

Defensive emerging market smartphone play

Upgrade to Buy and raise TP 28% to HKD10

Action: Attractive valuation with 38% potential upside

We believe TCLC is attractive on valuations at only 6.9x FY15F EPS (vs ~12x for peers, Fig 10), after its share price declined by 25% in the past four weeks on margin dilution concerns due to competition from Lenovo/Moto, Samsung, and Android One. We expect TCLC to post 30%/25% revenue and earnings growth in FY15F, driven by feature-phone to smartphone upgrades in LATAM, the Middle East and Africa (MEA), as well as market share gains in the US (from 0.2% in 2Q13 to 2.1% in 2Q14).

How to sustain growth in 2015F?

As a China OEM purely in overseas markets (92% of sales from overseas), we see large growth potential for TCLC, including in LATAM (67% smartphone penetration), and MEA (43%), where TCLC has already established a solid feature-phone distribution network. We think feature-phone to smartphone migration in those regions will remain a key revenue driver. We also expect TCLC to gain market share in the US (eg, partnerships with AT&T and T-Mobile) and Europe, driven by partnerships with local telcos.

How to protect GPM in 2015F?

We note rising investors' concerns on TCLC's GPM dilution risks in 2015F due to intensified competition. We note that TCLC mainly focuses on low-end (sub-USD150) smartphones in overseas operator channels, where pricing pressure is much less compared to the mid- to high-end segments.

Valuation: New TP of HKD10 based on 9x FY15F EPS of HKD1.06

Our 9x P/E is discounted 20% vs China technology peers to reflect the margin of safety in our valuation in case GPM falls more than expected. Our valuation already assumes a 0.7pp drop in GPM in FY15F; our sensitivity analysis (Fig 8) shows that even if an additional 1pp fall in GPM is included, our HKD10 TP would imply an FY15F P/E of 11.1x, which is still in line with peers.

Year-end 31 Dec	FY13	FY14F		FY15F		FY16F	
Currency (HKD)	Actual	Old	New	Old	New	Old	New
Revenue (mn)	19,362	22,136	30,090	23,676	39,111		45,970
Reported net profit (mn)	313	817	1,011	894	1,259		1,455
Normalised net profit (mn)	313	817	1,011	894	1,259		1,455
FD normalised EPS	26.52c	71.63c	86.23c	80.40c	1.06		1.20
FD norm. EPS growth (%)	na	238.4	225.1	12.2	22.5		13.7
FD normalised P/E (x)	27.4	N/A	8.4	N/A	6.9	N/A	6.0
EV/EBITDA (x)	10.2	N/A	6.2	N/A	5.8	N/A	5.2
Price/book (x)	2.9	N/A	2.3	N/A	1.8	N/A	1.5
Dividend yield (%)	1.4	N/A	3.5	N/A	4.3	N/A	4.9
ROE (%)	12.0	28.7	30.1	25.9	29.4		27.5
Net debt/equity (%)	103.9	39.2	73.3	12.9	66.0		43.7

Source: Company data, Nomura estimates

Key company data: See page 2 for company data and detailed price/index chart

Global Markets Research

31 October 2014

Rating	Buy
Up from Neutral	
Target price	HKD 10.00
Increased from 7.80	
Closing price	HKD 7.26
29 October 2014	
Potential upside	+37.7%

Anchor themes

TCLC is leveraging its overseas distribution network to expand its presence in the smartphone market. We are positive on TCLC's growth and find its current valuations highly attractive.

Nomura vs consensus

We are more bullish than consensus in our FY15F and FY16F revenues. However, we are more conservative on TCLC's GPM trends.

Research analysts

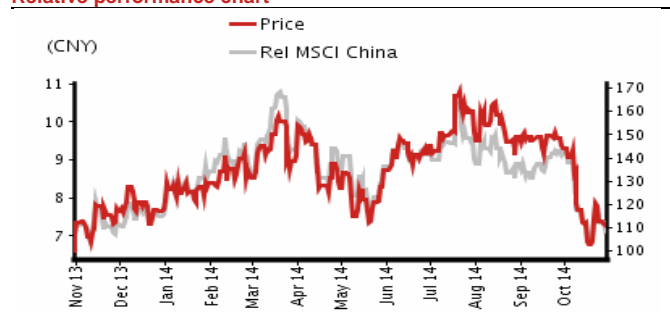
China Technology

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Key data on TCL Communication Tech

Relative performance chart



Source: Thomson Reuters, Nomura research

Notes:

Performance

(%)	1M	3M	12M		
Absolute (HKD)	-22.5	-29.4	17.5	M cap (USDmn)	1,138.2
Absolute (USD)	-22.5	-29.4	17.4	Free float (%)	36.6
Rel to MSCI China	-21.9	-23.5	15.7	3-mth ADT (USDmn)	6.0

Income statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Revenue	12,031	19,362	30,090	39,111	45,970
Cost of goods sold	-9,935	-15,690	-24,294	-31,834	-37,558
Gross profit	2,096	3,672	5,796	7,277	8,412
SG&A	-2,571	-3,643	-5,120	-6,417	-7,450
Employee share expense					
Operating profit	-475	29	676	860	962
EBITDA	314	1,165	1,876	2,060	2,172
Depreciation	-789	-1,136	-1,200	-1,200	-1,210
Amortisation					
EBIT	-475	29	676	860	962
Net interest expense	-47	-8	10	10	10
Associates & JCEs					
Other income	334	277	391	471	578
Earnings before tax	-188	298	1,077	1,341	1,550
Income tax	-32	18	-56	-69	-79
Net profit after tax	-220	316	1,021	1,272	1,470
Minority interests	12	-3	-10	-13	-15
Other items					
Preferred dividends					
Normalised NPAT	-208	313	1,011	1,259	1,455
Extraordinary items					
Reported NPAT	-208	313	1,011	1,259	1,455
Dividends	-34	-117	-303	-378	-437
Transfer to reserves	-242	196	708	882	1,019

Valuations and ratios

Reported P/E (x)	na	26.4	8.4	6.9	6.0
Normalised P/E (x)	-39.2	26.4	8.4	6.9	6.0
FD normalised P/E (x)	na	27.4	8.4	6.9	6.0
Dividend yield (%)	0.4	1.4	3.5	4.3	4.9
Price/cashflow (x)	37.3	13.4	4.9	5.5	3.4
Price/book (x)	3.5	2.9	2.3	1.8	1.5
EV/EBITDA (x)	44.3	10.2	6.2	5.8	5.2
EV/EBIT (x)	na	408.7	17.2	13.9	11.8
Gross margin (%)	17.4	19.0	19.3	18.6	18.3
EBITDA margin (%)	2.6	6.0	6.2	5.3	4.7
EBIT margin (%)	-3.9	0.1	2.2	2.2	2.1
Net margin (%)	-1.7	1.6	3.4	3.2	3.2
Effective tax rate (%)	na	-6.0	5.2	5.1	5.1
Dividend payout (%)	na	37.4	30.0	30.0	30.0
ROE (%)	-8.3	12.0	30.1	29.4	27.5
ROA (pretax %)	-3.8	0.2	4.5	4.9	4.9

Growth (%)

Revenue	12.9	60.9	55.4	30.0	17.5
EBITDA	-54.7	271.0	61.0	9.8	5.4
Normalised EPS	-127.5	na	213.9	22.5	13.7
Normalised FDEPS	-127.5	na	225.1	22.5	13.7

Source: Company data, Nomura estimates

Cashflow statement (HKDmn)

Year-end 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
EBITDA	314	1,165	1,876	2,060	2,172
Change in working capital	-259	-632	-416	-989	-165
Other operating cashflow	169	107	269	511	593
Cashflow from operations	224	640	1,729	1,582	2,600
Capital expenditure	-1,288	-1,489	-1,489	-1,489	-1,489
Free cashflow	-1,064	-849	240	93	1,111
Reduction in investments					
Net acquisitions					
Dec in other LT assets	-18	-68	0	-21	-21
Inc in other LT liabilities	44	10	7	0	0
Adjustments	210	284	130	-135	-133
CF after investing acts	-828	-623	377	-63	957
Cash dividends	-202	0	-117	-303	-378
Equity issue					
Debt issue	-1,185	-2,884	0	0	0
Convertible debt issue					
Others	1,997	2,679	12	12	12
CF from financial acts	610	-205	-105	-291	-366
Net cashflow	-218	-828	272	-354	592
Beginning cash	1,188	970	142	414	60
Ending cash	970	142	414	60	652
Ending net debt		3,022	2,786	3,140	2,548

Balance sheet (HKDmn)

As at 31 Dec	FY12	FY13	FY14F	FY15F	FY16F
Cash & equivalents	970	142	414	60	652
Marketable securities	4,221	1,698	1,698	1,698	1,698
Accounts receivable	4,612	7,284	8,420	9,870	10,340
Inventories	1,263	2,649	3,030	3,970	4,680
Other current assets	146	93	93	93	93
Total current assets	11,212	11,866	13,655	15,691	17,463
LT investments					
Fixed assets	1,771	2,151	2,400	2,700	3,000
Goodwill					
Other intangible assets					
Other LT assets	338	406	406	427	448
Total assets	13,321	14,423	16,461	18,818	20,911
Short-term debt	5,726	2,968	3,000	3,000	3,000
Accounts payable	2,429	3,875	4,900	6,400	7,500
Other current liabilities	2,451	4,378	4,454	4,355	4,270
Total current liabilities	10,606	11,221	12,354	13,755	14,770
Long-term debt	310	196	200	200	200
Convertible debt					
Other LT liabilities	83	93	100	100	100
Total liabilities	10,999	11,510	12,654	14,055	15,070
Minority interest	4	4	4	4	4
Preferred stock	0	0	0	0	0
Common stock	2,321	2,909	3,803	4,759	5,837
Retained earnings					
Proposed dividends					
Other equity and reserves	-3				
Total shareholders' equity	2,318	2,909	3,803	4,759	5,837
Total equity & liabilities	13,321	14,423	16,461	18,818	20,911

Liquidity (x)

Current ratio	1.06	1.06	1.11	1.14	1.18
Interest cover	-10.0	3.6	na	na	na

Leverage

Net debt/EBITDA (x)	net cash	2.59	1.49	1.52	1.17
Net debt/equity (%)	net cash	103.9	73.3	66.0	43.7

Per share

Reported EPS (HKD)	-18.50c	27.47c	86.23c	1.06	1.20
Norm EPS (HKD)	-18.50c	27.47c	86.23c	1.06	1.20
FD norm EPS (HKD)	-18.09c	26.52c	86.23c	1.06	1.20
BVPS (HKD)	2.05	2.49	3.20	3.94	4.75
DPS (HKD)	0.03	0.10	0.26	0.31	0.36

Activity (days)

Days receivable	128.6	112.1	95.2	85.3	80.5
Days inventory	41.3	45.5	42.7	40.1	42.1
Days payable	80.7	73.3	65.9	64.8	67.7
Cash cycle	89.3	84.3	72.0	60.7	54.9

Source: Company data, Nomura estimates

How to sustain growth in FY15F?

Review of TCLC's turnaround story in 2013-14

We think TCLC's global sales and distribution network (as shown below) for both operators and major retailers is its most valuable asset in terms of sustaining growth.

Fig. 1: Strong distribution network globally

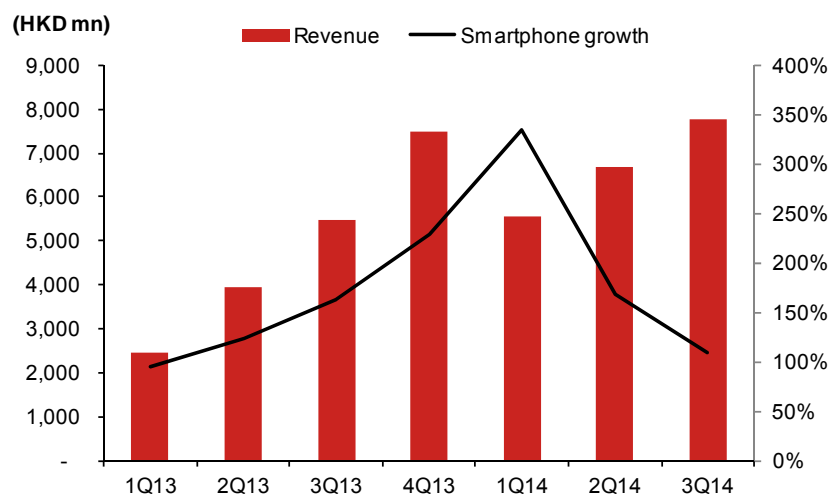
Strong overseas customer base inherited from Alcatel



Source: Company data

TCL posted quarterly losses between 3Q12 and 1Q13 due to the mismatch between what TCL was offering (mainly feature-phones) and what its channel partners wanted (smartphones).

Fig. 2: TCLC's revenue trends and smartphone y-y volume growth



Source: Company data

TCLC's strong earnings turnaround since 2Q13 has been driven mainly by catching up in terms of its smartphone portfolio. As shown below, the gap between TCLC's market share in feature-phones and smartphones has narrowed quickly since 1Q13, with its smartphone market share in major regions close to matching its feature-phone share by 2Q14.

Fig. 3: TCLC's channel capacity by region (feature-phone market share)

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	Avg.
Europe	1.8%	1.9%	2.3%	3.4%	2.9%	4.4%	3.3%
North America	0.5%	1.5%	4.6%	4.0%	4.3%	2.3%	3.8%
South America	9.0%	9.3%	10.1%	12.5%	12.6%	14.3%	12.4%
MEA	4.4%	4.0%	5.7%	7.0%	3.2%	3.9%	5.0%
APAC	0.7%	1.5%	1.5%	1.7%	0.8%	1.1%	1.3%

Source: Gartner, Nomura estimates

Fig. 4: TCLC's smartphone market share by region

	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	Avg.
Europe	1.5%	1.6%	1.9%	2.7%	2.4%	4.1%	2.8%
North America	0.7%	0.2%	2.5%	2.2%	3.7%	2.1%	2.6%
South America	1.6%	3.8%	4.7%	8.4%	10.8%	11.0%	8.7%
MEA	2.2%	2.5%	5.7%	6.4%	2.6%	3.6%	4.6%
APAC	0.6%	1.4%	1.4%	1.7%	0.8%	1.0%	1.2%

Source: Gartner, Nomura estimates

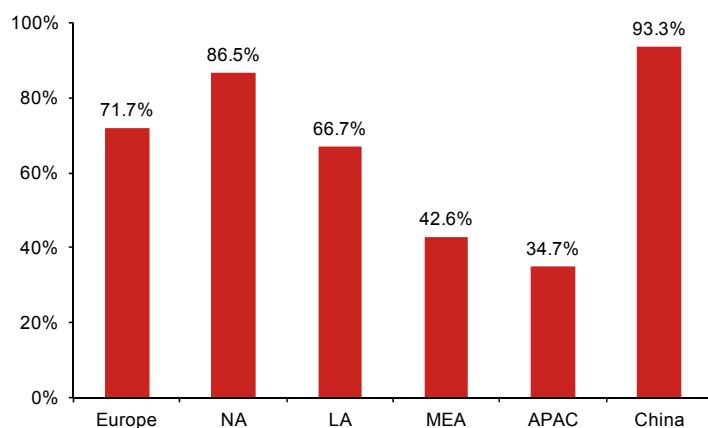
TCLC: 2015F growth outlook

In order to analyze TCLC's growth drivers in 2015F, we look at the smartphone markets in each region and the major brands' market shares.

Fig. 5: Market share ranking by region

FY15F Growth	Market share ranking (2Q14)											China OEM
	No. 1	No. 2	No. 3	No. 4	No. 5	No. 6	No. 7	No. 8	No. 9	No. 10	Others	
Europe 12.2%	Samsung 38.5%	Apple 14.6%	Sony 8.6%	LGE 6.1%	Huawei 5.1%	Nokia 5.0%	TCLC 4.1%	HTC 3.9%	Lenovo 2.7%	Fly 1.4%	9.9%	11.9%
NA 5.9%	Apple 32.4%	Samsung 31.9%	LGE 10.1%	ZTE 7.5%	Lenovo 4.2%	HTC 3.2%	Nokia 2.7%	TCLC 2.1%	Kyocera 2.1%	Huawei 1.6%	2.3%	15.4%
LA 20.1%	Samsung 34.5%	LGE 14.4%	TCLC 11.0%	Lenovo 9.1%	Nokia 7.4%	Huawei 6.6%	Apple 5.7%	ZTE 4.5%	Sony 2.7%	BlackBerry 0.5%	3.7%	31.2%
MEA 28.7%	Samsung 49.3%	Huawei 11.2%	Apple 5.8%	LGE 4.4%	Sony 4.4%	TCLC 3.6%	Tecno 2.4%	Nokia 2.2%	BlackBerry 2.1%	ZTE 2.1%	12.6%	16.9%
APAC 19.6%	Samsung 29.4%	Micromax 6.8%	Lenovo 5.3%	Apple 5.1%	Karbons 5.0%	LGE 4.3%	Nokia 3.8%	Sony 3.6%	Nexian 3.3%	Lava 2.1%	31.3%	5.3%
China 10.0%	Samsung 13.3%	Xiaomi 11.7%	Lenovo 10.9%	Yulong 10.0%	Huawei 9.6%	Apple 7.0%	BBK 4.6%	ZTE 4.6%	OPPO 4.0%	Tianyu 2.4%	22.0%	57.7%
Global 16.9%	Samsung 26.5%	Apple 12.3%	Lenovo 6.6%	Huawei 6.2%	LGE 4.8%	Xiaomi 4.4%	Yulong 3.6%	ZTE 3.6%	Sony 3.2%	Nokia 2.9%	26.0%	24.3%

Source: Gartner, Nomura estimates

Fig. 6: Smartphone penetration rate by region (2Q14)

Source: Gartner

We think TCLC's growth in FY15F will mainly be driven by the following areas:

- **Grow with market in Middle East and Africa (MEA) and Latin Africa (LA)**

As we show above, smartphone penetration in MEA and Latin America is still low. We expect TCLC's smartphone sales in each region will grow by 29%/20% y-y in 2015F.

- **Market share gains in North America**

The second driver is market share gains in relatively mature regions such as North America. This market is a very consolidated (non-top 10 only have 2% market share) with slow growth and two dominant players (Apple and Samsung) controlling 64% of the market (in 2Q14). We think Apple should not be impacted by China OEMs, and thus think TCLC's best chance is to capture market share from other Android players.

- **Grow with market and market share gains in Europe**

We expect the total market in Europe to grow moderately in 2015F, at 12% y-y. Other than Samsung having a dominant market share, other Android players are close to each other. We think TCLC (4.1% market share in 2Q14) may continue to see strong growth, with a combination of natural growth and capturing market share from foreign players ahead of them.

How to keep a stable GPM?

A major concern in the market is TCLC's GPM trend, which began to show signs of decline in 3Q14, after four quarters of consecutive growth since its smartphone recovery in 2Q13. Investors are worried that as overseas competition intensifies, GPM will deteriorate and net profit will deteriorate even more. We see several recent developments in the market that have raised investors' concerns:

- **Samsung to lower prices and re-capture market share lost to China OEMs**

This strategy is mainly targeting mid- to high-level smartphones in the CNY1,500 and above range. Since TCLC's most profitable smartphone segment is its overseas entry-level products (CNY1,000 and below), we believe the impact to its margins will be limited.


- **Motorola to launch Moto E to target entry-level smartphone markets**

- **Google launched Android ONE standard**

Android ONE, a standard targeting entry-level first-time smartphone buyers, was put forth by Google with a complete list of hardware and software requirements that any company may simply follow to manufacture the device. Micromax, Spice, and Karbonn launched their devices with identical specifications in September targeting South East Asian markets; more manufacturers will follow in other parts of the world gradually.

We put the entry-level smartphones side-by-side for comparison. TCLC's POP C5 is still the cheapest. Since emerging markets are still growing fast, we believe the chance for price competition is not high for the moment and pricing pressure on TCLC is minimal.

Fig. 7: Comparison between TCLC's entry-level smartphone with Moto E and Android ONE devices

	TCLC POP C5	Motorola E	Micromax* Canvas A1	Spice* Dream UNO Mi-498
				
Screen Size (inch)	4.5	4.3	4.5	4.5
Resolution	854 * 540	960 * 540	848 * 480	848 * 480
Core	Dual	Dual	Quad	Quad
Processor Speed	1.3 GHz	1.2 GHz	1.3 GHz	1.3 GHz
Rear Camera (MP)	5.0	5.0	5.0	5.0
Front Camera (MP)	VGA	na	2.0	2.0
Operating System	Android 4.4	Android 4.4	Android 4.4.4	Android 4.4.4
Battery (mAh)	1800	1980	1700	1700
Price (CNY)	629 (USD 102)	799 (USD129)	649 (USD106)	649 (USD106)

* Devices with Android ONE specifications

Source: Company data, Nomura research

Historically, TCLC's net profit has been very sensitive to GPM changes. Although we have already forecast a 0.7pp y-y drop in FY15F GPM, let's find out what happens if there are additional drops.

In our scenario analysis, we assume an **additional 1pp y-y drop in GPM**, on top of our already forecasted 0.7pp y-y drop in FY15F, due to intensifying competition. At the same time, we also assume an **additional 0.5pp y-y drop in the opex-to-sales ratio** to reflect the flattening of TCLC's R&D and administrative expenses. As a result, our TP of HKD10 would result in an 11.1x FY15F PE valuation (from our currently forecasted 10x), which we would consider still attractive.

Fig. 8: Sensitivity analysis on GPM

(HKD mn)	FY13	FY14F	Benchmark FY15F	Scenario 1 FY15F
Revenue	19,362	30,090	39,111	39,111
COGS	(15,690)	(24,294)	(31,834)	(32,225)
Gross Profit	3,672	5,796	7,277	6,886
GPM	19.0%	19.3%	18.6%	17.6%
OPEX	(3,643)	(5,120)	(6,417)	(6,221)
Opex-to-sales	18.8%	17.0%	16.4%	15.9%
Operating Income	29	676	860	665
Non-operating Income	269	401	481	481
Pretax Income	298	1,077	1,341	1,146
Tax	15	(66)	(82)	(70)
Tax rate	5.0%	-6.1%	-6.1%	-6.1%
Net Profit	313	1,011	1,259	1,076
NPM	1.6%	3.4%	3.2%	2.8%
Change in net profit				-15%
EPS (HKD)	0.27	0.86	1.06	0.90
FY15F PE @ HKD10		11.7	9.4	11.1

Source: Company data, Nomura estimates

FY14-15F earnings revisions

We revise upwards our FY14F and FY15F revenue forecasts by 36% and 65%, respectively, to reflect stronger-than-expected feature-phone and smartphone sales.

- For feature-phones, we expect TCLC to maintain stable shipment volumes regardless of our forecast for above-10% declines in the global feature-phone market for 2014/15. We think TCLC's share gains will be achieved thanks to other mobile phone vendors retreating from this market (eg, Nokia). As a result, we revise up TCLC's feature-phone volumes by 48%/41% in FY14/15F.
- For smartphones, we revise upwards our FY14/15F shipment volume targets for TCLC by 52%/120% to reflect faster-than-expected growth in entry level and mid-end smartphones. At the same time, we have revised up FY14/15F blended ASPs by 10%/18%, respectively, to reflect the improved product mix.

We revise down our FY14/15F GPM forecasts by 0.4pp/1pp respectively, to reflect the higher-than-expected decline in smartphone ASPs amid competition.

So overall, we have revised upwards our FY14/15F net profit forecasts by 24%/41%.

Fig. 9: TCLC: Earnings revisions

(HKD mn)	1Q14	2Q14	3Q14		2013	2014E	2015E	2016E		2014E	2015E		2014E	2015E
	A	A	A		A	(NOM)	(NOM)	(NOM)		(OLD)	(OLD)			
Turnover	5,541	6,677	7,778		19,362	30,090	39,111	45,970		22,136	23,676		36%	65%
% chg yoy	126%	69%	43%		61%	55%	30%	18%		14%	7%			
COGS	(4,454)	(5,383)	(6,297)		(15,690)	(24,294)	(31,834)	(37,558)		(17,787)	(19,025)			
Gross Profit	1,087	1,294	1,481		3,672	5,796	7,277	8,412		4,349	4,651		33%	56%
OPEX	(971)	(1,115)	(1,437)		(3,643)	(5,120)	(6,417)	(7,450)		(3,689)	(3,931)		39%	63%
Operating Income	116	179	44		29	676	860	962		660	720		2%	19%
% chg yoy	-165%	259%	-82%		-106%	2231%	27%	12%		2176%	9%			
Non-Operating Income	72	94	264		269	401	481	588		206	206		94%	133%
Pretax income	188	273	308		298	1,077	1,341	1,550		4,349	4,651		-75%	-71%
% chg yoy	-178%	1850%	40%		-259%	261%	25%	16%		1359%	7%			
Net income	177	254	294		313	1,011	1,259	1,455		817	894		24%	41%
% chg yoy	n.a.	551%	30%		-250%	223%	25%	16%		161%	9%			
EPS (HKD cents)	15	22	25		27	86	104	117						
Ratios (%)														
Gross margin	19.6%	19.4%	19.0%		19.0%	19.3%	18.6%	18.3%		19.6%	19.6%		-0.4pp	-1.0pp
SG&A / revenue	17.5%	16.7%	18.5%		18.8%	17.0%	16.4%	16.2%		16.7%	16.6%		0.4pp	-0.2pp
OPM	2.1%	2.7%	0.6%		0.1%	2.2%	2.2%	2.1%		3.0%	3.0%		-0.7pp	-0.8pp
PTI-to-sales	3.4%	4.1%	4.0%		1.5%	3.6%	3.4%	3.4%		19.6%	19.6%		-16.1pp	-16.2pp
Net Income margin	3.2%	3.8%	3.8%		1.6%	3.4%	3.2%	3.2%		3.7%	3.8%		-0.3pp	-0.6pp
Volume (mn units)	13.6	16.3	18.7		55.2	70.0	85.4	98.9		46.6	46.6		50%	83%
% chg yoy	60%	34%	21%		30%	27%	22%	16%		15%	0%			
Feature phone	7.3	7.6	7.8		37.6	32.0	30.4	28.9		21.6	21.6		48%	41%
Smartphone	6.3	8.7	10.9		17.6	38.0	55.0	70.0		25.0	25.0		52%	120%
ASP (US\$)	52.2	52.4	53.4		45.2	55.5	59.1	60.0		50.3	50.3		10%	18%
% chg yoy	40%	25%	18%		24%	23%	7%	2%		9%	0%			

Source: Company data, Nomura estimates

Fig. 10: Peer comparison valuations

Code	Company	Nomura Rating	Price 29-Oct	Target Price	MCaps USD mn	P/E (x)		P/B (x)		ROE FY14F	ROE FY15F	Share Price		
						FY14F	FY15F	FY14F	FY15F	FY14F	FY15F	5D	1M	YTD
MXCN	MSCI China		63.9									2%	3%	1%
HSCEI	H-Share index		10,724									3%	3%	-2%
China Technology														
2618 HK	TCL Com	Buy ↑	7.26	10.0 ↑	1,138	8.4	6.9	2.3	1.8	30%	30%	-8%	-24%	-10%
992 HK	Lenovo	Neutral	11.5	10.4	15,705	18.9	20.8	5.0	3.8	28%	21%	2%	-2%	21%
1211 HK	BYD	Buy	54.0	64.0	18,654	65.7	40.8	4.3	3.9	7%	10%	6%	-2%	32%
763 HK	ZTE	Buy	18.4	25.0	8,398	16.8	14.1	2.0	1.8	12%	13%	6%	6%	19%
552 HK	CCS	Buy	3.6	5.00	3,216	6.1	6.1	0.8	0.8	14%	13%	0%	-1%	-26%
981 HK	SMIC	Buy	0.80	1.10	3,599	21.7	17.9	1.3	1.2	6%	7%	-1%	0%	31%
2382 HK	Sunny Optical	Buy	12.9	18.3	1,828	18.6	13.7	3.3	2.8	19%	22%	0%	10%	68%
285 HK	BYD Electronics	Buy	10.0	14.0	2,906	15.6	11.7	1.8	1.6	12%	14%	5%	3%	105%
861 HK	Digital China	Reduce	7.2	9.0	1,018	6.4	6.1	0.9	0.8	15%	14%	2%	2%	-23%
819 HK	Tianneng	Buy	2.8	6.5	402	11.0	6.2	0.8	0.7	7%	12%	11%	6%	-2%
2369 HK	Coolpad	Neutral	1.6	1.2	902	5.8	na	1.0	na	20%	0%	7%	19%	29%
2342 HK	Comba	Buy	3.5	3.8	756	10.4	na	1.2	na	12%	0%	0%	9%	43%
751 HK	Skyworth	Buy	4.2	6.0	1,522	9.2	8.1	1.1	1.0	12%	13%	0%	4%	-2%
China Tech Median						11.0	11.7	1.3	1.6	12%	13%	2%	3%	21%
2498 TT	HTC	Reduce	132	125	3,643	na	na	1.4	1.4	1%	1%	-1%	1%	-5%
005930 KS	Samsung	Buy	1,130,000	1,370,000	159,182	7.8	8.8	1.1	1.0	14%	12%	2%	0%	-14%
066570 KS	LGE	Buy	67,800	96,000	10,611	11.0	8.5	0.9	0.8	8%	10%	5%	0%	-3%

Source: Bloomberg, Nomura estimates

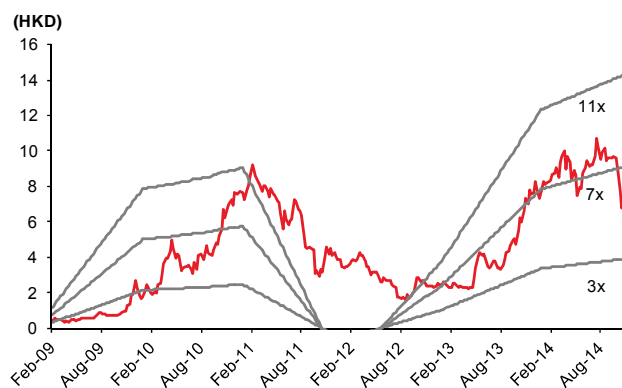
We are more bullish than consensus for revenue growth. However, we are more conservative on the GPM trend in FY14/15F, thus our net profit is roughly in line overall.

Fig. 11: Nomura vs consensus

(HKD)	FY2013 Actual	FY2014 (NOM) (CON) diff			FY2015 (NOM) (CON) diff			FY2016 (NOM) (CON) diff		
Revenue	19,362	30,090	29,715	1.3%	39,111	36,539	7.0%	45,970	41,839	9.9%
Operating Profit	29	676	1,082	-38%	860	1,403	-39%	962	1,707	-44%
Pretax Profit	298	1,077	1,172	-8%	1,341	1,465	-8%	1,550	1,689	-8%
Net Profit	313	1,011	1,068	-5%	1,259	1,310	-4%	1,455	1,518	-4%
EPS	0.27	0.86	0.89	-3%	1.06	1.09	-3%	1.20	1.26	-5%

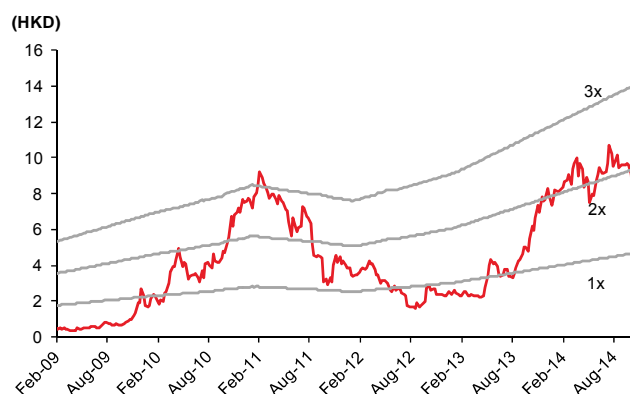
Source: Bloomberg consensus, Nomura estimates

Fig. 12: TCL: P/E bands



Source: Bloomberg, Nomura research

Fig. 13: TCL: P/B bands



Source: Bloomberg, Nomura research

Valuation

Our new TP of HKD10 is based on 9x FY15F EPS of HKD1.06. This multiple is discounted 20% vs China technology peers to reflect the margin of safety we have implemented in our valuation in case GPM deteriorates more than expected. Our analysis shows that even if we price in an additional 1pp GPM decline in FY15F, our HKD10 TP would imply an FY15F P/E of 11.1x, which is still in line with its peers.

Risks

Potential downside risk includes higher-than-expected margin erosion due to intensifying competition. Potential upside risk includes the faster-than-expected growth in smartphone shipments with controlled pricing pressure.

Appendix A-1

Analyst Certification

I, Leping Huang, hereby certify (1) that the views expressed in this Research report accurately reflect my personal views about any or all of the subject securities or issuers referred to in this Research report, (2) no part of my compensation was, is or will be directly or indirectly related to the specific recommendations or views expressed in this Research report and (3) no part of my compensation is tied to any specific investment banking transactions performed by Nomura Securities International, Inc., Nomura International plc or any other Nomura Group company.

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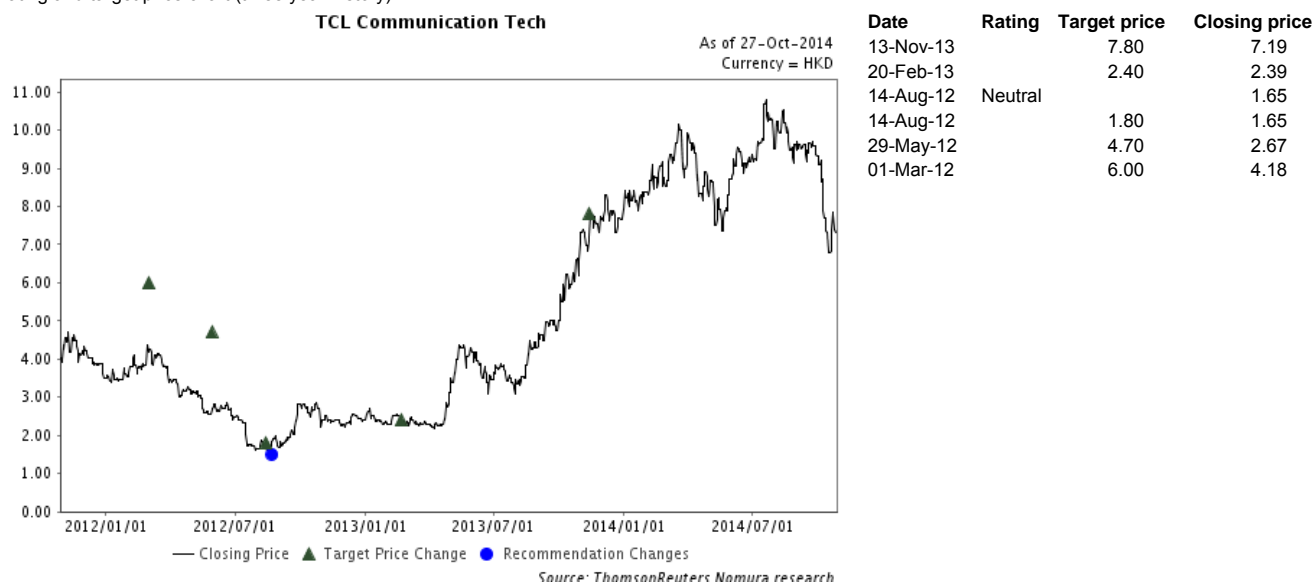
Materially mentioned issuers

Issuer	Ticker	Price	Price date	Stock rating	Sector rating	Disclosures
TCL Communication Tech	2618 HK	HKD 7.10	30-Oct-2014	Buy	N/A	

TCL Communication Tech (2618 HK)

HKD 7.10 (30-Oct-2014) Buy (Sector rating: N/A)

Rating and target price chart (three year history)



For explanation of ratings refer to the stock rating keys located after chart(s)

Valuation Methodology Our TP of HKD10 is based 9x FY15F EPS of HKD1.06. This multiple is discounted 20% vs. China technology peers to reflect the margin of safety we have implemented in our valuation in the case that GPM deteriorates more than expected. The benchmark index for this stock is MSCI China.

Risks that may impede the achievement of the target price Downside risk includes further margin erosion in the high-end feature-phone market.

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