

TCL Communication (2618 HK)

4 December 2013

In the fast lane

- **Maintain Outperform and raise target price to HK\$10.50.** We maintain our Outperform rating on TCL Communication (TCLC) and raise our FY13F/FY14F earnings forecasts by 14%/30% while bringing our target price from HK\$8.00 to HK\$10.50. Our new target price is still based on 15x forward P/E. We continue to like the company's "fast fashion" design approach, potential upside from 4G LTE smartphones, and the move to tablet PCs.
- **"Fast fashion" business model bearing fruit.** We like TCLC's embrace of fast-fashion, whereby the latest trends in color, form and style are quickly brought from the street and adapted into TCLC's smartphones. Based on the success of the "One Touch" series, we believe the company will soon become a meaningful smartphone player. Its improving model line-up and effective sales distribution channel should help it deliver 17m/30m unit shipments in FY13F/14F.
- **4G LTE the game plan for 2014F.** TCLC has been a bit behind its international peers in rolling out 4G LTE smartphones. So far it has only one 4G LTE model, the "Idol S". This will change in 2Q14F with the mass roll-out of the company's new 4G LTE models. With FDD-LTE smartphones being released overseas and TD-LTE domestically, 2014F is shaping up to be a big year for TCLC.
- **Tablets may hold key to further growth.** While its smartphones have taken the limelight, TCLC has been quietly working away at its next growth engine: tablets. This is new ground for an emerging Chinese handset company, yet we believe TCLC's impressive design capabilities, maturing chipset technologies and better-than-peer global distribution channels will help it jump-start the tablet business. We expect it to sell 4m/8m tablets in FY14F/15F.

Forecast and valuation

Year to 31 December	2011	2012	2013F	2014F	2015F
Revenue (HK\$m)	10,653	12,031	18,823	29,970	37,950
Net profit (HK\$m)	800	(208)	322	790	1,098
Revision (%)	–	–	14.1	30.4	41.7
EPS (HK\$)	0.70	(0.18)	0.28	0.70	0.97
YoY change (%)	11.8	N/A	N/A	N/A	38.9
DPS (HK\$ cents)	29.20	3.01	0.00	24.44	33.95
Dividend Yield (%)	3.8	0.4	0.0	3.2	4.5
P/E (x)	10.8	(42.2)	27.1	10.9	7.9
P/B (x)	3.2	3.8	3.3	2.5	2.0
ROE (%)	29.9	(8.9)	12.3	23.3	26.0

Source: CCBIS estimates

Company Rating: Outperform
(maintained)

Price: HK\$7.62
Target: HK\$10.50
(up from HK\$8.00)

Trading data

52-week range	HK\$2.18-7.99
Market capitalization (m)	HK\$8,778/US\$1,128
Shares outstanding (m)	1,152
Free float (%)	41.4
3M average daily T/O (m share)	5.9
3M average daily T/O (US\$m)	5.8
Expected return (%) – 1 year	37.5

Price as at close on 3 December 2013

Stock price vs. HSCEI



Source: Bloomberg

Ronnie Ho
(852) 2533 2486
ronnieho@ccbintl.com
Ke Qu
(852) 2844 3601
quke@ccbintl.com

TCL Communication – financial summary

Income statement

FYE 31 December (HK\$m)	2011	2012	2013F	2014F	2015F
Revenue	10,653	12,031	18,823	29,970	37,950
Cost of revenue	(8,325)	(9,935)	(15,246)	(24,276)	(30,740)
Gross profit	2,328	2,097	3,576	5,694	7,211
Other income and gains	313	329	355	500	607
Selling and distribution expenses	(866)	(1,154)	(1,600)	(2,383)	(2,960)
Administrative expenses	(558)	(658)	(941)	(1,379)	(1,708)
R&D costs	(459)	(740)	(1,035)	(1,558)	(1,898)
Other expenses	(28)	(109)	(19)	(30)	(38)
Operating profit	729	(234)	336	844	1,215
Net interest income	55	47	5	10	5
Share of result of jointly controlled entities/associates	(1)	(2)	(2)	0	0
Other	0	0	0	0	0
Profit before tax	783	(188)	339	854	1,220
Tax expense	17	(32)	(20)	(64)	(122)
Minority interest	(1)	12	3	0	0
Profit to shareholders	800	(208)	322	790	1,098
EPS (HK\$)	0.70	(0.18)	0.28	0.70	0.97
Handset shipments (m unit)	43.6	42.6	53.5	64.0	73.0

Cash flow

FYE 31 December (HK\$m)	2011	2012	2013F	2014F	2015F
Profit before tax	783	(188)	339	854	1,220
Depreciation and amortization	107	142	175	215	247
Change in working capital	(722)	(102)	(626)	(976)	(656)
Other	(47)	373	383	(109)	(172)
Operating cash flow	122	224	270	(16)	639
Capex	(232)	(246)	(350)	(250)	(250)
Other	(734)	(805)	(200)	(115)	(110)
Investment cash flow	(966)	(1,052)	(550)	(365)	(360)
Change in borrowings	735	(1,302)	194	0	0
Other	(99)	1,942	521	0	223
Financing cash flow	637	640	715	0	223
Change in cash	(207)	(187)	436	(381)	502
Exchange losses on cash and cash equivalents	49	(30)	0	0	0
Cash, beginning	1,345	1,187	970	1,406	1,025
Cash, ending	1,187	970	1,406	1,025	1,527

Source: Historical data from the Company, forecasts by CCBIS

Balance sheet

FYE 31 December (HK\$m)	2011	2012	2013F	2014F	2015F
Cash and bank balances	1,187	970	1,406	1,025	1,527
Pledged bank deposits	6,092	4,221	3,666	3,666	3,166
Trade and bills receivables	2,638	2,882	3,668	5,806	7,336
Prepayments, deposits and other assets	870	1,246	1,950	3,105	3,931
Inventories	981	1,263	2,089	3,325	4,211
Other current assets	485	630	459	459	459
Current assets	12,254	11,212	13,238	17,386	20,631
Property, plant and equipment	497	597	829	938	1,030
Goodwill	254	254	254	254	254
Prepaid lease payments	185	177	176	176	176
Intangible assets	702	921	662	749	820
Investment in jointly controlled entities/associates	2	4	2	2	2
Other non-current assets	132	157	157	157	157
Total non-current assets	1,773	2,109	2,081	2,277	2,439
Accounts and bills payable	1,952	2,429	3,342	5,321	6,737
Other payables and accruals	1,431	1,620	2,535	4,036	5,111
Short-term bank loans	7,222	5,726	5,726	5,726	5,726
Other current liabilities	710	830	638	711	806
Total current liabilities	11,315	10,606	12,241	15,795	18,381
Long-term bank loans	0	194	388	388	388
Other non-current liabilities	39	199	82	82	82
Total non-current liabilities	39	393	471	471	471
Shareholders' equity	2,669	2,321	2,609	3,399	4,220
Minority interest	4	2	(2)	(2)	(2)
Total equity	2,673	2,323	2,608	3,398	4,219

Financial ratios

FYE 31 December (%)	2011	2012	2013F	2014F	2015F
Profitability					
Gross margin	21.9	17.4	19.0	19.0	19.0
Operating margin	6.8	(1.9)	1.8	2.8	3.2
Net margin	7.5	(1.7)	1.7	2.6	2.9
ROE	29.9	(8.9)	12.3	23.3	26.0
Growth					
Sales revenue growth	22.4	12.9	56.4	59.2	26.6
Operating income growth	19.5	(9.9)	70.6	59.2	26.6
Net profit growth	14.0	N/A	N/A	145.6	38.9
EPS growth	11.8	N/A	N/A	N/A	38.9
Liquidity					
Net debt/equity	Net cash	31.4	40.0	41.9	33.7

TCL Communication – earnings revisions

Profit and loss (US\$m)	New			Previous			Change (%)		
	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
Revenue	18,823	29,970	37,950	18,756	28,160	33,515	0.4	6.4	13.2
Gross profit	3,576	5,694	7,211	3,564	5,491	6,535	0.4	3.7	10.3
Opex	(3,595)	(5,350)	(6,603)	(3,620)	(5,336)	(6,234)	(0.7)	0.2	5.9
Operating profit	336	844	1,215	289	630	849	16.2	34.0	43.0
Net profit	322	790	1,098	282	606	775	14.1	30.4	41.7
(%)									
Gross margin	19.0	19.0	19.0	19.0	19.5	19.5			
OPEX to sales	(19.1)	(17.9)	(17.4)	(19.3)	(19.0)	(18.6)			
OPM	1.8	2.8	3.2	1.5	2.2	2.5			
Net margin	1.7	2.6	2.9	1.5	2.2	2.3			

Source: CCBIS estimates

China technology sector valuation matrix

	Stock	CCBIS	Share price*	Market cap	EPS growth (%)			P/E (x)		
Company	code	rating	(local currency)	(US\$m)	CY13F	CY14F	CY15F	CY13F	CY14F	CY15F
China handset brands										
Lenovo	992 HK	Outperform	9.15	12,214	19.5	15.6	7.0	16.2	14.0	13.1
ZTE	763 HK	Outperform	16.98	8,939	N/A	42.1	16.8	24.6	17.0	14.5
HTC	2498 TT	Not Rated	151.50	4,344	N/A	25.6	26.2	NM	NM	NM
China Wireless	2369 HK	Outperform	2.64	716	20.4	44.5	16.6	14.5	10.0	8.6
TCLC	2618 HK	Outperform	7.62	1,128	N/A	148.6	38.9	27.1	10.9	7.9
Average								20.6	13.0	11.0
Handset components and others										
Mediatek	2454 TT	Not Rated	434.50	19,777	48.6	27.6	10.5	22.7	17.8	16.1
AAC	2018 HK	Neutral	36.55	5,761	44.6	(8.5)	14.6	14.1	15.0	13.1
Largan Precision	3008 TT	Not Rated	1,070.00	4,841	61.6	13.5	NA	15.9	14.0	12.2
FIH	2038 HK	Not Rated	3.68	3,582	N/A	N/A	NA	NM	NM	NM
TPK	3673 TT	Not Rated	179.00	1,987	(45.0)	(38.6)	NA	7.3	11.9	NA
Truly International	732 HK	Not Rated	4.33	1,618	83.5	17.4	17.5	9.2	7.8	6.7
Spreadtrum	SPRD US	Not Rated	30.59	1,525	26.3	15.0	(6.2)	12.1	10.5	11.2
Unimicron Tech	3037 TT	Not Rated	21.50	1,116	33.4	21.1	22.0	0.0	0.0	0.0
BYD Electronic	285 HK	Not Rated	3.72	1,074	47.1	26.4	17.1	14.9	11.8	10.1
Sunny Optical	2382 HK	Neutral	7.28	1,026	34.7	21.4	22.4	12.3	10.1	8.1
Merry Electronics	2439 TT	Not Rated	434.50	19,777	48.6	27.6	10.5	22.7	17.8	16.1
Average								13.4	11.7	10.2

* Price as at close on 3 December 2013

Source: Bloomberg, CCBIS estimates

TCL Communication – income statement

FYE 31 December (HK\$m)	2011	2012	2013F	2014F	2015F	1Q13	2Q13	3Q13	4Q13F
Revenue	10,653	12,031	18,823	29,970	37,950	2,449	3,958	5,454	6,962
Cost of revenue	(8,325)	(9,935)	(15,246)	(24,276)	(30,740)	(2,046)	(3,232)	(4,383)	(5,585)
Gross profit	2,328	2,097	3,576	5,694	7,211	402	727	1,071	1,377
Gross profit margin (%)	21.9	17.4	19.0	19.0	19.0	16.4	18.4	19.6	19.8
Other income and gains	313	329	355	500	607	56	121	76	102
Selling and distribution expense	(866)	(1,154)	(1,600)	(2,383)	(2,960)	(289)	(367)	(399)	(545)
Administrative expense	(558)	(658)	(941)	(1,379)	(1,708)	(188)	(237)	(219)	(298)
R&D costs	(459)	(740)	(1,035)	(1,558)	(1,898)	(224)	(208)	(265)	(338)
Other expenses	(28)	(109)	(19)	(30)	(38)	(5)	(26)	(42)	54
Operating profit	729	(234)	336	844	1,215	(247)	10	222	351
Operating margin (%)	6.8	(1.9)	1.8	2.8	3.2	(10.1)	0.3	4.1	5.0
Net interest income	55	47	5	10	5	6	4	(1)	(4)
Share of result of jointly controlled entities/associates	(1)	(2)	(2)	0	0	(0)	(0)	(0)	(1)
Other	0	0	0	0	0	0	0	0	0
Profit before tax	783	(188)	339	854	1,220	(241)	14	220	347
Tax expense	17	(32)	(20)	(64)	(122)	(6)	24	3	(42)
Minority interest	(1)	12	3	0	0	1	1	3	(2)
Profit to shareholders	800	(208)	322	790	1,098	(246)	39	226	303
Net profit margin (%)	7.5	(1.7)	1.7	2.6	2.9	(10.1)	1.0	4.1	4.4
EPS (HK\$)	0.70	(0.18)	0.28	0.70	0.97	(0.22)	0.03	0.19	0.26
EPS growth (%)	11.8	N/A	N/A	N/A	38.9	N/A	(48.9)	N/A	N/A
Gross profit margin (%)	21.9	17.4	19.0	19.0	19.0	16.4	18.4	19.6	19.8
Operating profit margin (%)	6.8	(1.9)	1.8	2.8	3.2	(10.1)	0.3	4.1	5.0
Net profit margin (%)	7.5	(1.7)	1.7	2.6	2.9	(10.1)	1.0	4.1	4.4
ROE (%)	29.9	(8.9)	12.3	23.3	26.0				
Net debt/equity (%)	Net cash	31.4	40.0	41.9	33.7				

Source: Historical data from the Company, forecasts by CCBIS

Rating definitions

Outperform (O) – expected return > 10% over the next twelve months

Neutral (N) – expected return between -10% and 10% over the next twelve months

Underperform (U) – expected return < -10% over the next twelve months

Analyst certification:

The author(s) of this document, hereby declare that: (i) all of the views expressed in this document accurately reflect his personal views about any and all of the subject securities or issuers and were prepared in an independent manner; and (ii) no part of any of his compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed in this document; and (iii) he receives no insider information/non-public price-sensitive information in relation to the subject securities or issuers which may influence the recommendations made by him. The author(s) of this document further confirm that (i) neither he nor his respective associate(s) (as defined in the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission issued by the Hong Kong Securities and Futures Commission) has dealt in or traded in the securities covered in this document within 30 calendar days prior to the date of issue of this document or will so deal in or trade such securities within 3 business days (as defined in the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) after the date of issue of this document; (ii) neither he nor his respective associate(s) serves as an officer of any of the companies covered in this document; and (iii) neither he nor his respective associate(s) has any financial interests in the securities covered in this document.

Company-specific regulatory disclosures: CCBi Group has investment banking relationship with ZTE Corporation (763 HK) in the past 12 months.

Disclaimers:

This document is prepared by CCB International Securities Limited. CCB International Securities Limited is a wholly-owned subsidiary of CCB International (Holdings) Limited ("CCBIH") and China Construction Bank Corporation ("CCB"). Information herein has been obtained from sources believed to be reliable but CCB International Securities Limited, its affiliates and/or subsidiaries (collectively "CCBIS") do not guarantee, represent and warrant (either express or implied) its completeness or accuracy or appropriateness for any purpose or any person whatsoever. Opinions and estimates constitute our judgment as of the date of this document and are subject to change without notice. CCBIS seeks to update its research as appropriate, but various regulations may prevent it from doing so. Besides certain industry reports published on a periodic basis, the large majority of reports are published at irregular intervals as appropriate according to the analyst's judgment. Forecasts, projections and valuations are inherently speculative in nature and may be based on a number of contingencies. Readers should not regard the inclusion of any forecasts, projections and valuations in this document as a representation or warranty by or on behalf of CCBIS that these forecasts, projections or valuations or their underlying assumptions will be achieved. Investment involves risk and past performance is not indicative of future results. Information in this document is not intended to constitute or be construed as legal, financial, accounting, business, investment, tax or any professional advice for any prospective investors and should not be relied upon in that regard. This document is for informational purposes only and should not be treated as an offer or solicitation for the purchase or sale of any products, investments, securities, trading strategies or financial instruments of any kind in any jurisdiction. CCBIS makes no representations on the availability of the securities covered in this document (or related investment) to the recipients. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. Neither CCBIS nor any other persons accept any liability whatsoever for any loss or damages (whether direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential) arising from any use of this document or its contents or otherwise arising in connection therewith. Securities, financial instruments or strategies mentioned herein may not be suitable for all investors. The opinions and recommendations herein do not take into account prospective investors' financial circumstances, investment objectives, or particular needs and are not intended as recommendations of particular securities, financial instruments or strategies to any prospective investors. The recipients of this document should consider this document as only a single factor in making their investment decision and shall be solely responsible for making their own independent investigation of the business, financial condition and prospects of companies referred to in this document. Readers are cautioned that (i) the price and value of securities referred to in this document and the income derived from them may fluctuate; (ii) past performance is not a guide to future performance; (iii) any analysis, ratings and recommendations made in this document are intended for long-term (at least for 12 months) and is not linked to a near-term assessment of the likely performance of the securities or companies in question. In any event, future actual results may differ materially from those set forth in any forward-looking statements herein; (iv) future returns are not guaranteed, and a loss of original capital may occur; and (v) fluctuations in exchange rates may adversely affect the value, price or income of any security or related instrument referred to in this document. It should be noted that this document covers only those securities or companies as specified herein and does not extend to any derivative instruments thereof, the value of which may be affected by many factors and may not correspond with the value of the underlying securities. Trading in these instruments is considered risky and are not suitable for all investors. While all reasonable care has been taken to ensure that the facts stated herein are accurate and that the forward-looking statements, opinions and expectations contained herein are based on fair and reasonable assumptions, CCBIS has not been able to verify independently such facts or assumptions and CCBIS shall not be liable for the accuracy, completeness or correctness thereof and no representation or warranty is made, express or implied, in this regard. All pricing referred to in this document is as of the close of local market for the securities discussed, unless otherwise stated and for information purposes only. There is no representation that any transaction can or could have been effected at those prices, and any prices do not necessarily reflect CCBIS' internal books and records or theoretical model-based valuations and may be based on certain assumptions. Different assumptions could result in substantially different results. Any statements which may be contained herein attributed to a third-party represent CCBIS' interpretation of the data, information and/or opinions provided by that third party either publicly or through a subscription service, and such use and interpretation have not been reviewed or endorsed by the third party. Reproduction and distribution of these third party contents in any form is prohibited except with the prior written consent of such third party. The recipients must make their own assessments of the relevance, accuracy and adequacy of the information contained in this document and make such independent investigation as they may consider necessary or appropriate for such purpose.

Recipients should seek independent legal, financial, accounting, business, investment and/or tax advice if they have any doubt about the contents of this document and satisfy themselves prior to making any investment decision that such investment is in line with their own investment objectives and horizons.

Use of hyperlinks to other internet sites or resources (if any) as referred to in this document is at users' own risk. They are provided solely for the purpose of convenience and information and the content of these internet sites or resources does not in any way form part of this document. The contents, accuracy, opinion expressed, and other links provided at these sites are not investigated, verified, monitored, or endorsed by CCBIS. CCBIS expressly disclaims any responsibility for and does not guarantee, represent and warrant (either express or implied) the completeness, accuracy, appropriateness, availability or security of information found on these websites. Users of these websites are solely responsible for making all enquiries, investigation and risk assessment before proceeding with any online or offline access or transaction with any of these third parties. All activities conducted by users via or at these websites are at their own risk. CCBIS does not guarantee the security of any information users may forward or be requested to provide to any third parties via these websites. Users are deemed to have irrevocably waived any claims against CCBIS for any loss or damage suffered as a result of any access to or interaction with any of these websites.

Upon request CCBIS may provide specialized research products or services to certain customers focusing on the prospects for specific securities as compared with other covered securities over varying time horizons or under differing market conditions. While the views expressed in these situations may not always be directionally consistent with the long-term views expressed in the analyst's published research, CCBIS has procedures in place to prevent selective disclosure and will update the relevant readers when our views has changed. CCBIS also has procedures in place to identify and manage potential conflicts of interest that may arise in connection with its research business and services. Chinese Wall procedures are also in place to ensure that any confidential and/or price sensitive information is properly handled. CCBIS will use its best endeavors to comply with the relevant laws and regulations in this respect. Nevertheless, the recipients should be aware that CCB, CCBIS, their affiliates and/or their officers, directors and employees may do business with the issuer(s) of the securities covered in this document, including investment banking business or direct investment business or may hold interest in (and/or later add or dispose) such securities (or in any related investment) for themselves and/or on behalf of their clients from time to time. As a result, investors should be aware that CCBIS may have a conflict of interest that could affect the objectivity of this document and CCBIS will not assume any responsibility in respect thereof. Further, the information contained herein may differ or be contrary to opinions expressed by other associates of CCBIS or other members of the CCB or CCBIH group of companies.

This document is for the information of the institutional and professional customers of CCBIS only and should not be distributed to retail customers. This document is not directed at you if CCBIS is prohibited or restricted by any legislation or regulation in any jurisdiction from making it available to you. You should satisfy yourself before reading it that CCBIS is permitted to provide research material concerning investments to you and that you are permitted and entitled to receive and read the document under relevant legislation and regulations. In particular, this document is only distributed to certain US Persons to whom CCBIS is permitted to distribute according to US securities laws, but cannot otherwise be distributed or transmitted, whether directly or indirectly, into the US or to any other US person. This document also cannot be distributed or transmitted, whether directly or indirectly, into Japan and Canada and not to the general public in the People's Republic of China (for the purpose of this document, excluding Hong Kong, Macau and Taiwan) unless under applicable laws.

Any unauthorized reproduction or redistribution by any means to any persons, in whole or in part of this document is strictly prohibited and CCBIS accepts no liability whatsoever for the actions of third parties in distributing this research report.

If this document has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. CCBIS therefore does not accept liability for any errors or omissions in the contents of this document, which may arise as a result of electronic transmission.

The disclosures contained in this document prepared by CCBIS shall be governed by and construed in accordance with the laws of Hong Kong.

Copyright 2013 CCBIS. The signs, logos and insignia used in this research report and the company name "CCB International Securities Limited" are the registered and unregistered trademarks of CCB, CCBIH and/or CCBIS. All rights are hereby reserved. All material presented in this document, unless indicated otherwise, is under copyright to CCBIS. This document or any portion hereof may not be reproduced, sold or redistributed without the written consent of CCBIS.