



Rating  
**Buy**

Asia  
Hong Kong

Technology  
Hardware & Equipment

Company  
**Tongda Group**

Reuters 0698.HK    Bloomberg 698 HK    Exchange HSI    Ticker 0698

Date  
19 March 2015

## Company Update

Price at 19 Mar 2015 (HKD)	1.12
Price target - 12mth (HKD)	1.53
52-week range (HKD)	1.32 - 0.77
HANG SENG INDEX	24,120

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## Strong 2H14 results and no slow season in 2015

### Continues to impress

As highlighted in earlier Tongda note, overall smartphone demand has been cooling off in China since late 3Q14. However, Tongda still managed to deliver strong 2H14 results, with gross margin surprising on the upside. It also released positive 1H15 guidance, propelled by continued order allocation gains with key clients (Huawei/Xiaomi) and rising contribution from metal casing orders. Retain Buy rating.

### Solid 2H14 results on strong gross margin

Tongda reported 2H14 operating profit of HK\$397m (+43% YoY; +47% HoH) and EPS of HK\$0.06 (+30% YoY; +99% HoH) on sales of HK\$2.69bn (+39% YoY; 28% HoH). Operating profit beat our estimate by 4% on strong gross margin. Gross margin improved by 1.6pt HoH to 24.6% (vs. DBe of 23.4%) due to better production scale and improved product mix. Sales contribution from metal casings increased from low single digit in 1H14 to ~10% in 2H14. Metal casings generate above-company-average gross margin of 25-30%.

### 1H15 outlook – keep busy in slow season

1H tends to be the industry's slow season, but Tongda expects 1H15 smartphone casings sales to increase mildly HoH, driven by metal casing orders from Huawei/Oppo and plastic casing orders from Xiaomi (both Mi series and Redmi series). Tongda is a key metal casing supplier of Huawei (which accounts for 40%+ of Tongda's smartphone casings sales), and currently supplies 3 models to this key client. Tongda expects Huawei to launch more metal casing phones in 2015. Oppo is a relatively new client. Production of metal casings for Oppo smartphone (Oppo U3 and R1x, in our view) just ramped up in 1Q15 and might keep trending up in coming quarters.

### Valuation and risks

We increase our EPS forecasts by 5-6%, and accordingly raise our target price from HKD1.45 to HKD1.53 (still based on 12x 2015E EPS). 12x FW P/E implies 0.46x PEG, in line with its historical trading average. Risks include slower metal casing adoption and price competition.

### Key changes

Price target	1.45 to 1.53	↑	5.5%
Sales (FYE)	4,699 to 4,791	↑	2.0%
Op prof margin (FYE)	13.9 to 14.6	↑	5.3%
Net profit (FYE)	481.4 to 499.7	↑	3.8%

Source: Deutsche Bank

### Price/price relative



Performance (%)	1m	3m	12m
Absolute	7.7	34.9	-13.7
HANG SENG INDEX	-2.9	4.3	11.8

Source: Deutsche Bank

### Key indicators (FY1)

ROE (%)	16.8
Net debt/equity (%)	17.2
Book value/share (HKD)	0.65
Price/book (x)	1.72
Net interest cover (x)	13.3
Operating profit margin (%)	14.6

Source: Deutsche Bank

### Forecasts And Ratios

Year End Dec 31	2012A	2013A	2014E	2015E	2016E
Sales (HKDm)	3,408.1	3,627.1	4,791.3	5,801.4	7,040.7
Reported NPAT (HKDm)	302.4	363.1	499.7	687.6	866.6
DB EPS FD(HKD)	0.06	0.07	0.09	0.13	0.16
OLD DB EPS FD(HKD)	0.06	0.07	0.09	0.12	0.15
% Change	0.0%	0.0%	5.2%	5.6%	4.6%
DB EPS growth (%)	18.7	17.2	24.0	37.6	26.0
DPS (net) (HKD)	0.02	0.02	0.03	0.04	0.06
ROE (%)	15.3	15.9	16.8	18.3	20.0
Yield (net) (%)	7.6	5.6	2.7	4.0	5.7
PER (x)	4.2	6.0	12.1	8.8	7.0

Source: Deutsche Bank estimates, company data

<sup>1</sup> DB EPS is fully diluted and excludes non-recurring items

Deutsche Bank AG/Hong Kong

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Model updated: 19 March 2015

### Running the numbers

Asia  
Hong Kong  
Hardware & Equipment

### Tongda Group

Reuters: 0698.HK Bloomberg: 698 HK

### Buy

Price (19 Mar 15) HKD 1.12  
Target Price HKD 1.53  
52 Week range HKD 0.77 - 1.32  
Market Cap (m) HKDm 6,042  
USDm 779

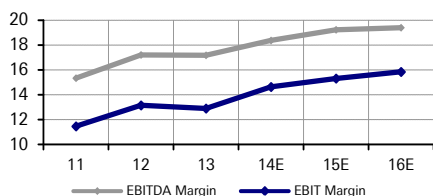
### Company Profile

Tongda Group is a leading consumer electronics casing manufacturer for a diversified applications including smartphone, notebook, communication facilities, home appliances, and etc. The company has a diversified customer mix including both international (HP, Dell, Toshiba, Nokia) and Chinese (Xiaomi, Huawei, ZTE, Lenovo, OPPO, TCL, Haier) consumer electronics brands.

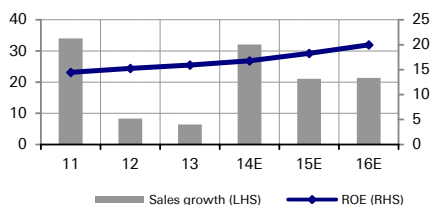
### Price Performance



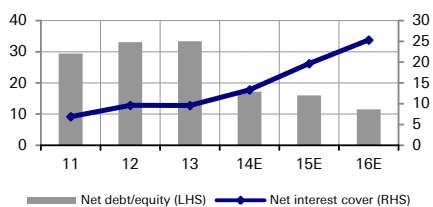
### Margin Trends



### Growth & Profitability



### Solvency



Fiscal year end 31-Dec

### Financial Summary

	2011	2012	2013	2014E	2015E	2016E
DB EPS (HKD)	0.05	0.06	0.07	0.09	0.13	0.16
Reported EPS (HKD)	0.05	0.06	0.07	0.09	0.13	0.16
DPS (HKD)	0.02	0.02	0.02	0.03	0.04	0.06
BVPS (HKD)	0.4	0.4	0.5	0.6	0.7	0.9
Weighted average shares (m)	4,678	4,742	4,859	5,395	5,395	5,395
Average market cap (HKDm)	1,312	1,261	2,188	6,042	6,042	6,042
Enterprise value (HKDm)	1,883	2,026	3,079	6,693	6,725	6,606

### Valuation Metrics

P/E (DB) (x)	5.2	4.2	6.0	12.1	8.8	7.0
P/E (Reported) (x)	5.2	4.2	6.0	12.1	8.8	7.0
P/BV (x)	0.47	0.82	1.00	1.72	1.50	1.30
FCF Yield (%)	nm	nm	0.0	nm	2.4	6.1
Dividend Yield (%)	6.1	7.6	5.6	2.7	4.0	5.7
EV/Sales (x)	0.6	0.6	0.8	1.4	1.2	0.9
EV/EBITDA (x)	3.9	3.5	4.9	7.6	6.0	4.8
EV/EBIT (x)	5.2	4.5	6.6	9.5	7.6	5.9

### Income Statement (HKDm)

Sales revenue	3,147	3,408	3,627	4,791	5,801	7,041
Gross profit	727	869	953	1,323	1,650	2,007
EBITDA	483	587	623	880	1,116	1,366
Depreciation	122	138	155	179	228	251
Amortisation	0	0	0	0	0	0
EBIT	361	448	468	701	888	1,116
Net interest income/(expense)	-52	-47	-49	-53	-45	-44
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	0	0	0	0	0	0
Other pre-tax income/(expense)	30	2	-1	-9	-5	-5
Profit before tax	338	403	418	640	838	1,067
Income tax expense	77	67	46	94	142	192
Minorities	9	34	9	47	8	8
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	251	302	363	500	688	867
DB adjustments (including dilution)	0	0	0	0	0	0
DB Net profit	251	302	363	500	688	867

### Cash Flow (HKDm)

Cash flow from operations	124	138	188	351	422	650
Net Capex	-174	-268	-187	-616	-280	-280
Free cash flow	-49	-130	1	-265	142	370
Equity raised/(bought back)	23	25	0	0	0	0
Dividends paid	-80	-95	-121	-165	-241	-347
Net inc/(dec) in borrowings	202	129	82	-49	-49	-47
Other investing/financing cash flows	-26	39	-5	662	58	88
Net cash flow	70	-32	-44	184	-90	64
Change in working capital	-249	-303	-331	-328	-493	-467

### Balance Sheet (HKDm)

Cash and other liquid assets	254	221	178	362	272	336
Tangible fixed assets	1,112	1,263	1,362	1,798	1,851	1,880
Goodwill/intangible assets	0	0	0	0	0	0
Associates/investments	51	52	54	64	74	84
Other assets	2,322	2,667	3,064	4,040	4,764	5,637
Total assets	3,739	4,204	4,657	6,264	6,960	7,937
Interest bearing debt	818	947	1,029	980	931	884
Other liabilities	1,005	1,064	1,079	1,685	1,907	2,305
Total liabilities	1,823	2,011	2,108	2,665	2,838	3,189
Shareholders' equity	1,858	2,102	2,455	3,503	4,024	4,648
Minorities	57	91	94	96	98	100
Total shareholders' equity	1,915	2,193	2,549	3,599	4,122	4,748
Net debt	564	726	851	618	659	548

### Key Company Metrics

Sales growth (%)	34.0	8.3	6.4	32.1	21.1	21.4
DB EPS growth (%)	16.3	18.7	17.2	24.0	37.6	26.0
EBITDA Margin (%)	15.3	17.2	17.2	18.4	19.2	19.4
EBIT Margin (%)	11.5	13.1	12.9	14.6	15.3	15.8
Payout ratio (%)	31.7	31.5	33.5	33.0	35.0	40.0
ROE (%)	14.5	15.3	15.9	16.8	18.3	20.0
Capex/sales (%)	5.5	7.9	5.2	12.9	4.8	4.0
Capex/depreciation (x)	1.4	1.9	1.2	3.4	1.2	1.1
Net debt/equity (%)	29.5	33.1	33.4	17.2	16.0	11.5
Net interest cover (x)	6.9	9.6	9.6	13.3	19.7	25.3

Source: Company data, Deutsche Bank estimates

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# Valuation and risks

Buy rating with a 12-month target price of HKD1.53

Figure 1: 2H14 P&L snapshot

	2H14	1H14	HoH	2H13	YoY	2H14 DBE	% of diff
Sales	2,690	2,101	28.1%	1,937	38.9%	2,598	3.6%
Gross profits	661	482	37.2%	442	49.5%	608	8.8%
Opex	264	212	24.6%	165	59.9%	225	17.3%
Op. profits	397	270	47.1%	277	43.3%	383	3.7%
Non-op	7	(35)	-120.9%	(38)	-119.4%	(20)	-136.0%
Pre-tax income	405	235	72.1%	240	68.9%	363	11.6%
Net profit	333	167	99.2%	230	44.8%	314	5.8%
EPS (TWD)	0.06	0.03	99.2%	0.05	30.4%	0.06	7.2%
<b>Margin analysis</b>							
Gross margin	24.6%	23.0%		22.8%		23.4%	
Operating margin	14.8%	12.9%		14.3%		14.7%	
Net margin	12.4%	7.9%		11.9%		12.1%	

Source: Deutsche Bank, Bloomberg Finance LP, company data

## Handset casing: Standing upon the shoulders of giants

Tongda's two largest handset customers – Huawei and Xiaomi – were showing accelerating momentum in the past two years by leveraging their 1) unique product design and 2) high cost/performance character. According to IDC's estimate, Huawei posted a 50% QoQ smartphone shipment increase vs. only 2% QoQ shipment growth in the China market.

Huawei is increasing metal casing adoption rate in its smartphone products, which helps differentiate its products over local/international competitors. As a major metal casing supplier to Huawei, Tongda is well positioned to benefit from the casing ASP hike as metal casing carries around 50% higher price vs. traditional plastic casing. Apart from this, Tongda also keeps broadening its customer base by tapping into other premium smartphone vendors' metal casing supply chain (OPPO in our view). We expect Tongda to deliver 47%/32% YoY handset casing revenue growth in 2015/2016E, which propels persistent earnings expansion for the company.

Figure 2: Worldwide smartphone shipment

mn units	2013Q1	2013Q2	2013Q3	2013Q4	2014Q1	2014Q2	2014Q3	2014Q4
Samsung	70	77	85	84	89	75	80	75
Apple	37	31	34	51	44	35	39	74
Lenovo	8	11	12	14	13	16	17	25
Huawei	9	10	13	17	14	20	16	24
Xiaomi	3	4	6	6	10	14	17	17
LG Electronics	10	12	12	13	12	15	17	16
TCL-Alcatel	2	3	5	7	6	8	9	14
ZTE	9	10	8	8	9	10	11	12
Sony	8	10	10	11	9	9	10	12
Microsoft	6	7	9	8	8	10	11	11
Others	58	65	71	73	76	90	107	101
Total	221	242	264	293	288	302	335	380

Source: IDC, company data, Deutsche Bank



Figure 3: Earnings revision

P/L Revision (TWD mn)	2013 (Actual)	2014E		2015E		2016E		% of change		
		Old	New	Old	New	Old	New	2014E	2015E	2016E
Net sales	3,627	4,699	4,791	5,808	5,801	6,920	7,041	2.0	-0.1	1.7
Gross profit	798	1,090	1,144	1,389	1,422	1,699	1,756	4.9	2.4	3.4
Operating expense	330	437	443	534	534	630	641	1.3	-0.1	1.7
Operating profit	468	653	701	854	888	1,069	1,116	7.3	4.0	4.3
Non-op gain/loss	-50	-55	-61	-40	-50	-44	-57	10.6	25.5	29.8
Pre-tax profit	418	598	640	815	838	1,025	1,059	7.0	2.9	3.2
Net profit	363	481	500	660	688	839	867	3.8	4.2	3.2
EPS (TWD)	0.07	0.09	0.09	0.12	0.13	0.15	0.16	5.2	5.6	4.6
Key ratio (%)										
Sales growth	6.4	29.6	32.1	23.6	21.1	19.2	21.4			
Gross margin	22.0	23.2	23.9	23.9	24.5	24.6	24.9			
Operating Margin	12.9	13.9	14.6	14.7	15.3	15.5	15.8			
Net margin	10.0	10.2	10.4	11.4	11.9	12.1	12.3			

Source: Deutsche Bank estimates, company data

### Upward EPS and target price revision

We increase our EPS forecasts by 5-6%, and accordingly raise our target price from HKD1.45 to HKD1.53 (still based on 12x 2015E EPS). 12x P/E is higher than the stock's historical trading average of 8x over the past four years. We believe Tongda's valuation will be re-rated, given its accelerated EPS growth (2014-16 EPS CAGR of 28% vs. 2010-13 EPS CAGR of 17%) and continued ROE expansion (15.3% in 2013 vs. 19.5% in 2016). 12x P/E multiple implies 0.46x PEG, which is in line with its historical PEG trading average (8x P/E over 15.3% EPS growth).

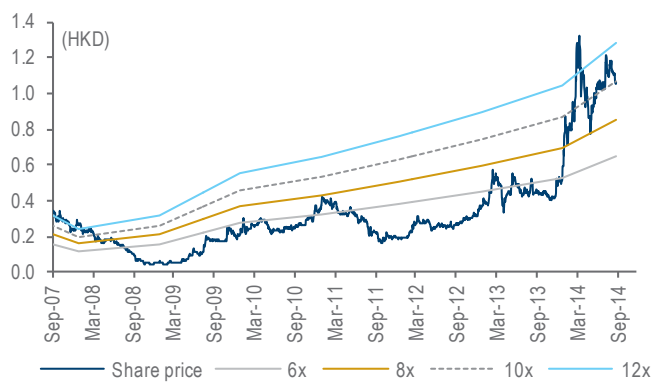
12x PER is in line with the trading average of its regional handset mechanical component peers.

Key share price catalysts for Tongda include new product launches from its major clients (Huawei and Xiaomi) and the rise of the metal casing business, which helps to drive up product ASP and gross margin.

Long-term growth drivers are derived from gross margin expansion (as a result of a favorable product mix change), Tongda's market share gain in the Chinese smartphone space and the organic growth of Chinese smartphones.



Figure 4: Forward P/E band



Source: Deutsche Bank, company data

Figure 5: Forward P/B band



Source: Deutsche Bank, company data

## Investment risks and sensitivity analysis

Risks to our target price being achieved include a gross margin decline as a result of intensified competition from local peers and slower-than-expected product upgrades, and/or slower sales growth due to weak demand for smartphones, and market share loss.

In order to assess key risks, we have conducted a sensitivity analysis with regard to changes to ASPs and gross margins, and their impact on our 2015 and 2016 EPS assumptions.

Figure 6: 2015 EPS sensitivity analysis

2015E EPS	% change in ASP assumption									
		-12.0%	-9.0%	-6.0%	-3.0%	0.0%	3.0%	6.0%	9.0%	12.0%
% change in gross margin assumption	-2.0%	0.090	0.095	0.101	0.106	0.111	0.116	0.122	0.127	0.132
	-1.5%	0.094	0.099	0.105	0.110	0.116	0.121	0.126	0.132	0.137
	-1.0%	0.098	0.103	0.109	0.114	0.120	0.126	0.131	0.137	0.142
	-0.5%	0.102	0.107	0.113	0.119	0.124	0.130	0.136	0.142	0.147
	0.0%	0.106	0.111	0.117	0.123	0.129	0.135	0.141	0.146	0.152
	0.5%	0.110	0.116	0.121	0.127	0.133	0.139	0.145	0.151	0.157
	1.0%	0.114	0.120	0.126	0.132	0.138	0.144	0.150	0.156	0.162
	1.5%	0.117	0.124	0.130	0.136	0.142	0.149	0.155	0.161	0.167
	2.0%	0.121	0.128	0.134	0.140	0.147	0.153	0.160	0.166	0.172

Source: Deutsche Bank estimates

Note 1: The column and row in blue represent the base-case scenario in our earnings model

Note 2: Other assumptions include: (1) 70% of opex is fixed and 30% is variable (in proportion to sales growth or decline); (2) non-op gain/loss (interest income/expense, forex gain/loss, etc), and tax rate are unchanged in our sensitivity analysis



Figure 7: 2016 EPS sensitivity analysis

2016E EPS	% change in ASP assumption									
		-12.0%	-9.0%	-6.0%	-3.0%	0.0%	3.0%	6.0%	9.0%	12.0%
% change in gross margin assumption	-2.0%	0.113	0.120	0.126	0.133	0.139	0.146	0.152	0.159	0.165
	-1.5%	0.118	0.125	0.131	0.138	0.145	0.151	0.158	0.165	0.171
	-1.0%	0.123	0.130	0.136	0.143	0.150	0.157	0.164	0.170	0.177
	-0.5%	0.127	0.134	0.141	0.148	0.155	0.162	0.169	0.176	0.183
	0.0%	0.132	0.139	0.146	0.154	0.161	0.168	0.175	0.182	0.189
	0.5%	0.137	0.144	0.151	0.159	0.166	0.173	0.181	0.188	0.195
	1.0%	0.142	0.149	0.156	0.164	0.171	0.179	0.186	0.194	0.201
	1.5%	0.146	0.154	0.161	0.169	0.177	0.184	0.192	0.199	0.207
	2.0%	0.151	0.159	0.166	0.174	0.182	0.190	0.198	0.205	0.213

Source: Deutsche Bank estimates

Note 1: The column and row in blue represent the base-case scenario in our earnings model

Note 2: Other assumptions include: (1) 70% of opex is fixed and 30% is variable (in proportion to sales growth or decline); (2) non-op gain/loss (interest income/expense, forex gain/loss, etc), and tax rate are unchanged in our sensitivity analysis

Figure 8: Semi-annual P&L highlights and sales breakdown

	1H13	2H13	2,013	1H14	2H14	2014	1H15E	2H15E	2015E
Sales	1,690	1,937	3,627	2,101	2,690	4,791	2,614	3,188	5,801
Gross profits	356	442	798	482	661	1,144	630	792	1,422
Op. profits	190	277	468	270	397	701	378	511	888
Non-op	-15	-38	-53	-35	7	-61	-20	-30	-50
Pre-tax income	175	240	415	235	405	640	358	481	838
Net profit	130	230	360	167	333	500	293	394	688
EPS (HKD)	0.03	0.05	0.07	0.03	0.06	0.09	0.05	0.07	0.13
<b>Margin Analysis (%)</b>									
Gross profits	21.0	22.8	22.0	23.0	24.6	23.9	24.1	24.9	24.5
Op. profits	11.3	14.3	12.9	12.9	14.8	14.6	14.4	16.0	15.3
Pre-tax income	10.4	12.4	11.4	11.2	15.0	13.4	13.7	15.1	14.4
Tax rate	25.7	4.1	13.3	29.0	17.8	21.9	18.0	17.9	18.0
<b>YoY growth (%)</b>									
Sales	21%	-4%	6%	24%	39%	32%	24%	18%	21%
Gross profits	15%	5%	9%	36%	50%	43%	31%	20%	24%
Op. profits	10%	1%	4%	42%	43%	50%	40%	28%	27%
Pre-tax income	12%	-2%	4%	34%	69%	54%	52%	19%	31%
Net profit	15%	23%	20%	28%	45%	39%	76%	19%	38%
<b>HoH growth (%)</b>									
Sales	-16%	15%		8%	28%		-3%	22%	
Gross profits	-16%	24%		9%	37%		-5%	26%	
Op. profits	-31%	46%		-3%	47%		-5%	35%	
Pre-tax income	-28%	37%		-2%	72%		-12%	34%	
Net profit	-30%	76%		-27%	99%		-12%	35%	
<b>Sales breakdown</b>									
Handset casing	48.7%	53.0%	45.6%	54.2%	50.4%	57.7%	62.1%	60.1%	63.1%
Electrical appliance	16.0%	14.1%	15.4%	9.8%	12.3%	11.7%	9.1%	10.2%	10.7%
Notebook casing	13.2%	13.8%	13.7%	12.8%	13.2%	9.4%	9.1%	9.2%	7.1%
Mechanical part	13.3%	14.6%	14.9%	13.9%	14.4%	12.2%	12.0%	12.1%	11.3%
Communication equipment & others	8.8%	4.5%	10.4%	9.2%	9.8%	9.0%	7.8%	8.4%	7.9%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Company data, Deutsche Bank



# Appendix 1

## Important Disclosures

Additional information available upon request

### Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Tongda Group	0698.HK	1.12 (HKD) 19 Mar 15	NA

\*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Data is sourced from Deutsche Bank and subject companies.

For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/Disclosure.egsr?ricCode=0698.HK>

## Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s) about the subject issuer and the securities of the issuer. In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Birdy Lu

### Historical recommendations and target price: Tongda Group (0698.HK)

(as of 3/19/2015)



#### Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

#### Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

\*New Recommendation Structure as of September 9, 2002

1.	19/09/2014:	Upgrade to Buy, Target Price Change HKD1.43	2.	07/01/2015:	Buy, Target Price Change HKD1.45
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Equity rating key

Buy: Based on a current 12- month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield ) , we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Notes:

1. Newly issued research recommendations and target prices always supersede previously published research.

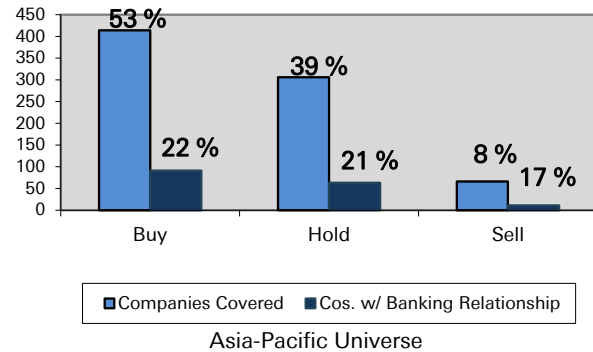
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Buy: Expected total return (including dividends) of 10% or more over a 12-month period

Hold: Expected total return (including dividends) between -10% and 10% over a 12-month period

Sell: Expected total return (including dividends) of -10% or worse over a 12-month period

Equity rating dispersion and banking relationships







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