

## Tongda (698 HK)

**Buy** (maintained)

Target price: HK\$1.27



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### Stock performance (HK\$)



Source: Bloomberg

### Key data

Mar 19 close (HK\$)	1.12
Share in issue (m)	5,469
Major shareholder	Wang Ya Nan (47.4%)
Market cap (HK\$bn)	6.1
3M avg. vol. (m)	15.3
52W high/low (HK\$)	1.41 / 0.77

Source: Bloomberg

Earnings growth to accelerate on margin expansion and robust sales growth

**What's new?** We have revised up our 2015 EPS estimates by 8%, taking into account upbeat management guidance for its smartphone casings business this year. We set a new target price of HK\$1.27 (17% upside), up from HK\$1.22, based on an unchanged 2015 P/E multiple of 10x on our revised EPS estimate. We maintain our Buy rating.

**Better-than-expected 2014 results** 2014 net profit increased 39% YoY to HK\$502m, 7% ahead of Bloomberg consensus of HK\$467m on better-than-expected margin improvement and opex control. Gross profit margin rose 1.9pp to reach a record high of 23.9% (see figure 2). Opex to sales ratio declined to 9.2%, down from 9.8% in 2013 (see figure 3).

**Margin expansion to continue in 2015** Management is upbeat on the outlook for its core smartphone casings business in 2015 (51% of sales in 2014), driven by 1) robust volume growth at its key customers including **Huawei**, **Xiaomi** and **Oppe**, and 2) margin expansion on an increased sales mix for high-margin metal casings this year. Metal casings are expected to account for 20% of division sales in 2015, up from 5% in 2014. The product has a gross profit margin of over 30%, compared to 25% for existing plastic casings.

**Premium customer mix** Huawei was Tongda's largest customer for smartphone casings, accounting for over 50% of the division's sales in 2014, followed by Xiaomi (around 20%). Lenovo is the largest customer for its notebook casings.

**Up to HK\$500m capex for capacity expansion in 2015** To support the increase in demand for metal casings, Tongda will expand its number of CNC (computer numerical control) machines to 1,500 sets by end of the year, up from 500 sets at present. Total capex for 2015 will be around HK\$450m-500m, down from HK\$625m in 2014. (Capex in 2014 was high due to spending on a new factory, which was completed in late 2014.)

**Our divisional sales growth forecasts** We project a 35% YoY increase in smartphone casing sales in 2015, and a 20% YoY rise in home appliance casing sales. However, we expect sales growth for notebook casings to slow to 5% YoY, down from 17% YoY growth in 2014, on expected lackluster notebook demand (IDC expects a 3.9% YoY decline in notebook shipment in 2015). Overall, we project 25% sales growth for 2015.

**Valuation** We believe the company's valuation remains undemanding, despite the 26% share price rally YTD. The stock is trading at 8.8x our revised 2015 EPS estimate.

**Risks** Key risks include a rapid slowdown in China's smartphone market, a poor yield for metal casings, and delays in the installation of CNC machinery.

### Stock valuation

	Turnover (HK\$ m)	YoY chg (%)	Net profit (HK\$m)	EPS (HK\$)	YoY chg (%)	P/E (x)	P/B (x)	Dividend Yield (%)	ROE (%)	Net gearing (%)
2013	3,627	6	360	0.07	16	15.2	2.2	2.2	15.8	23.9
2014	4,791	32	502	0.09	26	12.0	1.7	2.7	16.9	13.8
2015E	5,974	25	706	0.13	37	8.8	1.6	3.4	18.9	18.1
2016E	7,021	18	876	0.16	24	7.1	1.4	4.2	20.5	12.4
2017E	8,267	18	1084	0.20	24	5.7	1.2	5.2	21.8	6.9

Sources: Company data, GF Securities (HK)  
Note: Calculated based on diluted shares.

Figure 1: Revenue mix by product (2014)

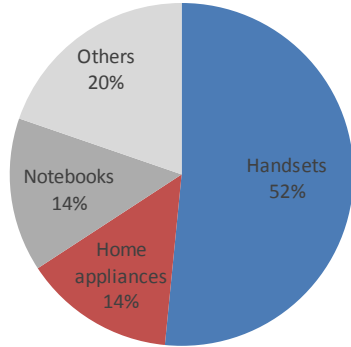
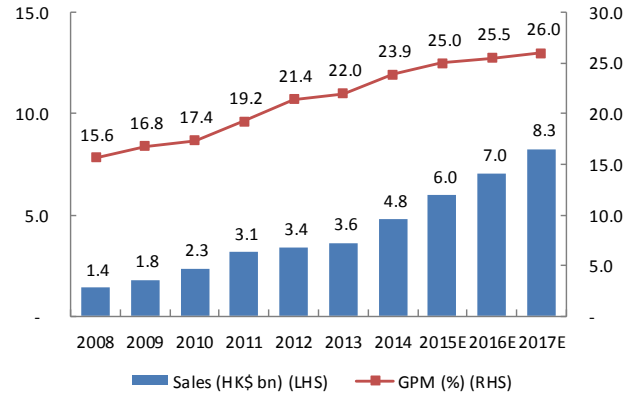


Figure 2: Sales and margin forecasts



Sources: Company data, GF Securities (HK)

Figure 3: Opex to sales ratio

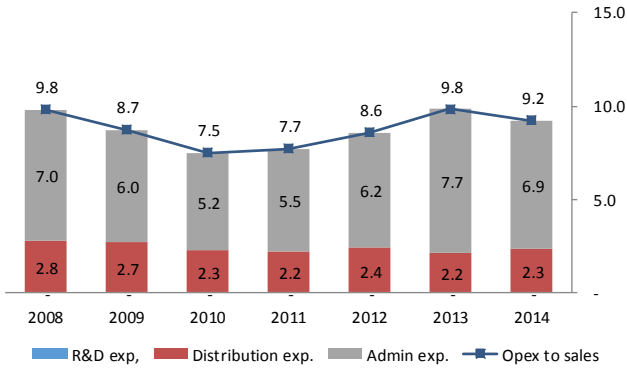
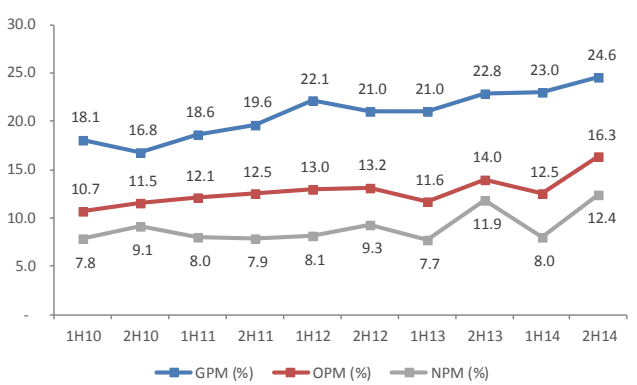


Figure 4: Half-yearly earnings projections (HK\$ m)



Sources: Company data

Figure 5: Earnings projections (HK\$ m)

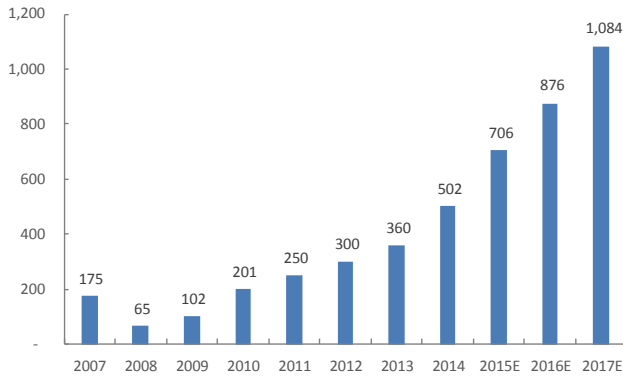
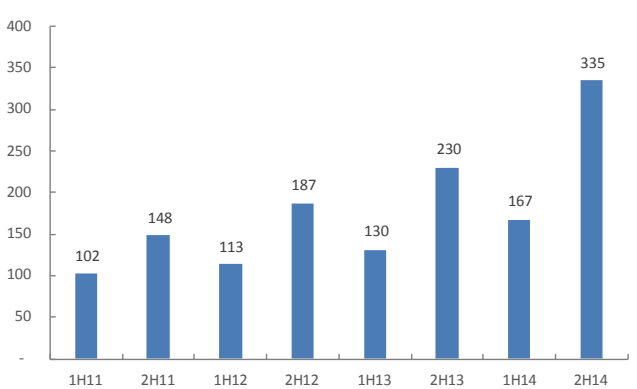


Figure 6: Half-yearly earnings (HK\$ m)



Sources: Company data, GF Securities (HK)

Figure 7: 2014 results summary

(HK\$m)	2013	2014	YoY chg	1H13	2H13	1H14	2H14	YoY chg	Remarks
Handsets	1,860	2,415	30%	823	1,037	958	1,457		41% Key customers include Huawei, Xiaomi, Oppo, etc
Home appliances	544	666	22%	270	274	324	342		25% Key customers include Haier, Gree, Midea
Notebooks	580	680	17%	224	357	287	392		10% Strong demand from Lenovo
Others	643	923		373	270	531	392		45%
<b>Turnover</b>	<b>3,627</b>	<b>4,791</b>	<b>32%</b>	<b>1,690</b>	<b>1,937</b>	<b>2,101</b>	<b>2,690</b>	<b>39%</b>	
<b>Gross profit</b>	<b>798</b>	<b>1,144</b>	<b>43%</b>	<b>356</b>	<b>442</b>	<b>482</b>	<b>661</b>	<b>49%</b>	
Gross margin (%)	22.0	23.9		21.0	22.8	23.0	24.6		
Opex to sales (%)	9.8	9.2		10.0	9.7	10.5	8.3		
Other income/gains	47	27		15	32	-	27		
Opex	(356)	(442)	24%	(168)	(188)	(220)	(222)	18%	
Other expenses	(21)	(27)		(5)	(16)	0	(27)		
<b>Operating profit</b>	<b>467</b>	<b>701</b>	<b>50%</b>	<b>197</b>	<b>270</b>	<b>262</b>	<b>439</b>	<b>62%</b>	
Op. margin (%)	12.9	14.6		11.6	14.0	12.5	16.3		
Finance costs	(52)	(57)		(21)	(31)	(27)	(30)		
<b>Pre-tax income</b>	<b>415</b>	<b>643</b>	<b>55%</b>	<b>175</b>	<b>240</b>	<b>235</b>	<b>407</b>	<b>70%</b>	
Taxation	(46)	(94)		(37)	(9)	(48)	(47)		
Effective tax (%)	11.1	14.7		21.2	3.7	20.2	11.5		
Minority interests	(9)	(47)		(8)	(1)	(21)	(26)		
<b>Net profit</b>	<b>360</b>	<b>502</b>	<b>39%</b>	<b>130</b>	<b>230</b>	<b>167</b>	<b>335</b>	<b>46%</b>	
Net margin (%)	9.9	10.5		7.7	11.9	8.0	12.4		
<b>EPS (fully diluted) HK cents</b>	<b>7.36</b>	<b>9.30</b>	<b>26%</b>						EPS dilution due to share placement in March 2014

Sources: Company data, GF Securities (HK)

Figure 8: Financial statements

Income Statement						Balance Sheet					
Year end Dec (HK\$ m)	2013	2014	2015E	2016E	2017E	Year end Dec (HK\$ m)	2013	2014	2015E	2016E	2017E
Handsets	1,860	2,415	3,260	3,912	4,695	Cash/ST Investments	241	478	224	383	594
Home appliances	544	666	800	919	1,057	Account receivables	1,586	2,166	2,619	3,078	3,624
Notebooks	580	680	714	749	787	Inventory	1,088	1,401	1,718	2,006	2,347
Others	643	923	1,200	1,440	1,728	Other Current Assets	134	134	134	134	134
<b>Turnover</b>	<b>3,627</b>	<b>4,791</b>	<b>5,974</b>	<b>7,021</b>	<b>8,267</b>	<b>Total current assets</b>	<b>3,048</b>	<b>4,266</b>	<b>4,695</b>	<b>5,601</b>	<b>6,698</b>
<b>Gross profit</b>	<b>798</b>	<b>1,144</b>	<b>1,493</b>	<b>1,790</b>	<b>2,150</b>	Prop, plant and equipment	1,328	1,757	2,077	2,092	2,107
Other income/gains	47	27	30	30	30	Intangible assets	6	0	0	0	0
Selling & distribution exp.	(79)	(112)	(131)	(154)	(182)	Other LT Assets	275	344	344	344	344
Admin exp.	(278)	(330)	(418)	(492)	(579)	<b>Total Assets</b>	<b>4,657</b>	<b>6,367</b>	<b>7,116</b>	<b>8,037</b>	<b>9,149</b>
Other expenses	(21)	(27)	(25)	(25)	(25)	ST Debt	592	629	629	629	629
<b>Operating profit</b>	<b>467</b>	<b>701</b>	<b>949</b>	<b>1,150</b>	<b>1,394</b>	Trade payables	894	1,329	1,534	1,791	2,095
Finance costs	(52)	(57)	(60)	(60)	(60)	Other Current Liabilities	328	374	374	374	374
Share of profits	(0)	(2)	-	-	-	<b>Total current liabilities</b>	<b>1,814</b>	<b>2,332</b>	<b>2,537</b>	<b>2,794</b>	<b>3,098</b>
<b>Pre-tax income</b>	<b>415</b>	<b>643</b>	<b>889</b>	<b>1,090</b>	<b>1,334</b>	LT Debt	258	352	352	352	352
Taxation	(46)	(94)	(133)	(163)	(200)	Other LT Liab	36	47	47	47	47
Minority interests	(9)	(47)	(50)	(50)	(50)	Minority Interests	94	159	209	259	309
<b>Net profit</b>	<b>360</b>	<b>502</b>	<b>706</b>	<b>876</b>	<b>1,084</b>	Shareholders' Equity	2,455	3,477	3,971	4,584	5,343
						<b>Total Equity &amp; liabilities</b>	<b>4,657</b>	<b>6,367</b>	<b>7,116</b>	<b>8,037</b>	<b>9,149</b>

Cash Flow Statement						Financial Ratio					
Year end Dec (HK\$ m)	2013	2014	2015E	2016E	2017E		2013	2014	2015E	2016E	2017E
Pretax profit	415	643	889	1,090	1,334	<b>Margins</b>					
Tax Paid	(46)	(94)	(133)	(163)	(200)	Gross margin (%)	22.0	23.9	25.0	25.5	26.0
Depr/Amort	153	175	180	185	185	EBITDA margin (%)	17.1	18.3	18.9	19.0	19.1
Change in working capital	(536)	(459)	(565)	(490)	(583)	Operating profit margin (%)	12.9	14.6	15.9	16.4	16.9
Others	65	-	-	-	-	Net margin (%)	9.9	10.5	11.8	12.5	13.1
<b>Operational cash flow</b>	<b>51</b>	<b>265</b>	<b>371</b>	<b>621</b>	<b>736</b>	<b>Return/Profitability</b>					
Capex	(210)	(625)	(500)	(200)	(200)	ROA (%)	8.1	9.1	10.5	11.6	12.6
Assoc, MI, Invsmt	(23)	-	-	-	-	ROE (%)	15.8	16.9	18.9	20.5	21.8
<b>Investment cash flow</b>	<b>(233)</b>	<b>(625)</b>	<b>(500)</b>	<b>(200)</b>	<b>(200)</b>	<b>Balance sheet</b>					
Net Change in Debt	197	131	-	-	-	Net gearing	23.9	13.8	18.1	12.4	6.9
New Capital	-	672	-	-	-	Current ratio (x)	1.7	1.8	1.9	2.0	2.2
Dividend	(102)	(162)	(212)	(263)	(325)	<b>Working capital</b>					
Others	23	-	-	-	-	Days receivable (days)	160	165	160	160	160
<b>Financing cash flow</b>	<b>117</b>	<b>641</b>	<b>(212)</b>	<b>(263)</b>	<b>(325)</b>	Days inventory (days)	140	140	140	140	140
FX and others	85	(44)	88	-	-	Days payable (days)	115	133	125	125	125
Chg in Cash	20	237	(253)	158	211	<b>Others</b>					
Beginning cash	221	241	478	224	383	Effective tax (%)	11.1	14.7	15.0	15.0	15.0
<b>Ending cash</b>	<b>241</b>	<b>478</b>	<b>224</b>	<b>383</b>	<b>594</b>	Dividend payout ratio (%)	34	32	30	30	30

Sources: Company data, GF Securities (HK)

## Rating definitions

Benchmark: Hong Kong Hang Seng Index

Time horizon: 12 months

### Company ratings

<b>Buy</b>	Stock expected to outperform benchmark by more than 15%
<b>Accumulate</b>	Stock expected to outperform benchmark by more than 5% but not more than 15%
<b>Hold</b>	Expected stock relative performance ranges between -5% and 5%
<b>Underperform</b>	Stock expected to underperform benchmark by more than 5%

### Sector ratings

<b>Positive</b>	Sector expected to outperform benchmark by more than 10%
<b>Neutral</b>	Expected sector relative performance ranges between -10% and 10%
<b>Cautious</b>	Sector expected to underperform benchmark by more than 10%

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