

TCL Communication (2618 HK)

24 October 2013

Hits a home run

- Blow-out 3Q13 results.** TCL Communication reported 3Q13 results, with sales revenue of HK\$5.5b and net income of HK\$223m. Reported net income was much higher than our HK\$93m estimate. Gross profit margin (GPM) was 19.6% up 120bp versus 2Q13 on stronger unit sales of higher ASP smartphones.
- Soon to be a meaningful player in the smartphone market.** TCL Communication shipped 5.2m smartphones in 3Q13. Blended handset ASP was up 8.6% QoQ to US\$45.4. We attribute the company's stand-out performance to the popular mid-end One-touch series smartphone. Provided it continues with its successful dual-brand strategy, we expect company smartphone unit sales to top 16.8/31.0m with higher ASP and GPM in FY13F/14F.
- Dual-brand strategy bears fruit.** TCL Communication has a dual-brand strategy whereby the "TCL" brand targets the domestic market while the "Alcatel" brand is used overseas. Although domestic sales accounted for merely 8.4% of total sales in 9M13, they will continuously explore the PRC markets. ASP should increase further after the imminent launch of the LTE 4G smartphone destined for both the overseas and domestic markets for FY14F/15F.
- Maintain Outperform and raise target price to HK\$8.00.** We maintain our Outperform rating on TCL Communication and raise our earnings forecasts for the company by 253%/35% for FY13F/14F. We also raise the target price from HK\$6.00 to HK\$8.00. Our new target price is still based on 15x forward P/E. We continue to like the company's overseas exposure, growing opportunities from China, and improving model line-up.

Forecast and valuation

Year to 31 December	2011	2012	2013F	2014F	2015F
Revenue (HK\$m)	10,653	12,031	18,756	28,160	33,515
Net profit (HK\$m)	800	(208)	282	606	775
Revision (%)	–	–	253.3	34.9	11.3
EPS (HK\$)	0.70	(0.18)	0.25	0.54	0.68
YoY change (%)	11.8	N/A	N/A	N/A	27.9
DPS (HK\$ cents)	29.20	3.01	0.00	18.74	23.96
Dividend Yield (%)	4.8	0.5	0.0	3.1	4.0
P/E (x)	8.6	(33.5)	24.6	11.3	8.9
P/BV (x)	2.6	3.0	2.7	2.2	1.8
ROE (%)	29.9	(8.9)	11.0	19.1	20.8

Source: CCBIS estimates

Company Rating: Outperform
 (maintained)

Price: HK\$6.06
Target: HK\$8.00
 (up from HK\$6.00)

Trading data

52-week range	HK\$2.12-6.36
Market capitalization (m)	HK\$6,935/US\$894
Shares outstanding (m)	1,144
Free float (%)	41.0
3M average daily T/O (m share)	4.4
3M average daily T/O (US\$m)	2.6
Expected return (%) – 1 year	32.5

Price as at close on 24 October 2013

Stock price vs. HSCEI



Source: Bloomberg

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TCL Communication – financial summary

Income statement

FYE 31 December (HK\$m)	2011	2012	2013F	2014F	2015F
Revenue	10,653	12,031	18,756	28,160	33,515
Cost of revenue	(8,325)	(9,935)	(15,192)	(22,669)	(26,980)
Gross profit	2,328	2,097	3,564	5,491	6,535
Other income and gains	313	329	345	475	547
Selling and distribution expenses	(866)	(1,154)	(1,632)	(2,408)	(2,815)
Administrative expenses	(558)	(658)	(938)	(1,380)	(1,609)
R&D costs	(459)	(740)	(1,032)	(1,521)	(1,776)
Other expenses	(28)	(109)	(19)	(28)	(34)
Operating profit	729	(234)	289	630	849
Net interest income	55	47	10	10	5
Share of result of jointly controlled entities/associates	(1)	(2)	(2)	(2)	(2)
Other	0	0	0	0	0
Profit before tax	783	(188)	297	638	852
Tax expense	17	(32)	(18)	(38)	(85)
Minority interest	(1)	12	3	6	8
Profit to shareholders	800	(208)	282	606	775
EPS (HK\$)	0.70	(0.18)	0.25	0.54	0.68
Handset shipments (m unit)	43.6	42.6	50.0	55.0	57.5

Cash flow

FYE 31 December (HK\$m)	2011	2012	2013F	2014F	2015F
Profit before tax	783	(188)	297	638	852
Depreciation and amortization	107	142	175	215	247
Change in working capital	(722)	(102)	(620)	(823)	(411)
Other	(47)	373	295	(81)	(123)
Operating cash flow	122	224	147	(52)	565
Capex	(232)	(246)	(350)	(250)	(250)
Other	(734)	(805)	(110)	(115)	(120)
Investment cash flow	(966)	(1,052)	(460)	(365)	(370)
Change in borrowings	735	(1,302)	194	0	0
Other	(99)	1,942	521	0	288
Financing cash flow	637	640	715	0	288
Change in cash	(207)	(187)	403	(417)	483
Exchange losses on cash and cash equivalents	49	(30)	0	0	0
Cash, beginning	1,345	1,187	970	1,373	956
Cash, ending	1,187	970	1,373	956	1,439

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	1,373	956	1,439
Pledged bank deposits	6,092	4,221	3,666	3,666	3,166
Trade and bills receivables	2,638	2,882	3,655	5,459	6,486
Prepayments, deposits and other assets	870	1,246	1,943	2,917	3,472
Inventories	981	1,263	2,081	3,105	3,696
Other current assets	485	630	459	459	459
Current assets	12,254	11,212	13,178	16,563	18,718
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	0	(2)
Other non-current assets	132	157	157	157	157
Total non-current assets	1,773	2,109	2,081	2,275	2,435
Accounts and bills payable	1,952	2,429	3,330	4,969	5,913
Other payables and accruals	1,431	1,620	2,526	3,793	4,514
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	12,220	15,199	16,960
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	2,570	3,175	3,738
Minority interest	4	2	(1)	(7)	(15)
Total equity	2,673	2,323	2,568	3,168	3,723

Financial ratios

FYE 31 December (%)	2011	2012	2013F	2014F	2015F
Profitability					
Gross margin	21.9	17.4	19.0	19.5	19.5
Operating margin	6.8	(1.9)	1.5	2.2	2.5
Net margin	7.5	(1.7)	1.5	2.2	2.3
ROE	29.9	(8.9)	11.0	19.1	20.8
Growth					
Sales revenue growth	22.4	12.9	55.9	50.1	19.0
Operating income growth	19.5	(9.9)	70.0	54.1	19.0
Net profit growth	14.0	N/A	N/A	N/A	27.9
EPS growth	11.8	N/A	N/A	N/A	27.9
Liquidity					
Net debt/equity	Net cash	31.4	41.9	47.1	40.5

TCL Communication – earnings revisions

Profit and loss	New			Previous			Change (%)		
	2013F	2014F	2015F	2013F	2014F	2015F	2013F	2014F	2015F
(US\$m)									
Revenue	18,756	28,160	33,515	18,756	26,740	32,275	0.0	5.3	3.8
Gross profit	3,564	5,491	6,535	3,451	5,161	6,229	3.3	6.4	4.9
Opex	(3,620)	(5,336)	(6,234)	(3,751)	(5,188)	(6,068)	(3.5)	2.9	2.7
Operating profit	289	630	849	79	477	750	267.5	32.0	13.2
Net profit	282	606	775	80	449	696	253.3	34.9	11.3
(%)									
Gross margin	19.0	19.5	19.5	18.4	19.3	19.3			
OPEX to sales	(19.3)	(19.0)	(18.6)	(20.0)	(19.4)	(18.8)			
OPM	1.5	2.2	2.5	0.4	1.8	2.3			
Net margin	1.5	2.2	2.3	0.4	1.7	2.2			

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	8.13	10,862	16.5	10.7	14.6	15.0	13.4	11.8
HTC	2498 TT	Not Rated	145.50	4,214	(104.5)	(241.9)	(117.0)	NM	NM	NM
ZTE	763 HK	Outperform	16.56	8,575	N/A	25.6	26.2	21.5	17.0	13.4
China Wireless	2369 HK	Outperform	2.89	784	50.7	35.7	21.7	12.0	9.5	7.4
TCL	2618 HK	Outperform	6.06	891	N/A	253.3	34.9	24.6	11.3	8.9
Average								16.2	12.8	10.4
Handset components and others										
Mediatek	2454 TT	Not Rated	394.00	18,070	45.5	28.3	10.0	21.0	16.4	14.9
AAC	2018 HK	Neutral	33.90	5,351	29.9	13.8	19.3	18.3	15.6	13.7
Largan Precision	3008 TT	Not Rated	1005.00	4,582	60.9	13.8	NA	15.0	13.2	NA
FIH	2038 HK	Not Rated	4.42	4,253	N/A	N/A	NA	N/A	N/A	NA
Truly International	732 HK	Not Rated	5.07	1,873	69.8	20.0	21.4	11.6	9.7	8.0
Unimicron Tech	3037 TT	Not Rated	24.10	1,260	(27.9)	21.3	10.8	14.8	12.2	11.0
Sunny Optical	2382 HK	Neutral	7.65	1,079	33.4	21.1	22.0	13.8	10.4	8.4
Spreadtrum	SPRD US	Not Rated	30.49	1,520	34.6	15.7	-0.4	11.3	9.8	9.8
Merry Electronics	2439 TT	Not Rated	99.00	592	78.8	35.4	N/A	20.2	14.9	N/A
Average								15.8	12.8	11.0

* Price as at close on 24 October 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	18,756	28,160	33,515	2,449	3,958	5,454	6,895
Cost of revenue	(8,325)	(9,935)	(15,192)	(22,669)	(26,980)	(2,046)	(3,232)	(4,383)	(5,531)
Gross profit	2,328	2,097	3,564	5,491	6,535	402	727	1,071	1,364
Gross profit margin (%)	21.9	17.4	19.0	19.5	19.5	16.4	18.4	19.6	19.8
Other income and gains	313	329	345	475	547	56	121	76	92
Selling and distribution expense	(866)	(1,154)	(1,632)	(2,408)	(2,815)	(289)	(367)	(399)	(577)
Administrative expense	(558)	(658)	(938)	(1,380)	(1,609)	(188)	(237)	(219)	(294)
R&D costs	(459)	(740)	(1,032)	(1,521)	(1,776)	(224)	(208)	(265)	(335)
Other expenses	(28)	(109)	(19)	(28)	(34)	(5)	(26)	(42)	54
Operating profit	729	(234)	289	630	849	(247)	10	222	305
Operating margin (%)	6.8	(1.9)	1.5	2.2	2.5	(10.1)	0.3	4.1	4.4
Net interest income	55	47	10	10	5	6	4	(1)	1
Share of result of jointly controlled entities/associates	(1)	(2)	(2)	(2)	(2)	(0)	(0)	(0)	(1)
Other	0	0	0	0	0	0	0	0	0
Profit before tax	783	(188)	297	638	852	(241)	14	220	305
Tax expense	17	(32)	(18)	(38)	(85)	(6)	24	3	(40)
Minority interest	(1)	12	3	6	8	1	1	3	(2)
Profit to shareholders	800	(208)	282	606	775	(246)	39	226	263
Net profit margin (%)	7.5	(1.7)	1.5	2.2	2.3	(10.1)	1.0	4.1	3.8
EPS (HK\$)	0.70	(0.18)	0.25	0.54	0.68	(0.22)	0.03	0.19	0.23
EPS growth (%)	11.8	N/A	N/A	N/A	27.9	N/A	(48.9)	N/A	N/A
Gross profit margin (%)	21.9	17.4	19.0	19.5	19.5	16.4	18.4	19.6	19.8
Operating profit margin (%)	6.8	(1.9)	1.5	2.2	2.5	(10.1)	0.3	4.1	4.4
Net profit margin (%)	7.5	(1.7)	1.5	2.2	2.3	(10.1)	1.0	4.1	3.8
ROE (%)	29.9	(8.9)	11.0	19.1	20.8				
Net debt/equity (%)	Net cash	31.4	41.9	47.1	40.5				

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

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