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Other items	0	0	0	0	0
Reported net profit	800	(208)	313	1,003	1,297
Non recurring items & goodwill (net)	1	(12)	3	0	0
Recurring net profit	801	(220)	316	1,003	1,297
Per share (HKD)					
Recurring EPS *	0.72	(0.20)	0.28	0.86	1.12
Reported EPS	0.72	(0.18)	0.27	0.86	1.12
DPS	0.15	0.00	0.10	0.35	0.45
Growth					
Revenue (%)	22.4	12.9	60.9	38.0	13.8
Operating EBITDA (%)	22.7	(35.7)	99.9	200.4	16.8
Operating EBIT (%)	14.4	(102.2)	(2,054.8)	167.2	26.8
Recurring EPS (%)	11.8	(127.1)	(241.5)	212.3	29.3
Reported EPS (%)	11.7	(125.6)	(248.4)	215.0	29.3
Operating performance					
Gross margin inc depreciation (%)	21.9	17.4	19.0	19.9	20.6
Operating EBITDA margin (%)	11.3	6.4	8.0	17.4	17.8
Operating EBIT margin (%)	8.7	(0.2)	2.1	4.1	4.5
Net margin (%)	7.5	(1.8)	1.6	3.8	4.3
Effective tax rate (%)	(2.2)	-	(6.0)	1.3	1.3
Dividend payout on recurring profit (%)	20.9	-	35.1	40.0	40.0
Interest cover (x)	6.6	(0.1)	3.8	16.4	23.3
Inventory days	39.9	44.8	49.1	56.2	56.2
Debtor days	95.1	95.6	89.2	86.8	85.9
Creditor days	93.6	93.0	84.6	88.7	87.5
Operating ROIC (%)	82.0	(1.2)	15.8	37.8	55.9
ROIC (%)	47.9	(0.7)	9.8	24.1	33.7
ROE (%)	32.7	(8.8)	12.1	27.7	24.8
ROA (%)	7.2	(0.4)	3.0	7.0	7.8
*Pre exceptional, pre-goodwill and fully diluted					
Revenue By Division (HKD m)					
Smartphone	1,140	5,200	12,300	19,775	24,689
Feature phone	9,513	6,831	7,062	6,943	5,710

Sources: TCL Communication; BNP Paribas estimates

Financial statements

TCL Communication

Cash Flow (HKD m) Year Ending Dec	2011A	2012A	2013E	2014E	2015E
Recurring net profit	801	(220)	316	1,003	1,297
Depreciation	276	793	1,138	3,554	4,044
Associates & minorities	1	2	2	0	0
Other non-cash items	0	0	0	0	0
Recurring cash flow	1,078	574	1,456	4,557	5,340
Change in working capital	(637)	(385)	(737)	(230)	(468)
Capex - maintenance	0	0	0	0	0
Capex - new investment	(464)	(893)	(1,482)	(2,843)	(3,235)
Free cash flow to equity	(23)	(704)	(762)	1,484	1,638
Net acquisitions & disposals	0	0	0	0	0
Dividends paid	(168)	0	(113)	(401)	(519)
Non recurring cash flows	(950)	(236)	(105)	0	0
Net cash flow	(1,141)	(939)	(980)	1,082	1,119
Equity finance	(166)	114	795	0	0
Debt finance	1,019	(1,264)	(3,218)	431	774
Movement in cash	(289)	(2,089)	(3,402)	1,513	1,893
Per share (HKD)					
Recurring cash flow per share	0.97	0.51	1.27	3.92	4.59
FCF to equity per share	(0.02)	(0.62)	(0.67)	1.28	1.41
Balance Sheet (HKD m) Year Ending Dec	2011A	2012A	2013E	2014E	2015E
Working capital assets	4,826	5,875	9,933	10,688	12,535
Working capital liabilities	(3,783)	(4,447)	(7,768)	(8,293)	(9,672)
Net working capital	1,043	1,428	2,165	2,395	2,863
Tangible fixed assets	497	597	941	230	(579)
Operating invested capital	1,540	2,026	3,105	2,625	2,284
Goodwill	0	0	0	0	0
Other intangible assets	0	0	0	0	0
Investments	29	30	82	82	82
Other assets	1,247	1,482	1,534	1,534	1,534
Invested capital	2,816	3,537	4,722	4,241	3,900
Cash & equivalents	(7,428)	(5,337)	(1,933)	(3,447)	(5,340)
Short term debt	7,532	6,159	3,453	3,101	2,852
Long term debt *	0	310	196	176	162
Net debt	104	1,132	1,716	(169)	(2,326)
Deferred tax	0	0	0	0	0
Other liabilities	39	83	93	93	93
Total equity	2,673	2,323	2,913	4,317	6,133
Minority interests	0	0	0	0	0
Invested capital	2,816	3,537	4,722	4,241	3,900
* includes convertibles and preferred stock which is being treated as debt					
Per share (HKD)					
Book value per share	2.40	2.06	2.51	3.71	5.28
Tangible book value per share	2.40	2.06	2.51	3.71	5.28
Financial strength					
Net debt/equity (%)	3.9	48.7	58.9	(3.9)	(37.9)
Net debt/total assets (%)	0.7	8.5	11.9	(1.1)	(12.3)
Current ratio (x)	1.1	1.1	1.1	1.2	1.4
CF interest cover (x)	4.2	2.1	7.9	66.4	83.9
Valuation	2011A	2012A	2013E	2014E	2015E
Recurring P/E (x) *	12.0	neg	31.2	10.0	7.7
Recurring P/E @ target price (x) *	14.3	neg	37.4	12.0	9.3
Reported P/E (x)	12.0	neg	31.5	10.0	7.7
Dividend yield (%)	1.8	0.0	1.1	4.0	5.2
P/CF (x)	8.9	16.9	6.8	2.2	1.9
P/FCF (x)	(424.7)	(13.8)	(13.0)	6.8	6.1
Price/book (x)	3.6	4.2	3.4	2.3	1.6
Price/tangible book (x)	3.6	4.2	3.4	2.3	1.6
EV/EBITDA (x) **	7.5	13.4	7.3	2.3	1.6
EV/EBITDA @ target price (x) **	9.1	15.8	8.6	2.8	2.0
EV/invested capital (x)	3.5	3.1	2.5	2.3	2.0
* Pre exceptional, pre-goodwill and fully diluted ** EBITDA includes associate income and recurring non-operating income					

Sources: TCL Communication; BNP Paribas estimates

Disclaimers and Disclosures

APPENDIX

DISCLAIMERS AND DISCLOSURES APPLICABLE TO NON-US BROKER-DEALER(S) (BNP Paribas Securities (Taiwan) Ltd)

ANALYST(S) CERTIFICATION

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