

Coolpad Group Limited (2369 HK)

Reduce

Target price (HKD)	1.20
Share price (HKD)	1.50
Upside/Downside (%)	-20

Dec	2013 a	2014 e	2015 e
HSBC EPS	0.08	0.12	0.12
HSBC PE	18.5	12.8	12.8
Performance	1M	3M	12M
Absolute (%)	0.7	6.4	-23.9
Relative^ (%)	-0.4	1.0	-39.4

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Reduce: 2H14 results a miss; FY15e a difficult year

- ▶ **2H14 results a miss**
- ▶ **Rebuilding channels takes time**
- ▶ **Establish Reduce rating and set fair value TP of HKD1.2**

2H14 results a miss. 2H14 net profit was HKD100mn (up 76% HoH, down 28% YoY) on sales of HKD10bn (down 33% HoH, flatish YoY). 2H14 earnings were 79%/58% behind HSBC/consensus estimates owing to slower shipment and pricing competition of entry-level 4G phones, especially after Chinese carriers cut subsidy last May. Its gross margin contracted 3.6pts HoH to 9.9%. This is 3.0/2.6pts lower than HSBC/consensus estimates, because ASP of entry-level 4G phones dropped more than 30% in 2H14.

Rebuilding channel takes time. More than 80% of Coolpad's shipment in FY14 went to carriers. Given shrinking carrier market in China after subsidy cut last May, Coolpad restructured its smartphone business into four units – (1) Coolpad for carriers market, (2) Ivvi for open market, (3) Dazen for on-line channel and (4) overseas market. However rebuilding channels takes time. Among all channels, the on-line channel is easier in our view. Coolpad announced in Dec 2014 it would sell a 45% stake in Dazen to Qihoo. We expect the shipment of Dazen can triple to 15mn units in FY15 owing to its better cost performance compared to its other lines.

Establish Reduce rating with a fair value TP of HKD1.2 (from our 12-month TP of HKD1.6 under our previous rating system). To reflect worse than expected competition and pricing environment, we reduced our FY15e/FY16e sales by 12%/26% to HKD30.4bn/HKD30.8bn and our FY15e/FY16e EPS estimates by 28%/47% to HKD0.12/HKD0.11, respectively. We lowered FY15/FY16 operating margin assumptions from 2.6%/2.6% to 2.1%/1.9%. We see fair value at 10x FY15e earnings, which represents our TP of HKD1.2. Our 10x multiple is where the stock traded in the down cycle in the past five years. The upside risks include: better-than-expected handset demand and faster-than-expected progress in overseas markets.

Coolpad: Financials and valuation

	Revenue (HKDm)	Cons revenue (HKDm)	EPS (HKD)	Con EPS (HKD)	P/E (x)	ROE (%)	Div yield (%)
2014a	24,900	NA	0.12	NA	12.8	17.3	1%
2015e	30,430	34,396	0.16	0.19	12.8	15.0	1%
2016e	30,786	41,266	0.18	0.21	14.3	11.9	1%

Source: Company data, HSBC estimates and Bloomberg consensus

Index^	HSCEI	Enterprise value (HKDm)	3005
Index level	12,178	Free float (%)	59
RIC	2369.HK	Market cap (USDm)	831
Bloomberg	2369 HK	Market cap (HKDm)	6,444

Source: HSBC

Source: HSBC

Financials & valuation

Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Profit & loss summary (HKDm)				
Revenue	19,624	24,900	30,430	30,786
EBITDA	633	866	823	755
Depreciation & amortisation	-172	-172	-172	-172
Operating profit/EBIT	461	695	651	583
Net interest	-23	-87	-50	-44
PBT	437	607	601	539
HSBC PBT	437	607	601	0
Taxation	-89	-93	-87	-78
Net profit	349	515	514	461
HSBC net profit	349	515	514	461

Cash flow summary (HKDm)

Cash flow from operations	647	2,556	-1,870	4,629
Capex	-145	-145	-145	-145
Cash flow from investment	-235	-145	-145	-145
Dividends	-105	-88	-44	-44
Change in net debt	-311	-2,323	2,058	-4,440
FCF equity	390	2,231	-2,151	4,362

Balance sheet summary (HKDm)

Intangible fixed assets	0	0	0	0
Tangible fixed assets	568	541	514	487
Current assets	8,811	9,110	11,113	10,136
Cash & others	1,628	3,952	1,893	6,334
Total assets	10,062	10,335	12,311	11,306
Operating liabilities	6,698	6,543	8,049	6,627
Gross debt	603	603	603	603
Net debt	-1,025	-3,349	-1,290	-5,731
Shareholders funds	2,761	3,188	3,659	4,076
Invested capital	1,053	-844	1,685	-2,338

Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Y-o-y % change				
Revenue	36.4	26.9	22.2	1.2
EBITDA	6.4	37.0	-5.1	-8.2
Operating profit	-3.9	50.7	-6.3	-10.4
PBT	4.6	38.7	-0.9	-10.3
HSBC EPS	-46.3	44.6	-0.2	-10.3

Ratios (%)

Revenue/IC (x)	19.2	239.0	72.4	-94.2
ROIC	35.9	565.0	132.5	-152.7
ROE	13.5	17.3	15.0	11.9
ROA	3.8	5.0	4.5	3.9
EBITDA margin	3.2	3.5	2.7	2.5
Operating profit margin	2.3	2.8	2.1	1.9
EBITDA/net interest (x)	27.3	9.9	16.5	17.2
Net debt/equity	-37.1	-105.0	-35.3	-140.6
Net debt/EBITDA (x)	-1.6	-3.9	-1.6	-7.6
CF from operations/net debt				

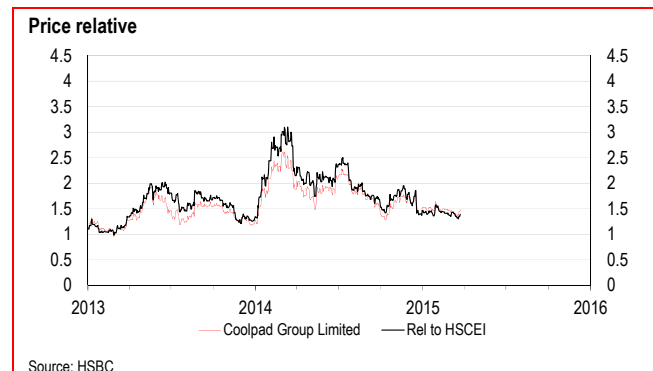
Per share data (HKD)

EPS reported (fully diluted)	0.08	0.12	0.12	0.11
HSBC EPS (fully diluted)	0.08	0.12	0.12	0.11
DPS	0.02	0.01	0.01	0.01
Book value	0.64	0.73	0.83	0.93

Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	0.3	0.1	0.2	0.0
EV/EBITDA	8.5	3.5	6.2	0.8
EV/IC	5.1		3.0	
PE*	18.5	12.8	12.8	14.3
P/Book value	2.3	2.1	1.8	1.6
FCF yield (%)	6.1	35.1	-33.9	68.7
Dividend yield (%)	1.3	0.7	0.7	0.6

Note: * = Based on HSBC EPS (fully diluted)



Note: price at close of 24 Mar 2015

A bumpy road ahead

- ▶ 2H14 results a miss
- ▶ Rebuilding channels takes time
- ▶ Establish Reduce rating and set fair value TP of HKD1.2

2H14 results a miss

2H14 net profit was HKD100mn (EPS: HKD0.02, up 76% HoH, down 28% YoY) on sales of HKD10bn (down 33% HoH, flattish YoY). 2H14 earnings were 79%/58% behind HSBC/consensus estimates owing to slower shipment and pricing competition of entry-level 4G phones, especially after Chinese carriers cut subsidy last May. Its gross margin contracted 3.6pts HoH to 9.9%. This is 3.0/2.6pts lower than HSBC/consensus estimates, because ASP of entry-level 4G phones dropped more than 30% in 2H14. Coolpad managed to lower opex ratio from 10.2% in 1H14 to 8.1% in 2H14. It was better than HSBC/consensus estimates but not enough to offset the gross margin contraction, leading operating margin to miss HSBC/consensus estimates, Cash conversion cycle was 55.8 days versus 56.6 for FY13. Inventory days came down by 2 days YoY to 45 days, considered to be healthy. Board of Director proposed not to distribute final dividend for FY14 earnings. This is disappointing but should not be surprising given its poor set of earnings in 2H14.

Coolpad: 2H14 results snapshot

(HKDm)	2H14a	1H14a	H/H	2H13a	Y/Y	HSBCe	Diff.	Cons.	Diff.
Revenue	9,966	14,935	-33%	9,976	0%	18,430	-46%	14901	-33%
Gross Profit	990	2,026	-51%	1,260	-21%	2,376	-58%	1863	-47%
GP Margin (%)	9.9%	13.6%	-3.6 pts	12.6%	-2.7 pts	12.9%	-3 pts	12.5%	-2.6 pts
Operating Profit	181	514	-65%	186	-3%	584	-69%	584	-69%
OP Margin (%)	1.8%	3.4%	-1.6 pts	1.9%	0 pts	3.2%	-1.4 pts	3.9%	-2.1 pts
Non-Operating	(57)			(8)		(31)		(222)	
Pre-Tax Income	124	483	-74%	178	-30%	553	-78%	362	-66%
After-Tax Income	100	413	-76%	136	-26%	473	-79%	286	-65%
EPS (HKD)	0.02	0.09	-76%	0.03	-28%	0.11	-79%	0.07	-65%

Source: Company data, HSBC estimates, Bloomberg consensus

Hurt by heavy reliance on Chinese carriers after subsidy cut

Coolpad shipped 45mn units of smartphones in FY14, up from 34mn units in FY13. 43mn units were shipped into domestic market and we estimate more than 80% of these shipments were shipped to carriers. Coolpad had a strong 1H14 owing to its first mover advantage in 4G in China. However, the shipment sharply slowed down in 3Q14 after Chinese carriers reduced subsidy in May. As a result, Coolpad

restructured its smartphone business into four units – (1) Coolpad for carriers market, (2) Ivvi for open market, (3) Dazen for on-line channel and (4) overseas market.

Rebuilding channel takes time

Coolpad historically has had strong working relationship with Chinese carriers. Given shrinking carrier market in China after subsidy cut last May, Coolpad is trying to diversify its distribution channel including overseas markets. We estimate Coolpad shipped less than 3m units of smartphone overseas and believe the progress will be slow owing to the nature of dealing with overseas carriers. We only forecast 5 mn units in FY15 for overseas market. Coolpad is late in moving into open channel. It will take time to climb the learning curve. For the on-line channel, Coolpad announced in Dec 2014 it would a 45% stake in Dazen to Qihoo 360 and the deal is expected to be concluded by the middle of 2015. Coolpad shipped around 5 mn units of on-line brand Dazen and we expect the shipment could triple to 15mn units in FY15 owing to its better cost performance compared to its other phones. Nonetheless Coolpad will share its profit from selling Dazen with Qihoo 360.

Establish Reduce rating and set fair value TP of HKD1.2

To reflect worse than expected competition and pricing environment, we reduced our FY15e/FY16e sales by 12%/26% to HKD30.4bn/HKD30.8bn and our FY15/FY16 EPS estimates by 28%/47% to HKD0.12/HKD0.11, respectively. We lowered FY15/FY16 operating margin assumptions from 2.6%/2.6% to 2.1%/1.9%. We see fair value at 10x FY15e earnings, which represents our TP of HKD1.2. Our 10x multiple is where the stock traded in the down cycle in the past five years. Upside risks include: better-than-expected handset demand and faster-than-expected progress in overseas markets.

Coolpad: forecast revisions

(HKDm)	2014			2015e			2016e		
	HSBCe	Actual	% Change	Old	New	% Change	Old	New	% Change
Revenue	33,364	24,900	-25%	34,396	30,430	-12%	41,721	30,786	-26%
Gross Profit	4,402	3,015	-32%	4,303	3,671	-15%	5,124	3,575	-30%
Operating Income	1,098	695	-37%	889	651	-27%	1,078	583	-46%
Net Income	886	515	-42%	708	514	-27%	869	461	-47%
EPS	0.20	0.12	-42%	0.16	0.12	-28%	0.20	0.11	-47%
Gross Margin	13.2%	12.1%	-1 pts	12.5%	12.1%	0 pts	12.3%	11.6%	-1 pts
Operating Margin	3.3%	2.8%	-1 pts	2.6%	2.1%	0 pts	2.6%	1.9%	-1 pts
Net Margin - post EE	2.7%	2.1%	-1 pts	2.1%	1.7%	0 pts	2.1%	1.5%	-1 pts

Source: Company data, HSBC estimates

Coolpad: Semi-annual earnings forecast

(HKDm)	Fiscal 2012	Fiscal 2013		Fiscal 2013	Fiscal 2014		Fiscal 2014	Fiscal 2015		Fiscal 2015E	Fiscal 2016		Fiscal 2015E
		1H13	2H13		1H14	2H14		1H15E	2H15E		1H16E	2H15E	
Sales	14,390	9,648	9,976	19,624	14,935	9,966	24,900	13,444	16,986	30,430	14,303	16,483	30,786
QoQ		18%	3%		50%	-33%		35%	26%		-16%	15%	
YoY	96%	55%	22%	36%	55%	0%	27%	-10%	70%	22%	6%	-3%	1%
Gross profit	1,751	1,270	1,260	2,530	2,026	990	3,015	1,625	2,046	3,671	1,694	1,881	3,575
GM	12%	13%	13%	13%	14%	10%	12%	12%	12%	12%	12%	11%	12%
Operating Income	479	275	186	461	514	181	695	291	360	651	289	295	583
OPM	3%	3%	2%	2%	3%	2%	3%	2%	2%	2%	2%	2%	2%
Pre-tax Income	418	260	178	437	483	124	607	266	335	601	267	273	539
PBT margin	3%	3%	2%	2%	3%	1%	2%	2%	2%	2%	2%	2%	2%
Net Profit	326	213	136	349	413	102	515	227	287	514	228	233	461
NM	2%	2%	1%	2%	3%	1%	2%	2%	2%	2%	2%	1%	1%
QoQ		23%	-36%		204%	-75%		122%	26%		-20%	2%	
YoY	20%	40%	-22%	7%	94%	-25%	48%	-45%	180%	0%	0%	-19%	-10%
EPS (HKD)	0.151	0.050	0.032	0.081	0.095	0.023	0.117	0.052	0.065	0.117	0.052	0.053	0.105
QoQ		-38%	-36%		199%	-75%		122%	26%		-20%	2%	
YoY	24%	-29%	-61%	-46%	91%	-26%	45%	-45%	180%	0%	0%	-19%	-10%

Source: Company data, HSBC estimates

Disclosure appendix

Analyst Certification

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From 23rd March 2015 HSBC has assigned ratings on the following basis:

The target price is based on the analyst's assessment of the stock's actual current value, although we expect it to take six to 12 months for the market price to reflect this. When the target price is more than 20% above the current share price, the stock will be classified as a Buy; when it is between 5% and 20% above the current share price, the stock may be classified as a Buy or a Hold; when it is between 5% below and 5% above the current share price, the stock will be classified as a Hold; when it is between 5% and 20% below the current share price, the stock may be classified as a Hold or a Reduce; and when it is more than 20% below the current share price, the stock will be classified as a Reduce.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation or resumption of coverage, change in target price or estimates).

Upside/Downside is the percentage difference between the target price and the share price.

Prior to this date, HSBC's rating structure was applied on the following basis:

For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The target price for a stock represented the value the analyst expected the stock to reach over our performance horizon. The performance horizon was 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, had to exceed the required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). For a stock to be classified as Underweight, the stock was expected to underperform its required return by at least 5 percentage points over the succeeding 12 months (or 10 percentage points for a stock classified as Volatile*). Stocks between these bands were classified as Neutral.

*A stock was classified as volatile if its historical volatility had exceeded 40%, if the stock had been listed for less than 12 months (unless it was in an industry or sector where volatility is low) or if the analyst expected significant volatility. However, stocks which we did not consider volatile may in fact also have behaved in such a way. Historical volatility was defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility had to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

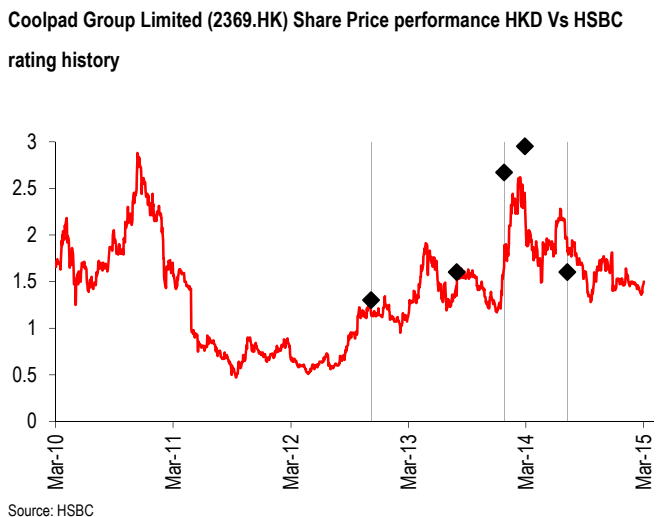
Rating distribution for long-term investment opportunities

As of 24 March 2015, the distribution of all ratings published is as follows:

Buy	41%	(30% of these provided with Investment Banking Services)
Hold	39%	(28% of these provided with Investment Banking Services)
Sell	20%	(20% of these provided with Investment Banking Services)

For the purposes of the distribution above the following mapping structure is used during the transition from the previous to current rating models: under our previous model, Overweight = Buy, Neutral = Hold and Underweight = Sell; under our current model Buy = Buy, Hold = Hold and Reduce = Sell. For rating definitions under both models, please see “Stock ratings and basis for financial analysis” above.

Share price and rating changes for long-term investment opportunities



Recommendation & price target history		
From	To	Date
N/A	Neutral (V)	28 November 2012
Neutral (V)	Overweight (V)	15 January 2014
Overweight (V)	Underweight (V)	30 July 2014
Target Price	Value	Date
Price 1	1.30	28 November 2012
Price 2	1.60	21 August 2013
Price 3	2.67	15 January 2014
Price 4	2.95	21 March 2014
Price 5	1.60	30 July 2014

Source: HSBC

HSBC & Analyst disclosures

Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
COOLPAD GROUP LIMITED	2369.HK	1.50	24-Mar-2015	4

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
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