

## Company Report

China Merchants Securities (HK) Co., Ltd.  
Hong Kong Equity Research

### TCL Comm (2618 HK)

**NDR takeaway: Profitability outlook intact; Reiterate BUY**

- US/LATAM/China shipment momentum remain strong; Expect 26mn/64mn feature/smartphone shipments (+20%/54%) in FY15E
- Healthy GPM/OPM/ASP on emerging leadership (Global No.4)
- Maintain BUY on attractive valuation (6.9x FY15 P/E, vs peers 10x P/E)

#### Expect strong FY15 backed by solid product roadmap

Following our NDR with TCLC mgmt, we become more confident on the company outlook in FY15-16E, thanks to 1) stronger FY15 revenue guidance (+30% YoY), 2) continued share gains in America/China (+33%/ +164% YoY in 4Q sales), 2) better ASP uptrend on high-end model launch (USD150+) in US, 3) improving operating leverage (esp. R&D) to offset GPM risk, and 4) solid product pipeline in tablets/4G smartphones. We lift our FY15E-16E EPS by 9%/4% to reflect stronger smartphone volume, higher ASP on faster mix shift and better cost control.

#### Catalysts ahead: Palm, wearables, Cisco cloud, Smarthome

Mgmt expects product launches with Palm brand in 4Q15E-1Q16E, targeting high-end segment in US, while in near term further upside could come from wearables (smart watch in 2Q15). In addition, we expect more details to announce about partnerships with its parent, TCL Group, on two new JVs focusing on enterprise cloud service (with Cisco) and smart home products with (TCL Multimedia (1070 HK)). We view any progress of above projects will be positive catalysts for TCLC in FY15E.

#### Reiterate BUY on solid execution and attractive valuation

We believe market concerns over margin pressure from Chinese peers in emerging markets are overdone, given TCLC's time-to-market product pipeline, less vulnerable to IPR issues with strong patent portfolio, and better economies of scale (global No 4 in handsets) with operating leverage. Trading at 6.9x FY15 P/E, the stock looks very attractive. We maintain BUY with revised TP HK\$10.42 (based on unchanged 9x FY15E P/E). Catalysts include monthly sales and product launches. Downside risks include competition, slower EM demand and component shortage.

#### Financials

HKD mn	2013	2014	2015E	2016E	2017E
Revenue	19,362	30,691	40,445	46,706	54,419
Growth (%)	61%	59%	32%	15%	17%
Net profit	313	1,093	1,407	1,579	1,793
Growth (%)	-251%	249%	29%	12%	14%
EPS (HKD)	0.28	0.89	1.19	1.33	1.51
DPS (HKD)	0.11	0.40	0.47	0.53	0.60
P/E (x)	29.8	9.3	6.9	6.2	5.5
P/B (x)	2.2	2.4	1.9	1.6	1.4
ROE (%)	10.8%	26.1%	27.9%	26.3%	25.2%

Source: Company data, CMS (HK) estimates

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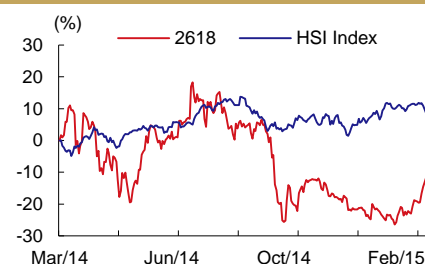
#### WHAT'S NEW

TP/Estimate upgrade

### BUY

Previous	BUY
Price	HK\$8.24
12-month Target Price (Potential upside)	HK\$10.42 (+26%)
Previous	HK\$9.90

#### Price Performance



Source: Bigdata

%	1m	6m	12m
2618 HK	15.1	(14.2)	(8.6)
HSI	(2.1)	(4.3)	6.4

#### Hardware Technology

Hang Seng Index	24123
HSCEI	11676

#### Key Data

52-week range (HK\$)	6.6-10.96
Market cap (HK\$ mn)	10900.5
Avg. daily volume (mn)	496.8
BVPS (HK\$)	3.20

#### Shareholdings Structure

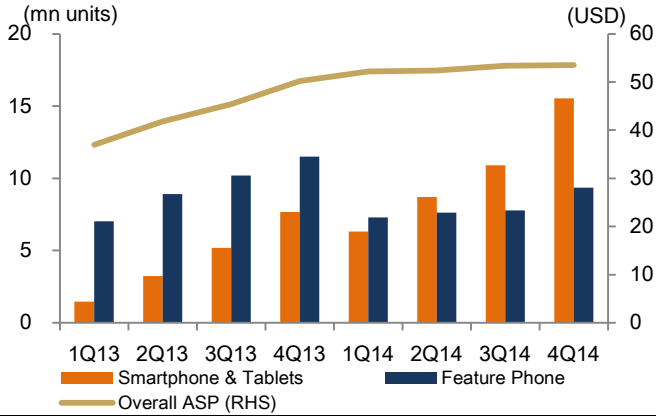
TCL Corporation	60.0%
VALUE PARTNERS LIMITED	5.0%
DONG SHENG LI	3.8%
No. of shares outstanding	1,224.2M
Free float	36.0%

#### Related Research

1. TCL Comm (2618 HK) – Solid FY14 and stronger outlook with China/Palm/wearables potential upside (13/1/2015)
2. TCL Comm (2618 HK) – Earnings cut for near-term ASP/GPM uncertainties (24/10/2014)

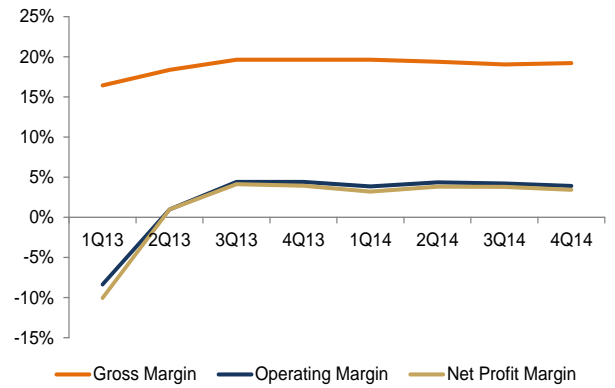
Focus charts

Figure 1: Higher shipment mix from smart devices to lift blended ASP



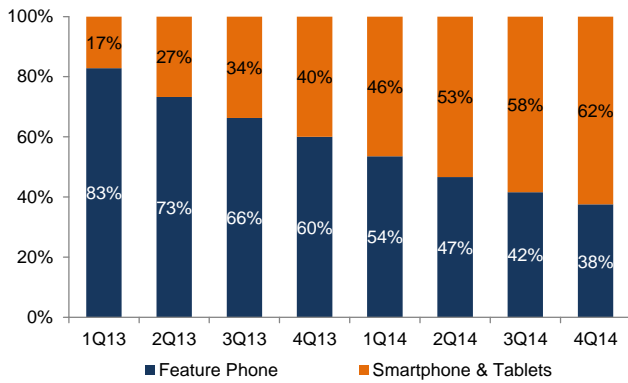
Source: Company, CMS (HK)

Figure 2: Stabilized net margins despite gross margin downward pressure



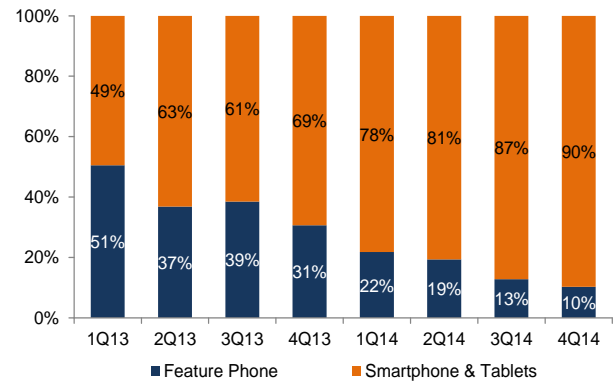
Source: Company, CMS (HK)

Figure 3: Shipment breakdown by product



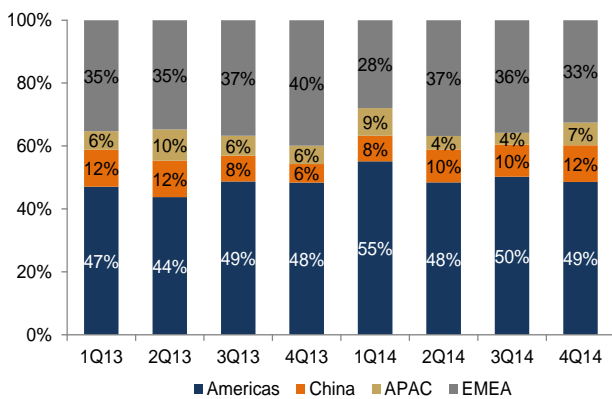
Source: Company, CMS (HK)

Figure 4: Revenue breakdown product



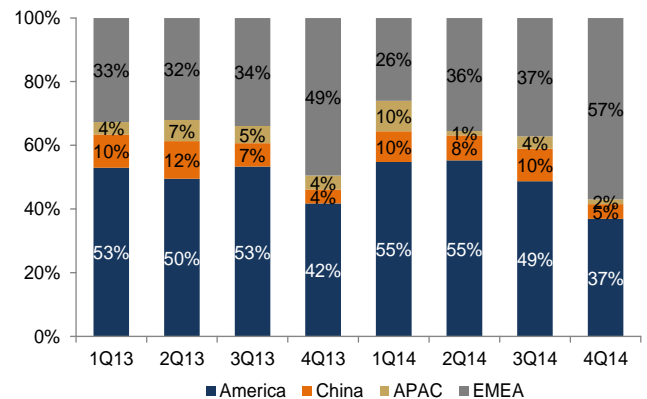
Source: Company, CMS (HK)

Figure 5: Shipment breakdown by region



Source: Company, CMS (HK)

Figure 6: Revenue breakdown by region



Source: Company, CMS (HK)

## Earnings revisions

Figure 7: Key assumptions and revisions

	3Q14	4Q14	1Q15E	2Q15E	3Q15E	4Q15E	2015E	2016E	2017E
Shipment (mn unit)	7,772	9,345	6,635	6,303	5,988	6,766	25,693	20,554	15,416
Feature Phone									
ASP (HKD)	128.7	117.7	111.8	112.9	109.6	106.3	110.1	99.1	89.2
Revenue (HKD mn)	1,000	1,100	742	712	656	719	2,829	2,037	1,375
Smartphone & Tablet									
Shipment (mn unit)	10,896	15,532	12,426	14,663	16,862	19,897	63,847	79,809	99,761
ASP (HKD)	624	618	618	600	582	570	589	560	532
Revenue (HKD mn)	6,800	9,600	7,680	8,791	9,806	11,339	37,616	44,669	53,044
Blended ASP (USD)	53.4	53.5	56.6	58.1	58.7	58.0	57.9	59.7	59.7
Total Revenue (HKD mn)	7,800	10,700	8,422	9,502	10,462	12,059	40,445	46,706	54,419
YoY Revenue Growth	43.0%	42.6%	53.1%	41.8%	34.1%	12.7%	31.7%	15.5%	16.5%
Gross Margin	19.0%	19.2%	19.3%	19.0%	18.5%	19.0%	18.9%	18.7%	18.6%

Source: Company, CMS (HK)

Figure 8: Estimate revisions

(HKD mn)	New		Old		Change (%)	
	2015E	2016E	2015E	2016E	2015E	2016E
Revenue	40,445	46,706	37,014	43,452	9%	7%
Gross profit	7,657	8,734	7,107	8,299	8%	5%
Operating profit	1,584	2,008	1,554	1,911	2%	5%
Net profit	1,407	1,579	1,292	1,517	9%	4%
EPS (HKD)	1.19	1.33	1.0889	1.2788	9%	4%
Gross margin	18.9%	18.7%	19.2%	19.1%		
Operating margin	4.3%	4.3%	4.2%	4.4%		
Net Margin	3.5%	3.4%	3.5%	3.5%		

Source: Company, CMS (HK)

Figure 9: CMS (HK) estimates vs consensus

(HKD mn)	CMS (HK)			Consensus			Diff (%)		
	2015E	2016E	2017E	2015E	2016E	2017E	2015E	2016E	2017E
Revenue	40,445	46,706	54,419	38,372	44,300	52,068	5%	5%	5%
Gross profit	7,657	8,734	10,122	7,268	8,284	9,607	5%	5%	5%
Operating profit	1,584	2,008	2,286	1,440	1,600	1,820	10%	26%	26%
Net profit	1,407	1,579	1,793	1,332	1,483	1,615	6%	6%	11%
EPS (HKD)	1.19	1.33	1.51	1.10	1.22	1.32	8%	9%	14%
Gross margin	18.9%	18.7%	18.6%	18.9%	18.7%	18.5%	0.0%	0.0%	0.2%
Operating margin	4.3%	4.3%	4.2%	3.8%	3.6%	3.5%	0.5%	0.7%	0.7%
Net Margin	3.5%	3.4%	3.3%	3.5%	3.3%	3.1%	0.0%	0.0%	0.2%

Source: CMS (HK), Bloomberg

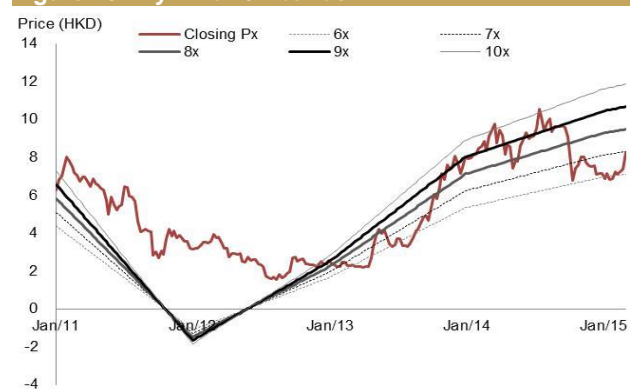
## Valuation

Reiterate BUY with up-revised TP of HK\$10.42 (26% upside)

We set our 12-month price target of HK\$10.42 based on our unchanged target P/E multiple of 9.0x (10% discount on peers' 10x P/E) and 2015E EPS of HK\$1.20. As an emerging global handset leader (No.4 in total handset; No.7 in smartphones) with continued share gains and stronger product portfolio, we see the valuation of 6.9x 2015E P/E is undemanding and maintain our BUY rating.

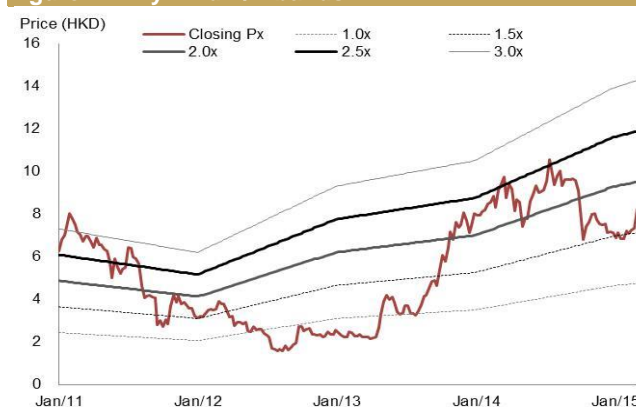
Catalysts include new product releases and monthly shipment data. Downside risks include component shortage and delayed 4G product launches.

Figure 10: 1-yr fwd P/E bands



Source: Company, CMS (HK)

Figure 11: 1-yr fwd P/B bands



Source: Company, CMS (HK)

## Peers Comparison

Figure 12: Sector valuation comparison

Company	Ticker	Rating	Mkt Cap (USD mn)	Current Price (local)	Target Price (HKD)	Upside (%)	P/E (x)		P/B (x)		ROE (%)	
							FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
TCL Comm	2618 HK	Buy	1,302	8.24	10.42	26%	6.9	6.2	1.78	1.56	28%	27%
Coolpad	2369 HK	Neutral	793	1.4	1.55	8%	8.4	6.8	1.54	1.30	19%	19%
ZTE	763 HK	N/A	10,400	17.6	N/A	N/A	14.7	13.2	1.72	1.54	13%	13%
Sunny Optical	2382 HK	Buy	1,823	12.9	16.7	30%	13.0	10.0	2.73	2.24	21%	21%
AAC Tech	2018 HK	Neutral	8,564	54.1	48.7	-10%	16.6	14.1	4.43	3.65	27%	27%
Truly Intl	732 HK	Neutral	1,272	3.4	3.81	12%	6.1	5.1	1.04	0.90	17%	17%
BYD E	285 HK	N/A	2,561	8.8	N/A	N/A	10.8	9.0	1.44	1.28	14%	14%
FIH	2038 HK	N/A	7,294	297.0	N/A	N/A	11.7	10.5	2.25	1.93	21%	21%
Ju Teng	3336 HK	N/A	11,890	2,770.0	N/A	N/A	16.7	14.5	6.24	4.98	43%	43%
Catcher	2474 TT	N/A	1,302	8.2	N/A	N/A	11.7	9.9	2.57	2.15	22%	22%
Largan	3008 TT	N/A	793	1.4	N/A	N/A	7.1	6.3	1.78	1.56	27%	27%
<b>Average</b>							<b>11.3</b>	<b>9.6</b>	<b>2.5</b>	<b>2.1</b>	<b>23%</b>	<b>23%</b>

Source: CMS (HK), Bloomberg

## 4Q14 Review: Solid ASP/Margin; Stronger FY15 revenue guidance (+30%YoY) a surprise

Management guided 30% revenue YoY growth for FY15, implying total sales of HK\$39.90bn, which is 10% higher than consensus/our estimates of HK\$36.7bn/HK\$37.01bn following a strong set of 4Q14 results. 4Q14 revenue/net profit was up by 43%/25%YoY to HK\$10,695mn/HK\$368mn, ahead of consensus by 8%/2% and our estimates by 13%/18%. TCLC reported 4Q GPM of 19.2%, up 0.2ppt QoQ but down 0.4ppt YoY. Product mix continued to improve with 62% sales from smart devices (vs 58%/53% in 3Q/2Q) and thus resulted in better blended ASP at US\$55.1 (vs US\$53.4/52.4 in 3Q/2Q). We attribute 4Q14 solid result to:

### 1. Strong growth in America to continue with new operators introduced with new models.

4Q shipment in America remained solid at 12.1mn, up 33% YoY. As 60% of total shipment came from higher-margin smartphones (GPM:20-21%) and tablets (GPM: 18%), revenue growth is higher at 42% YoY reaching HKD5.6mn. In 4Q14, TCLC ranked No. 4/No.1 in terms of total phones shipment in N. America and LATAM (excluding Brazil). Partnering with AT&T/T-Mobile in US, America shipments account for 49% of the total. Management expects Americas to remain the key growth driver in 2015 with 30%+ YoY sales growth on increasing 3G/4G smartphones.

### 2. APAC market recovering, surpassing EMEA in smart devices shipment for the first time.

After 2 quarters of negative growth in APAC due to faster than expect feature phones fall, TCLC regained shares in 4Q14 with revenue growth at 162%YoY to HKD1mn, thanks to record-high smart devices shipment at 1.8mn in 4Q14, up 157% YoY. Improving product mix in APAC allows it to become the 3<sup>rd</sup> largest market for TCLC's smart devices shipment in 4Q14, surpassing EMEA for the first time with 1.6m shipments vs. 0.7m in EMEA.

### 3. China business ramp up with revenue up 185%YoY to HKD1.3m.

For China market, TCL continues to post strong revenue growth of 185%YoY in 4Q14, backed by 164% YoY handset shipment growth reaching 2.9 units. Smart devices contributed 79% of total shipment at 2.3m. However, as China blended ASP is 15% lower than overseas shipment ASP, the increasing exposure in China market has dragged down the GPM by 0.4ppt YoY to 19.2% in 4Q14.

### 4. EMEA weakened with -19%YoY smart devices growth in 4Q14, revenue was up by 4%YoY to HKD2.9m.

EMEA sales growth slowed down to 4%YoY, attributable to the decreasing smart devices shipment at 0.7m units (vs. 3.8/3.3m units in 3Q/2Q). However, feature phone shipment showed 11%YoY growth to 7.4m (vs. 2.9/2.7m units in 3Q/2Q), contributing >90% of EMEA shipments.

Figure 13: 4Q14 Review

(HK\$ mn) / (Volume mn)	Actual								Consensus		CMS	
	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14	YoY	QoQ	4Q14	Diff%	4Q14	Diff%
Feature phone vol.	10,203	11,511	7,292	7,614	7,772	9,345	-19%	2%				
Smart phone vol.	5,192	7,662	6,316	8,720	10,896	15,532	103%	25%				
Blended ASP	45	50	52	52	53	54	7%	2%				
Revenue	5,454	7,501	5,541	6,677	7,779	10,695	43%	16%	9,866	8%	9,432	13%
Net profit	226	295	177	254	294	368	25%	16%	362	2%	250	47%
EPS (HK cents)	20	26	15	21	22	30	18%	5%	29	3%	21	43%
<b>MARGIN</b>												
Gross margin	19.6%	19.6%	19.6%	19.4%	19.0%	19.2%	-0.4ppt	-0.2ppt	19.1%	0.1ppt	19.0%	0.2ppt
% R&D	4.9%	4.9%	4.6%	3.9%	4.4%	5.8%						
% Selling Exp	7.3%	7.4%	8.4%	8.5%	7.9%	7.2%						
% Admin Exp	4.0%	4.0%	4.2%	4.4%	4.1%	3.8%						
Operating Exp.	15.2%	15.2%	15.8%	15.0%	14.8%	15.3%	-0.1ppt	0.5ppt				
Operating margin	4.4%	4.4%	3.8%	4.4%	4.2%	3.9%	-0.5ppt	-0.3ppt	3.6%	0.3ppt	3.1%	0.8ppt
Net profit margin	4.1%	3.9%	3.2%	3.8%	3.8%	3.4%	-0.5ppt	-0.4ppt	3.7%	-0.3ppt	2.7%	0.7ppt

Source: CMS (HK), Bloomberg

## Financial Summary

### Statement of financial position

HKD million	2013	2014E	2015E	2016E	2017E
<b>Current Assets</b>	<b>11,866</b>	<b>16,006</b>	<b>19,355</b>	<b>20,397</b>	<b>25,148</b>
Cash & equivalents	142	473	927	2,477	2,588
Trading investments	0	0	0	0	0
Trade notes	0	0	0	0	0
Trade receivables	5,551	7,873	9,192	8,467	10,319
Other receivables	1,670	1,959	2,577	2,976	3,468
Inventories	2,649	3,293	4,252	4,070	6,367
Other current assets	1,854	2,407	2,407	2,407	2,407
<b>Non-current assets</b>	<b>2,557</b>	<b>3,691</b>	<b>3,895</b>	<b>4,030</b>	<b>4,109</b>
Investment property	0	0	0	0	0
PPE	941	1,439	1,537	1,609	1,611
Intangible assets	1,210	1,514	1,514	1,514	1,514
Other non-current assets	407	694	801	864	941
<b>Total assets</b>	<b>14,423</b>	<b>19,696</b>	<b>23,250</b>	<b>24,427</b>	<b>29,257</b>
<b>Liquid Liabilities</b>	<b>11,221</b>	<b>15,408</b>	<b>17,999</b>	<b>18,175</b>	<b>21,866</b>
Bank loans	2,205	3,941	3,941	3,941	3,941
Trade payables	3,875	5,167	6,511	6,597	9,180
Prepaid Accounts	0	0	0	0	0
Other liquid liabilities	5,141	6,300	7,547	7,637	8,746
<b>Long term Liabilities</b>	<b>289</b>	<b>109</b>	<b>209</b>	<b>240</b>	<b>279</b>
Loans	196	0	0	0	0
Others	93	109	209	240	279
<b>Total Liabilities</b>	<b>11,510</b>	<b>15,517</b>	<b>18,208</b>	<b>18,416</b>	<b>22,145</b>
Issued capital	1,162	1,221	1,221	1,221	1,221
Capital reserves	0	0	0	0	0
Reserves	1,747	2,868	3,712	4,659	5,735
NCI	4	90	110	131	156
Parents	2,909	4,089	4,933	5,880	6,956
<b>Total equity and liabilities</b>	<b>14,423</b>	<b>19,696</b>	<b>23,250</b>	<b>24,427</b>	<b>29,257</b>

### Statement of cash flows

HKD million	2013	2014E	2015E	2016E	2017E
<b>CF from OA</b>	<b>640</b>	<b>1,105</b>	<b>1,316</b>	<b>2,481</b>	<b>1,078</b>
PBT	298	1,149	1,584	1,861	2,138
D&A	1,136	177	202	227	248
Finance costs	105	100	146	146	146
Investment income	0	0	0	0	0
Changes of WC	(762)	(271)	(321)	675	(961)
Others	(135)	(191)	(296)	(428)	(494)
<b>CF from IA</b>	<b>(1,263)</b>	<b>(300)</b>	<b>(300)</b>	<b>(300)</b>	<b>(250)</b>
Capital expenditure	(484)	(300)	(300)	(300)	(250)
Other investments	(779)	0	0	0	0
<b>CF from FA</b>	<b>(230)</b>	<b>(473)</b>	<b>(563)</b>	<b>(632)</b>	<b>(717)</b>
Borrowings	18,185	0	0	0	0
Share capital	78	0	0	0	0
Changes of reserves	0	0	0	0	0
Dividends	0	(473)	(563)	(632)	(717)
Others	(18)	0	0	0	0
<b>Net cash flow</b>	<b>(853)</b>	<b>331</b>	<b>454</b>	<b>1,550</b>	<b>111</b>

Source: Company, CMS(HK)

### Statement of comprehensive income

HKD million	2013	2014E	2015E	2016E	2017E
<b>Revenues</b>	<b>19,362</b>	<b>30,691</b>	<b>40,445</b>	<b>46,706</b>	<b>54,419</b>
Cost of sales	(15,690)	(24,774)	(32,787)	(37,972)	(44,297)
Selling exp	(1,611)	(2,420)	(3,118)	(3,550)	(4,136)
Admin exp	(946)	(1,246)	(1,598)	(1,822)	(2,122)
Op expenses	(3,267)	(4,087)	(5,926)	(6,726)	(7,836)
<b>Op Profit</b>	<b>405</b>	<b>1,249</b>	<b>1,732</b>	<b>2,008</b>	<b>2,286</b>
Fin. costs	(105)	(100)	(146)	(146)	(146)
Impairments	0	0	0	0	0
FV changes	0	0	0	0	0
Inv income	(2)	(0)	(1)	(1)	(1)
Non-op inc	0	0	0	0	0
Non-op exp	0	0	0	0	0
<b>PBT</b>	<b>298</b>	<b>1,149</b>	<b>1,584</b>	<b>1,861</b>	<b>2,138</b>
Taxes	18	(41)	(158)	(261)	(321)
PAT	316	1,108	1,426	1,601	1,818
NCI	3	15	19	22	25
<b>Net Profit</b>	<b>313</b>	<b>1,093</b>	<b>1,407</b>	<b>1,579</b>	<b>1,793</b>
<b>EPS (HKD)</b>	<b>0.28</b>	<b>0.89</b>	<b>1.19</b>	<b>1.33</b>	<b>1.51</b>

### Ratios

	2013	2014E	2015E	2016E	2017E
<b>YoY growth rate</b>					
Revenue	61%	59%	32%	15%	17%
Op profit	-2055%	208%	39%	16%	14%
Net profit	-251%	249%	29%	12%	14%
<b>Profitability</b>					
Gross margin	19.0%	19.3%	18.9%	18.7%	18.6%
NP margin	1.6%	3.6%	3.5%	3.4%	3.3%
ROE	10.8%	26.1%	27.9%	26.3%	25.2%
ROIC	6.4%	22.3%	22.5%	25.6%	28.2%
<b>Liquidity</b>					
D/A	20.0%	20.0%	16.9%	16.1%	13.5%
ND/A	17.6%	17.6%	13.0%	6.0%	4.6%
Liquid ratio	1.0	1.0	1.1	1.1	1.2
Quick ratio	0.8	0.8	0.8	0.9	0.9
<b>Operating efficiency</b>					
Asset turnover	1.2	1.9	2.1	2.3	2.2
Inventory turnover	4.8	7.5	7.7	9.3	7.0
AR turnover	2.5	3.9	4.4	5.5	5.3
AP turnover	2.0	3.1	3.6	4.5	4.3
<b>Per share ratios (HKD)</b>					
EPS	0.28	0.89	1.19	1.33	1.51
CFPS	0.97	0.93	1.11	2.09	0.91
BVPS	3.68	3.50	4.25	5.07	6.00
DPS	0.11	0.40	0.47	0.53	0.60
<b>Valuation</b>					
PE	29.8	9.3	6.9	6.2	5.5
PB	2.2	2.4	1.9	1.6	1.4
EV/EBITDA	35.5	12.7	11.0	10.2	10.8



## 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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