

## Coolpad Group (2369 HK)

Unleashing 4G potential at full speed; Upgrade to Buy

We upgrade Coolpad to Buy from Neutral with new TP of HK\$5.45, as we expect Coolpad to benefit from 1) first mover advantage in RMB-1K 4G smartphones, 2) close partnership with China Mobile (CM), 3) strengthening e-commerce sales channel, and 4) brand consolidation in China. Given CM's aggressive 4G strategy and its solid experience in 4G handsets, Coolpad targets to sell 60mn handsets in 2014 (+58% YoY), with 40mn units from higher margin 4G models. We raise our 2013-15E EPS by 19%/56%/73% to reflect higher shipment estimates and better ASP/GM on China 4G growth and expanding e-commerce channel. Our 2013-15E EPS are 18%/26%/34% above consensus. We raise our TP to HK\$5.45, based on 14.5x 2014E P/E (10% discount from 16x peak valuation).

**Close partnership with CM to bolster 4G shipment growth.** As one of the largest CM's handset partners in China, we expect Coolpad to benefit from CM's aggressive shipment strategy in 2014 (TD-LTE: 100mn; TD: 190-210mn, +27%-40% YoY). Coolpad targets to sell 40mn 4G handsets in 2014 (total target: 60mn, +58% YoY), by leveraging its established operator channels and strong product pipeline. Our checks suggested its 4G models received tremendous attention in various trade shows and 4G pre-orders in China amounted to 2mn/3mn in Jan/Feb.

**First mover advantage in RMB-1K 4G smartphone.** Coolpad is the first brand to launch two RMB-1K 4G models in Jan, among 21 TD-LTE models announced by CM (8 high-end, 10 mid-end, 3 RMB-1K). Given Coolpad's 4G overseas shipments since 2010, we believe its R&D capability and experience in 4G will continue to strengthen its leadership, and higher mix of 4G handsets should provide margin upside in 1H14.

**E-commerce model to lift brand image and profitability.** Following the launch of new brand, Coolpad Halo (酷派大神), based on e-commerce business model in Jan, Coolpad's two new models have gained huge traction rapidly with over 10mn pre-orders in one month. Featuring high competitive features/pricing through viral marketing, Coolpad targets e-commerce channel to contribute 20% of shipments in 2014. We believe this Xiaomi-like sales model could enhance brand awareness and reduce marketing cost as shipment volume scales up.

**Upgrade to Buy with 20% upside to new TP of HK\$5.45.** We lift our 2013-15E EPS forecast by 19%/56%/73% to reflect higher volume and improving ASP/margins. Despite 80% rally YTD, we think current valuation (12.1x 14E P/E) is still attractive, given its promising growth outlook and market leadership. Catalysts include e-commerce shipment growth and product launches at MWC.

### Financials

(Yr-end Dec, HK\$ mn)	2011	2012	2013E	2014E	2015E
Revenue	7,340	14,359	20,921	32,559	41,895
Growth (%)	59.8	95.6	45.7	55.6	28.7
Net income	271	326	492	792	1,094
Growth (%)	-43.5	20.0	51.0	61.1	38.1
EPS (HK\$)	0.12	0.15	0.23	0.38	0.52
DPS (HK\$)	0.02	0.03	0.03	0.07	0.10
P/E (x)	36.8	29.6	19.6	12.1	8.8
P/B (x)	4.6	4.0	3.6	2.8	2.2
ROE (%)	12.4	13.5	12.8	23.2	25.1

Source: Company data, CMS (HK) estimate

**Buy**

(Previous: Neutral)

**Target Price: HK\$5.45**

Current price: HK\$4.56

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21 Feb 2013

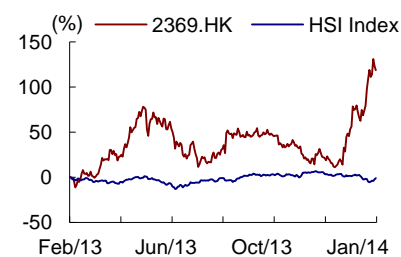
### Key data

HSI Index	22394.08
HSCEI Index	9978.06
S/O(mn)	2116.1
S/O (HK)(mn)	2116.1
Mkt cap (HK\$) (mn)	9882.1
BVPS(HKD)	0.2

Major shareholder	Holding (%)
DATA DREAMLAND	39.28
Free float	38.00
Industry	Hardware Tech

### Share performance

%	1m	6m	12m
Absolute	20	70	115
Relative	22	67	116

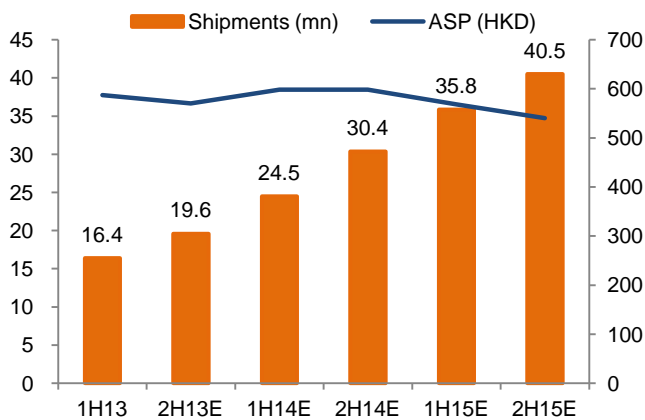


Source: Bloomberg

### Related research

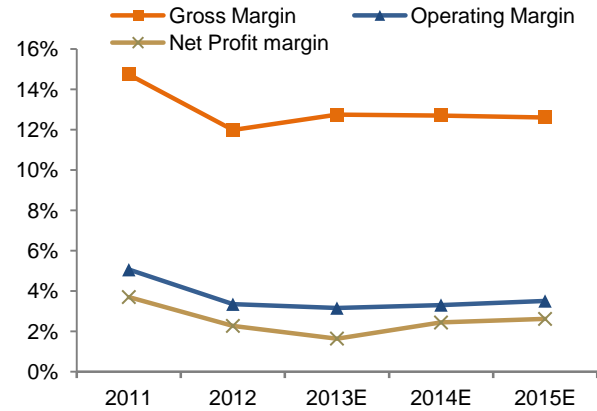
## Focus charts

Figure 1: ASP stabilises in 1H14 as 4G shipments ramp



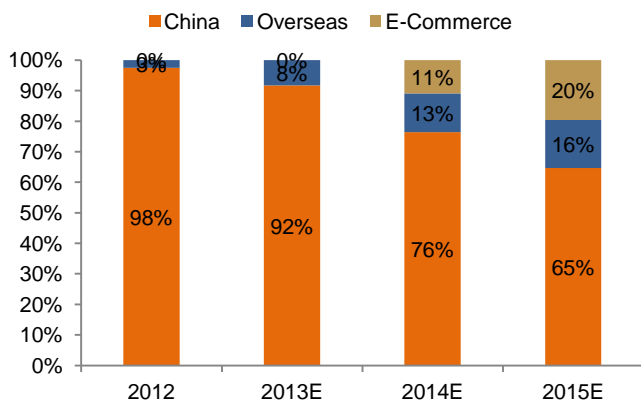
Source: Company, CMS (HK)

Figure 2: Margin to expand on scaling benefits



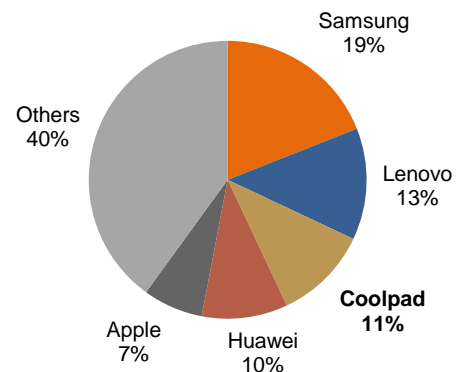
Source: Company, CMS(HK)

Figure 3: Diversifying sales channels to lift profitability



Source: Company, CMS(HK)

Figure 4: Coolpad moved up to top 3 in China (4Q13)



Source: IDC, CMS(HK)

Figure 5: Coolpad latest 4G-LTE smartphone products

	Coolpad 8720L	Coolpad 8730L	Coolpad 8970L	Coolpad S6	Coolpad 8736	Coolpad 8735
						
<b>Screen Size</b>	5"	5.5"	5.9"	5.95"	5"	5"
<b>Resolution</b>	1280x720 (294ppi)	1280x720 (294ppi)	1920x1080 (373ppi)	1280x720 (247ppi)	1280x720 (294ppi)	1280x720 (294ppi)
<b>Processor</b>	Marvel Quad-Core 1.2GHz	Qualcomm Quad-Core 1.2GHz	Nvidia Quad-Core 1.8GHz	Qualcomm Quad-Core 1.2GHz	Nvidia Quad-Core 1.5GHz	Nvidia Quad-Core 1.5GHz
<b>RAM/ROM</b>	1GB/4GB	1GB/8GB	2GB/16GB	2GB/16GB	1GB/4GB	1GB/4GB
<b>Camera</b>	5MP / 2MP	8MP / 2MP	13MP / 2MP	13MP / 5MP	8MP / 0.3MP	8MP / 0.3MP
<b>Battery</b>	2000mAh	2500mAh	3000mAh	2800mAh	3000mAh	3000mAh
<b>OS</b>	Android 4.3	Android 4.3	Android 4.2	Android 4.2	Android 4.2	Android 4.2
<b>Launch Date</b>	Dec 2013	Dec 2013	Jan 2014	Jan 2014	Dec 2013	Dec 2013
<b>Retail Price</b>	1299	1888	-	1999	2899	-

Source: Company, CMS(HK)

## Earnings revisions

We revise up our 2013E-2015E core net profit by 19%/56%/73% to reflect higher volume and improving ASP/margins due to robust product pipeline and expanding e-commerce/overseas sales channel.

- We raise 2014E-2015E revenue estimates by 21%/26% to reflect 1) stronger smartphone shipment to 54.9mn/76.4mn, and 2) higher handset ASP to HKD593/ HKD564.
- We lift gross margin estimates for 2013-2015E to 12.7%/12.7%/12.6% for higher contribution from advanced 4G smartphones and expansion of e-commerce sales channel.
- We also include the one-off write-down of HK\$184mn in 2013, to factor in the reconstruction of Coolpad's Shenzhen office. It will demolish two buildings (HKD184mn) in 2013 and another two (HKD190mn) in the second phase in 2016. As a result, we adjusted down the pretax profit by HK\$184mn in 2013. However, as a non-recurring event, we believe it will not impact Coolpad's core business operations.

**Figure 6: Key assumptions**

	1H13	2H13E	1H14E	2H14E	1H15E	2H15E	2013E	2014E	2015E
Shipment (mn)	16.4	19.6	24.5	30.4	35.8	40.5	36.0	54.9	76.4
Blended ASP (HKD)	587	576	593	593	564	535	581	593	564
Total revenue (HKD mn)	9,632	11,290	14,535	18,024	20,205	21,690	20,921	32,559	41,895
YoY revenue growth	54.9%	38.7%	50.9%	59.7%	39.0%	20.3%	45.7%	55.6%	28.7%

Source: Company, CMS (HK)

**Figure 7: Coolpad estimate revisions**

(HKD mn)	New			Old			Change (%)		
	2013E	2014E	2015E	2013E	2014E	2015E	2013E	2014E	2015E
<b>Revenue</b>	<b>20,921</b>	<b>32,559</b>	<b>41,895</b>	<b>20,964</b>	<b>27,463</b>	<b>33,779</b>	<b>0%</b>	<b>19%</b>	<b>24%</b>
Gross profit	2,665	4,135	5,279	2,369	3,048	3,749	13%	36%	41%
Operating profit	659	1,074	1,466	587	714	878	12%	50%	67%
Pretax profit	428	1,028	1,420	532	659	823	-19%	56%	73%
Net profit	344	792	1,094	414	509	636	-17%	56%	72%
EPS (HKD)	0.16	0.38	0.52	0.20	0.24	0.30	-17%	57%	74%
<b>Adj. Net profit</b>	<b>492</b>	<b>792</b>	<b>1,094</b>	<b>414</b>	<b>509</b>	<b>636</b>	<b>19%</b>	<b>56%</b>	<b>72%</b>
<b>Adj. EPS (HKD)</b>	<b>0.23</b>	<b>0.38</b>	<b>0.52</b>	<b>0.20</b>	<b>0.24</b>	<b>0.30</b>	<b>19%</b>	<b>56%</b>	<b>73%</b>
Gross margin	12.7%	12.7%	12.6%	11.3%	11.1%	11.1%			
Operating margin	3.1%	3.3%	3.5%	2.8%	2.6%	2.6%			
Net Margin	2.4%	2.4%	2.6%	2.0%	1.9%	1.9%			

Source: Company, CMS (HK)

## Estimates vs Consensus

Figure 8: CMS (HK) estimates vs street

(HKD mn)	CMS (HK)			Consensus			Diff (%)		
	2013E	2014E	2015E	2013E	2014E	2015E	2013E	2014E	2015E
Revenue	20,921	32,559	41,895	20,337	28,859	35,562	3%	13%	18%
Gross profit	2,665	4,135	5,279	2,588	3,699	4,573	3%	12%	15%
Net profit	492	792	1,094	424	653	856	16%	21%	28%
EPS (HKD)	0.23	0.38	0.52	0.20	0.30	0.39	18%	26%	34%
Gross margin	12.7%	12.7%	12.6%	12.73%	12.82%	12.86%			
Net Margin	2.4%	2.4%	2.6%	2.1%	2.3%	2.4%			

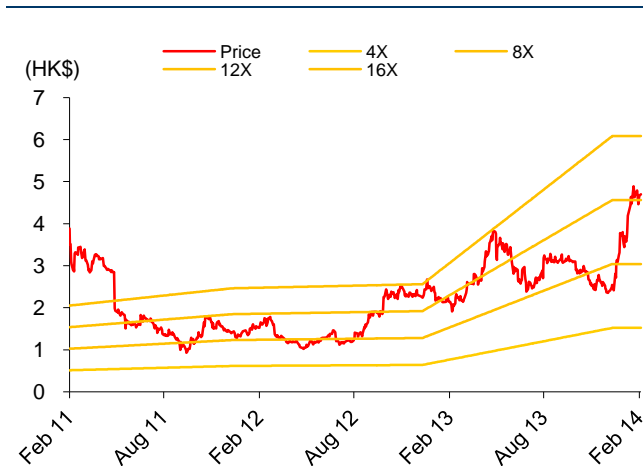
Source: CMS (HK), Bloomberg

## Valuation

### Upgrade to BUY with 20% upside to new TP of HK\$5.45

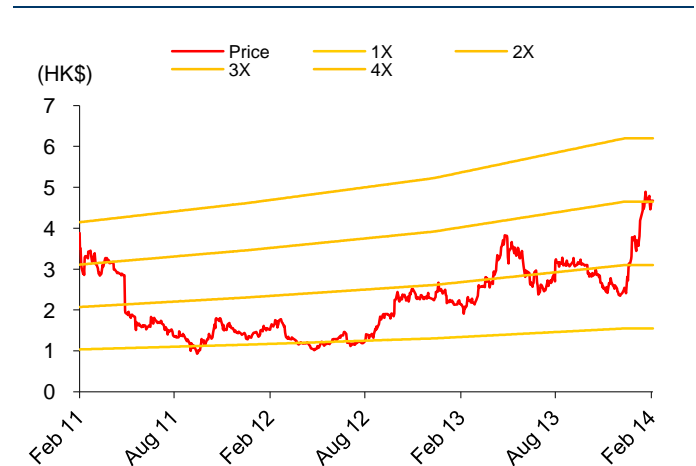
Our new 2013-15E EPS are 18%/26%/34% above consensus. We believe the market consensus will continue to revise up, and we set our 12-month TP of HK\$5.45 based on 14.5x 2014E P/E (10% discount from 16x peak valuation). Catalysts include e-commerce shipment growth and product launches at MWC. Downside risks include component shortage, slower 4G product demand and delayed product launches.

Figure 9: Forward P/E band



Source: Company, CMS (HK)

Figure 10: Forward P/B band



Source: Company, CMS (HK)

## Peers Comparison

Figure 11: Sector valuation comparison

Company	Ticker	Rating	Mkt Cap (USD mn)	Current Price (local)	Target Price (HKD)	Upside (%)	P/E (x)		P/B (x)		ROE (%)	
							FY13E	FY14E	FY13E	FY14E	FY13E	FY14E
China Wireless	2369 HK	Buy	1,237	4.56	5.45	20%	19.6	12.1	3.58	3.01	17.0	21.8
TCL Comm	2618 HK	Buy	1,356	9.05	8.52	-6%	36.5	11.8	4.01	3.14	11.1	28.1
ZTE	763 HK	N/A	7,704	16.36	N/A	N/A	28.5	16.9	1.92	1.76	6.8	10.4
Sunny Optical	2382 HK	Neutral	880	6.26	8.37	34%	11.6	8.9	1.88	1.61	18.3	19.3
Truly Intl	732 HK	Buy	1,632	4.36	7.15	64%	9.0	7.7	1.88	1.52	24.3	23.5
AAC Tech	2018 HK	Neutral	5,762	36.6	40.0	9%	14.0	13.3	4.35	3.58	34.4	28.9
BYD E	285 HK	N/A	1,135	3.93	N/A	N/A	13.1	10.2	0.84	0.80	6.1	7.0
FIH	2038 HK	N/A	3,760	3.87	N/A	N/A	37.0	17.8	0.97	0.93	2.5	4.3

Source: CMS (HK), Bloomberg

**Appendix: Financial summary**
**Statement of financial position**

HKD million	2011	2012	2013E	2014E	2015E
<b>Current Assets</b>	<b>6,380</b>	<b>6,859</b>	<b>9,731</b>	<b>14,196</b>	<b>17,958</b>
Cash & equivalents	1,059	1,274	912	1,472	3,011
Trading investments	0	0	0	0	0
Trade notes	0	0	0	0	0
Trade receivables	1,572	2,183	3,434	5,308	5,941
Other receivables	1,000	882	1,284	1,999	2,572
Inventories	1,669	1,811	3,391	4,708	5,725
Other current assets	1,081	710	710	710	710
<b>Non-current assets</b>	<b>1,152</b>	<b>1,244</b>	<b>1,569</b>	<b>1,850</b>	<b>2,095</b>
Investment property	335	310	310	310	310
PPE	527	537	683	863	1,026
Intangible assets	112	161	161	161	161
Other non-current assets	177	237	416	517	599
<b>Total assets</b>	<b>7,531</b>	<b>8,103</b>	<b>11,300</b>	<b>16,047</b>	<b>20,053</b>
<b>Liquid Liabilities</b>	<b>5,198</b>	<b>5,592</b>	<b>8,479</b>	<b>12,452</b>	<b>15,481</b>
Bank loans	1,190	536	536	536	536
Trade payables	1,377	1,742	3,159	4,472	5,359
Prepaid Accounts	0	0	0	0	0
Other liquid liabilities	2,631	3,314	4,784	7,444	9,586
<b>Long term Liabilities</b>	<b>143</b>	<b>99</b>	<b>127</b>	<b>177</b>	<b>218</b>
Loans	68	24	24	24	24
Others	75	75	103	154	194
<b>Total Liabilities</b>	<b>5,342</b>	<b>5,690</b>	<b>8,606</b>	<b>12,629</b>	<b>15,699</b>
Issued capital	21	21	21	21	21
Capital reserves	0	0	0	0	0
Reserves	2,121	2,326	2,602	3,237	4,115
NCI	5	3	3	3	2
Parents	2,185	2,410	2,691	3,415	4,352
<b>Total equity and liabilities</b>	<b>7,531</b>	<b>8,103</b>	<b>11,300</b>	<b>16,047</b>	<b>20,053</b>

**Statement of cash flows**

HKD million	2011	2012	2013E	2014E	2015E
<b>CF from OA</b>	<b>29</b>	<b>912</b>	<b>(53)</b>	<b>923</b>	<b>1,992</b>
Net profit	271	326	344	792	1,094
D&A	73	115	54	70	87
Finance costs	46	55	46	46	46
Investment income	0	0	0	0	0
Changes of WC	(366)	322	(371)	22	771
Others	(62)	(52)	(210)	(243)	(332)
<b>CF from IA</b>	<b>(452)</b>	<b>190</b>	<b>(200)</b>	<b>(250)</b>	<b>(250)</b>
Capital expenditure	(78)	(109)	(200)	(250)	(250)
Other investments	(374)	299	0	0	0
<b>CF from FA</b>	<b>805</b>	<b>(886)</b>	<b>(108)</b>	<b>(114)</b>	<b>(202)</b>
Borrowings	491	(702)	0	0	0
Share capital	0	0	0	0	0
Changes of reserves	0	0	0	0	0
Dividends	(134)	(43)	(63)	(68)	(157)
Others	448	(141)	(46)	(46)	(46)
<b>Net cash flow</b>	<b>(352)</b>	<b>(56)</b>	<b>575</b>	<b>1,122</b>	<b>934</b>

**Statement of comprehensive income**

HKD million	2011	2012	2013E	2014E	2015E
<b>Revenues</b>	<b>7,340</b>	<b>14,359</b>	<b>20,921</b>	<b>32,559</b>	<b>41,895</b>
Cost of sales	(6,259)	(12,639)	(18,256)	(28,424)	(36,616)
Selling exp	(1,025)	(1,543)	(2,379)	(3,744)	(4,692)
Admin exp	(559)	(674)	(1,285)	(1,921)	(2,430)
Op expenses	(711)	(1,240)	(2,006)	(3,061)	(3,812)
<b>Op Profit</b>	<b>371</b>	<b>479</b>	<b>659</b>	<b>1,074</b>	<b>1,466</b>
Fin. costs	(46)	(55)	(46)	(46)	(46)
Impairments	0	0	0	0	0
FV changes	0	0	(184)	0	0
Inv income	(0)	(6)	(1)	(1)	(1)
Non-op inc	0	0	0	0	0
Non-op exp	0	0	0	0	0
<b>PBT</b>	<b>324</b>	<b>418</b>	<b>428</b>	<b>1,028</b>	<b>1,420</b>
Taxes	(53)	(94)	(85)	(237)	(327)
Net Profit	271	324	344	792	1,094
NCI	(0)	(1)	(0)	(0)	(0)
<b>Adj. Parents</b>	<b>271</b>	<b>326</b>	<b>492</b>	<b>792</b>	<b>1,094</b>
<b>Adj. EPS (HKD)</b>	<b>0.12</b>	<b>0.15</b>	<b>0.23</b>	<b>0.38</b>	<b>0.52</b>

**Ratios**

	2011	2012	2013E	2014E	2015E
<b>YoY growth rate</b>					
Revenue	60%	96%	46%	56%	29%
Op profit	-33%	29%	37%	63%	36%
Net profit	-43%	20%	51%	61%	38%
<b>Profitability</b>					
Gross margin	14.7%	12.0%	12.7%	12.7%	12.6%
NP margin	3.7%	2.3%	2.4%	2.4%	2.6%
ROE	12.4%	13.5%	12.8%	23.2%	25.1%
ROIC	13.9%	15.9%	17.0%	32.7%	49.6%

**Liquidity**

D/A	15.8%	6.6%	4.7%	3.3%	2.7%
ND/A	1.7%	-9.1%	-3.3%	-5.8%	-12.3%
Liquid ratio	1.2	1.2	1.1	1.1	1.2
Quick ratio	0.9	0.9	0.7	0.8	0.8

**Operating efficiency**

Asset turnover	1.2	2.1	2.2	2.3	2.3
Inventory turnover	3.8	7.0	5.4	6.0	6.4
AR turnover	4.7	6.6	6.1	6.1	7.1
AP turnover	4.0	5.8	5.3	5.4	6.2

**Per share ratios (HKD)**

Adj. PE	0.12	0.15	0.23	0.38	0.52
PCF	0.01	0.43	(0.03)	0.44	0.95
PB	1.00	1.14	1.28	1.62	2.07
DPS	0.02	0.03	0.03	0.07	0.10

**Valuation**

PE	36.8	29.6	19.6	12.1	8.8
PB	4.6	4.0	3.6	2.8	2.2
EV/EBITDA	22.9	15.2	13.7	7.6	4.6

Source: Company data, CMS (HK) estimates

**RATING DEFINITION & DISCLAIMER**

RATING	DEFINITION
<b>BUY</b>	Expected to outperform the market index by >10% over the next twelve months
<b>NEUTRAL</b>	Expected to outperform or underperform the market index by 10% or less over the next twelve months
<b>SELL</b>	Expected to underperform the market index by >10% over the next twelve months

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