

Company Report

China Merchants Securities (Hong Kong)
Hong Kong Equity Research

TCL Comm (2618 HK)

Nokia's scale-down implies significant upside for TCL

- Nokia's massive layoff is positive for TCL's feature phones
- Our analysis suggested TCL's 1-2% market share gain (7-13mn units) from Nokia in 2014 will increase 2014E EPS by 4-8%
- Accumulate ahead of 2Q results; Reiterate BUY with TP HK\$12.50

What's new

Microsoft announced to cut record 18,000 jobs (14% of workforce) next year, with 12,500 workers from its mobile phone unit (Nokia Devices and Services business) which was acquired in past Spring (25,000 employees). Nokia was ranked No. 1 in feature phone market with ~25% market share in 2013, vs TCL's No.3 ranking with 5% share.

TCL poised to gain shares from Nokia's feature phones

We believe massive scale-down of Nokia's feature phone business would be a major positive catalyst to TCL Comm, as we expect the company to accelerate share gain in feature phone market in the coming 2-3 years at the expense of Nokia. Despite the shrinking global feature phone market (660mn, -15% yoy in 2014E; vs 810mn in 2013), this segment remains a higher-margin and cash-generating business for global handset brand leaders (e.g. Nokia, Samsung, TCL, LG), due to limited R&D/marketing expenses and established operator networks.

Expect upward revision on stronger 2H; Reiterate Buy

We currently estimate TCL's 2014-15E feature phone shipment of 34.1mn/31.1mn (-9.4% yoy/-9% yoy), accounting for 16%/11% of 14-15E revenue. We believe Nokia's exit in feature phone will imply potential upside surprise for TCL's feature phone shipment in 2014. Our analysis suggested that 1-2% market share gain (7-13mn units) from Nokia in 2014 will increase TCL's 2014E revenue and EPS by 3-6% and 4-8% respectively. We also expect stronger 4G pipeline and China momentum in 2H14. Our 2014/15E EPS are HK\$0.98/1.34, 8%/15% higher than consensus, due to stronger smartphone/tablets shipment and better operating leverage. Trading at 10.8x 2014 EPS, we reiterate our BUY rating with TP HK\$12.50 (based on 12.7x 14E P/E).

Financials

HKD mn	2012	2013	2014E	2015E	2016E
Revenue	12,031	19,362	32,409	41,945	52,915
Growth (%)	13%	61%	67%	29%	26%
Net profit	(208)	313	1,152	1,578	2,189
Growth (%)	-126%	-251%	267%	37%	39%
EPS (HKD)	(0.18)	0.28	0.98	1.34	1.86
DPS (HKD)	0.03	0.11	0.39	0.54	0.75
P/E (x)	-57.8	38.7	10.8	7.9	5.7
P/B (x)	5.2	3.3	3.5	2.7	2.1
ROE (%)	-8.9%	10.8%	31.7%	34.2%	36.7%

Source: Company data, CMS (HK) estimates

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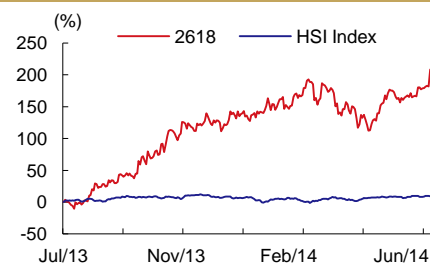
WHAT'S NEW

No changes

BUY

Previous	BUY
Price	HK\$10.68
12-month Target Price (Potential upside)	HK\$12.50 (+17%)
Previous	HK\$12.50

Price Performance



Source: Bigdata

%	1m	6m	12m
2618 HK	17.8	32.9	191.4
HSI	1.2	1.4	9.9

Hardware Technology

Hang Seng Index	23455
HSCEI	10441

Key Data

52-week range (HK\$)	3.05-10.84
Market cap (HK\$ mn)	13026.1
Avg. daily volume	534.24
BVPS (HK\$)	2.50

Shareholdings Structure

TCL INDUSTRIES HOLDINGS	49.03%
VALUE PARTNERS LIMITED	6.99%
DONG SHENG LI	3.30%
No. of shares outstanding	2914.8M
Free float	44.13%

Related Research

1. China Hardware Tech - Operators' selling expense reduction as expected; Revised 4G subsidy strategy to benefit handset brands in 2H -9/7/2014
2. TCL Comm (2618 HK) - More drivers from LTE/EM/China in 2H; Lift TP to HK\$12.50 - 17/6/2014

Figure 1: TCLC monthly shipment by product categories (2013 to 2014 MTD)

(000' unit)	2013							2014							
	Feature	YoY	Smart & Tab	YoY	SP%	Total	YoY	Feature	YoY	Smart & Tab	YoY	SP%	Total	YoY	
Jan	3,041	63%	593	322%	16%	3,633	81%	Jan	2,904	-4%	2,310	290%	44%	5,214	43%
Feb	1,556	-27%	355	30%	19%	1,911	-20%	Feb	2,023	30%	1,733	389%	46%	3,756	97%
Mar	2,435	-22%	506	52%	17%	2,942	-15%	Mar	2,365	-3%	2,273	349%	49%	4,638	58%
Apr	3,066	20%	820	123%	21%	3,887	33%	Apr	2,876	-6%	2,515	207%	47%	5,391	39%
May	3,095	3%	1,108	119%	26%	4,203	19%	May	2,445	-21%	3,009	172%	55%	5,454	30%
Jun	2,738	-27%	1,319	126%	33%	4,057	-6%	Jun	2,293	-16%	3,196	142%	58%	5,489	35%
Jul	3,599	51%	1,408	147%	28%	5,007	70%								
Aug	3,160	6%	1,770	175%	36%	4,930	36%								
Sep	3,444	8%	2,014	162%	37%	5,458	38%								
Oct	3,573	1%	2,144	181%	37%	5,717	33%								
Nov	4,243	4%	3,015	223%	42%	7,257	45%								
Dec	3,696	6%	2,504	292%	40%	6,199	50%								
Total	37,646	4%	17,555	169%	32%	55,201	30%	CMS Est.	34,123	-9.4%	40,470	131%	54%	74,592	35%

Source: Company, CMS(HK)

Figure 2: TCLC shipment breakdown by region (2013 to 2014 MTD)

(000' unit)	2013						2014						
	China	YoY	Overseas	YoY	Total	China %	China	YoY	Overseas	YoY	Total	China %	
Jan	540	343%	3,094	64%	3,633	15%	Jan	377	-30%	4,837	56%	5,214	7%
Feb	683	29%	1,228	-34%	1,911	36%	Feb	276	-60%	3,480	183%	3,756	7%
Mar	394	-37%	2,548	-10%	2,942	13%	Mar	426	8%	4,212	65%	4,638	9%
Apr	431	8%	3,456	37%	3,887	11%	Apr	507	18%	4,884	41%	5,391	9%
May	457	-21%	3,745	27%	4,203	11%	May	618	35%	4,836	29%	5,454	11%
Jun	457	-21%	3,600	-4%	4,057	11%	Jun	598	31%	4,891	36%	5,489	11%
Jul	348	-26%	4,659	88%	5,007	7%							
Aug	438	-15%	4,493	44%	4,930	9%							
Sep	449	-26%	5,010	49%	5,458	8%							
Oct	337	5%	5,380	35%	5,717	6%							
Nov	387	-19%	6,870	51%	7,257	5%							
Dec	454	-17%	5,746	61%	6,199	7%							
Total	5,374	-7%	49,827	35%	55,201	9.7%	CMS Est.	7,820	46%	66,772	34%	74,592	11%

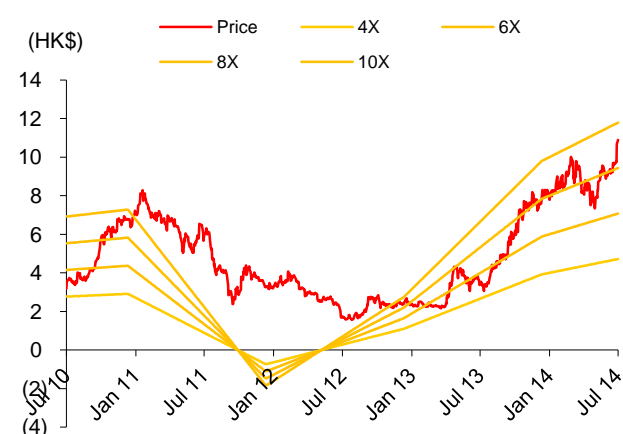
Source: Company, CMS(HK)

Valuation

Reiterate BUY with new TP of HK\$12.50 (17% upside)

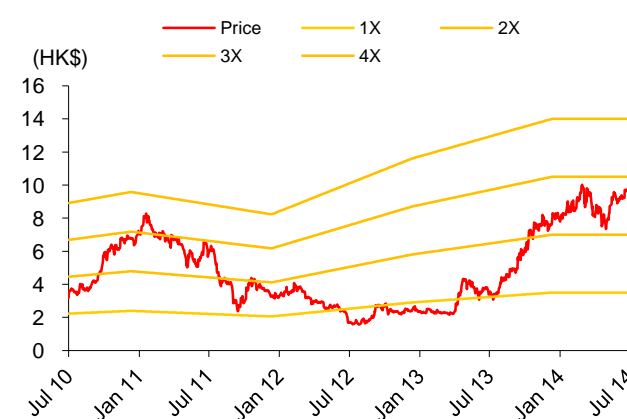
We set our 12-month price target of HK\$12.50 based on our target P/E multiple of 12.7x and 2014E EPS of HK\$0.98, in-line with HK-listed peers. As an emerging global handset leader (No.5 in total handset; No.10 in smartphones) with continued share gains, we see the valuation of 10.8x 2014E P/E is undemanding and reiterate our BUY rating. Catalysts include new product releases, MediaTek LTE SoC models and monthly shipment data. Downside risks include component shortage and delayed 4G product launches.

Figure 3: Price vs Earnings multiples



Source: Company, CMS (HK)

Figure 4: Price vs P/B



Source: Company, CMS (HK)

Peers Comparison

Figure 5: Sector valuation comparison

Company	Ticker	Rating	Mkt Cap (USD mn)	Current Price (local)	Target Price (HKD)	Upside (%)	P/E (x)		P/B (x)		ROE (%)	
							FY14E	FY15E	FY14E	FY15E	FY14E	FY15E
TCL Comm	2618 HK	Buy	1,687	10.84	12.5	15%	10.8	7.9	3.3	2.6	31.5	30.1
Lenovo	992 HK	Buy	14,607	10.86	10.5	-3%	18.0	17.7	4.6	4.0	27.6	24.0
Coolpad	2369 HK	Buy	1,196	2.17	2.73	26%	11.5	9.5	2.7	2.2	24.3	24.4
ZTE	763 HK	N/A	7,285	16.18	N/A	N/A	17.0	14.3	1.8	1.6	10.5	11.5
Sunny Optical	2382 HK	Neutral	1,565	11.06	8.37	-24%	16.0	12.9	2.8	2.4	18.6	19.7
AAC Tech	2018 HK	Neutral	7,596	47.95	40.0	-17%	17.9	15.0	4.9	4	29.7	29.4
Truly Intl	732 HK	Buy	1,720	4.58	7.15	56%	7.0	5.9	1.6	1.3	23.8	23.5
BYD E	285 HK	N/A	1,817	6.25	N/A	N/A	11.8	9.9	1.2	1.1	10.3	11.1
Ju Teng	3336 HK	N/A	828	5.50	N/A	N/A	6.8	5.7	1.0	0.9	13.5	14.3
Average							13.1	11.1	2.7	2.2	21.1	20.9

Source: CMS (HK), Bloomberg

Financial Summary

Statement of financial position

HKD million	2012	2013	2014E	2015E	2016E
Current Assets	11,212	11,866	17,499	19,974	26,094
Cash & equivalents	970	142	503	561	780
Trading investments	0	0	0	0	0
Trade notes	0	0	0	0	0
Trade receivables	2,842	5,551	8,498	9,659	12,087
Other receivables	1,718	1,670	2,836	3,670	5,717
Inventories	1,263	2,649	3,809	4,231	5,656
Other current assets	4,419	1,854	1,854	1,854	1,854
Non-current assets	2,109	2,557	2,808	3,001	3,184
Investment property	0	0	0	0	0
PPE	597	941	1,063	1,161	1,233
Intangible assets	1,174	1,210	1,210	1,210	1,210
Other non-current assets	337	407	535	631	740
Total assets	13,321	14,423	20,308	22,975	29,278
Liquid Liabilities	10,606	11,221	16,333	17,953	22,841
Bank loans	5,726	2,205	2,205	2,205	2,205
Trade payables	2,429	3,875	6,530	7,722	10,902
Prepaid Accounts	0	0	0	0	0
Other liquid liabilities	2,451	5,141	7,598	8,026	9,734
Long term Liabilities	393	289	346	414	469
Loans	310	196	196	196	196
Others	83	93	150	218	273
Total Liabilities	10,998	11,510	16,679	18,367	23,310
Issued capital	1,128	1,162	1,162	1,162	1,162
Capital reserves	0	0	0	0	0
Reserves	1,193	1,747	2,438	3,385	4,698
NCI	2	4	28	61	107
Parents	2,321	2,909	3,600	4,547	5,861
Total equity and liabilities	13,321	14,423	20,308	22,975	29,278

Statement of cash flows

HKD million	2012	2013	2014E	2015E	2016E
CF from OA	224	640	795	750	1,120
PBT	(208)	313	1,152	1,578	2,189
D&A	789	1,136	177	202	227
Finance costs	166	105	96	96	96
Investment income	0	0	0	0	0
Changes of WC	(102)	(762)	(495)	(1,042)	(1,294)
Others	(230)	(135)	(287)	(402)	(538)
CF from IA	(1,052)	(1,263)	(300)	(300)	(300)
Capital expenditure	(246)	(484)	(300)	(300)	(300)
Other investments	(805)	(779)	0	0	0
CF from FA	640	(230)	(134)	(393)	(601)
Borrowings	17,295	18,185	0	0	0
Share capital	26	78	0	0	0
Changes of reserves	0	0	0	0	0
Dividends	(202)	0	(461)	(631)	(875)
Others	(16)	(18)	0	0	0
Net cash flow	(187)	(853)	361	58	219

Statement of comprehensive income

HKD million	2012	2013	2014E	2015E	2016E
Revenues	12,031	19,362	32,409	41,945	52,915
Cost of sales	(9,935)	(15,690)	(25,899)	(33,346)	(41,962)
Selling exp	(1,154)	(1,611)	(2,536)	(3,272)	(4,074)
Admin exp	(658)	(946)	(1,372)	(1,762)	(2,222)
Op expenses	(2,117)	(3,267)	(5,108)	(6,605)	(8,227)
Op Profit	(21)	405	1,402	1,994	2,727
Fin. costs	(166)	(105)	(96)	(96)	(96)
Impairments	0	0	0	0	0
FV changes	0	0	0	0	0
Inv income	(2)	(2)	(2)	(2)	(2)
Non-op inc	0	0	0	0	0
Non-op exp	0	0	0	0	0
PBT	(188)	298	1,304	1,896	2,629
Taxes	(32)	18	(128)	(284)	(394)
PAT	(220)	316	1,176	1,611	2,235
NCI	(12)	3	24	33	46
NP to shareholders	(208)	313	1,152	1,578	2,189
EPS (HKD)	(0.18)	0.28	0.98	1.34	1.86

Ratios

	2012	2013	2014E	2015E	2016E
YoY growth rate					
Revenue	13%	61%	67%	29%	26%
Op profit	-102%	-2055%	246%	42%	37%
Net profit	-126%	-251%	267%	37%	39%
Profitability					
Gross margin	17.4%	19.0%	20.1%	20.5%	20.7%
NP margin	-1.7%	1.6%	3.6%	3.8%	4.1%
ROE	-8.9%	10.8%	31.7%	34.2%	36.7%
ROIC	-3.0%	6.4%	22.2%	34.5%	39.0%
Liquidity					
D/A	45.3%	11.8%	11.8%	10.5%	8.2%
ND/A	38.0%	9.3%	9.3%	8.0%	5.5%
Liquid ratio	1.1	1.1	1.1	1.1	1.1
Quick ratio	0.9	0.8	0.8	0.9	0.9
Operating efficiency					
Asset turnover	1.1	1.1	1.9	2.1	2.0
Inventory turnover	7.9	4.1	6.8	7.9	7.4
AR turnover	4.2	2.3	3.8	4.3	4.4
AP turnover	3.5	1.8	3.0	3.5	3.5
Per share ratios (HKD)					
EPS	(0.18)	0.28	0.98	1.34	1.86
CFPS	0.20	0.70	0.68	0.64	0.95
BVPS	2.07	3.20	3.09	3.93	5.08
DPS	0.03	0.11	0.39	0.54	0.75
Valuation					
PE	-57.8	38.7	10.8	7.9	5.7
PB	5.2	3.3	3.5	2.7	2.1
EV/EBITDA	44.5	42.3	15.5	12.2	8.9

Investment Ratings

Rating	Definition
BUY	Expected to outperform the market index by >10% over the next 12 months
NEUTRAL	Expected to outperform or underperform the market index by 10% or less over the next 12 months
SELL	Expected to underperform the market index by >10% over the next 12 months

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