

Rating:

Buy

Maintain at Buy

- The sales revenue and net profit of Tongda Group has reached about 2.1 billion HKD (similarly hereinafter) and 167 million in 1H14, respectively increasing by 24.3% and 28.3% yearly which mainly benefits from the over-expectation performance of non-phone revenue and the promotion of profitability. The gross profit margin rises to 23.0% from 21% compared with the same period of last year, and gross profit increases by 35.6% to 482 million. Overall speaking, it maintains a steady growth.
- The growth of cellphone casing business slowed down in the first half of year. But in the next half of year, China Telecom and China Unicom will accelerate the 4G construction and will provide pre-commercial services in 16 cities, and more alternative terminals and the 4G tariff which is hopeful to go down again may stimulate the shipment of 4G cellphones. The market shares of Tongda's major clients such as Huawei, Lenovo, Xiaomi and Coolpad are further rising. Meanwhile, the newly built plants in Xiamen are predicted to go into operation in September, the number of CNC machines will increase from 200 in 2013 to 500 at the end of this year, and the company's cellphone casing business will be improved both in production capacity and product structure.
- The data of July shows that the selling of household appliances in inland is persistently improved. In addition, China may launch subsidy programs to encourage the wider use of energy-efficient household appliances, together with the successive withdrawal of home-purchase restriction policies. The household appliance industry is hopeful to continue the trend of recovery, and the company will also benefit from this.
- The company begins to disperse the business into the production of automobile parts. The auto industry is holding a steady growth, and the annual output of 90 million cars shows that the market witnesses a broad prospect. In addition, auto parts also enjoy good profitability, so we predict that auto parts are hopeful to become the new growth impetus of the company in the medium term.

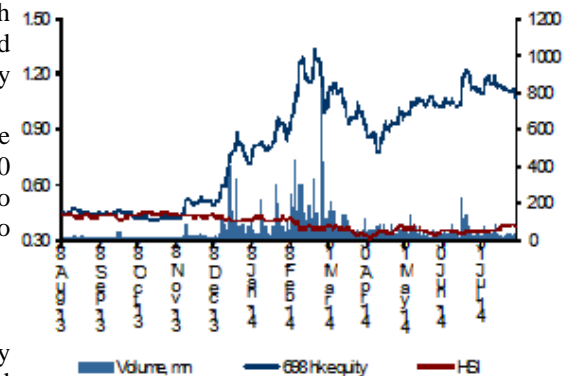
Target Price (HKD)	1.37
Forecast Dividend (RMB)	0.04
Closing Price (HKD)	1.07
Potential Upside	31.8%

Company Description

Tongda Group mainly produces casings applied to handsets, notebook computer, and electrical appliances including refrigerators and air conditioners. The company plans to continue to increase input in cellphone business, and LDS antenna technique will become main growth motivation.

Company Data

Market Cap. (HKD mn)	5,902
Enterprise Value (HKD mn)	6,765
52 week range (HKD)	889 - 14.72
Closing Price in 52 week range	



Major Shareholders

1 Wang Yanan	47.43%
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Investment Action

The factors such as the slowing down of smartphone's growth, etc. make the company perform poorly. But in the next half of year, both cellphone shell and household appliance business will face the possibility of improvement. In the meantime, the promotion expectation of product structure will still support the improvement of profitability.

Although the company's scale of operation is not equipped with any advantage now, its ability of sustainable growth is rare in the same industry. Based on more optimistic prospect in the second half of year, we give the company the valuation level of 15 P/E times earnings per share corresponding to 2014, and the target price of 1.37 HKD, with the rating of "Buy".

Key Financial Summary

FYE	12/12	12/13	12/14F	12/15F
Turnover (HKD mn)	3,408	3,627	4,705	5,957
Net Profit, adj. (HKD mn)	300	360	472	620
EPS, adj. (HKD)	0.06	0.08	0.09	0.11
P/E (X)	16.9	14.5	11.8	9.5
BVPS (HKD)	0.44	0.53	0.58	0.66
P/B (X)	2.40	2.10	1.90	1.60
DPS (HKD)	0.02	0.03	0.04	0.04
Div. Yield	1.9%	2.3%	3.2%	3.7%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

P/E

Research Department

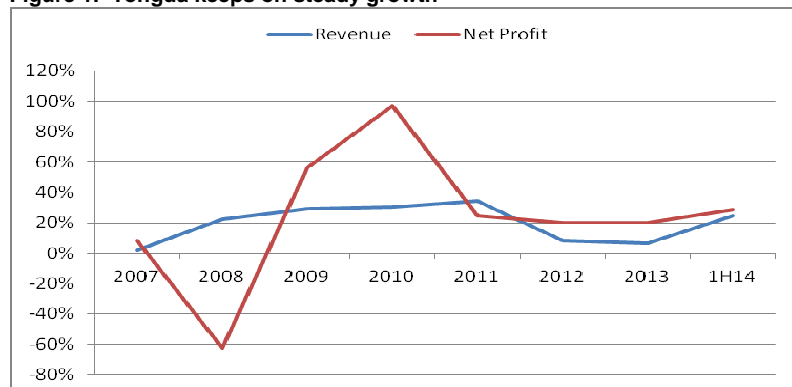
research@phillip.com.cn

+86 21 51699400-110

Solid growth in 1H14

The interim report of 2014 show that the sales revenue and net profit of Tongda Group has reached about 2.1 billion HKD (similarly hereinafter) and 167 million in 1H14, respectively increasing by 24.3% and 28.3% yearly which mainly benefits from the over-expectation performance of non-phone revenue and the promotion of profitability. The gross profit margin rises to 23.0% from 21% compared with the same period of last year, and gross profit increases by 35.6% to 482 million. Overall speaking, it maintains a steady growth.

Figure 1. Tongda keeps on steady growth

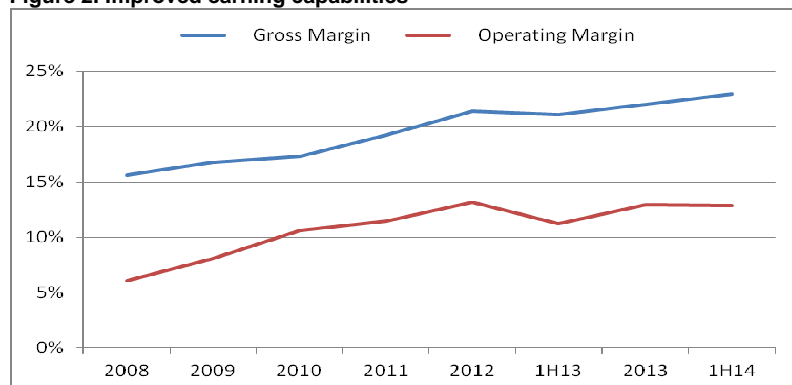


Source: Company reports; PSR

According to category, although benefiting from becoming the certified supplier of Xiaomi and Coolpad and the increased market share of domestic cellphone brands, the slowing down of smartphones' growth makes the turnover growth of cellphone casing business accounting for half of its revenue slow down to 16.4%, reaching about 960 million. But the performance of other businesses exceeds the expectation, for example: the selling of electrical appliance business increases by 19.9% from 270 million to 324 million compared with the same period of last year; in the aspect of laptop, though the client Sony VAIO is lost, benefiting from the order growth of HP, Lenovo and NEC, and the income increases by 28.5% to 287 million; while ironware component department benefits from the increase of the demand for high-end household electrical appliances IML decoration shell, and the revenue increases by 39.8% from 224 million to 314 million; the revenue of communication equipment department also increases by 47.0% from 148 million to 218 million on year-on-year basis; and the demand for SATV receiver and plastic STB shell increases under the World Cup effect.

The company's profitability continues to increase, the gross profit margin increases from 21.0% to 23.0% on year-on-year basis, while the operating profit margin increases from 11.2% to 12.9%, among which the operating profit margin of electrical accessories increases from 12% to 14.5%, and the operating profit margin of communication equipment vastly increases from 5.1% to 11.5%.

Figure 2. Improved earning capabilities

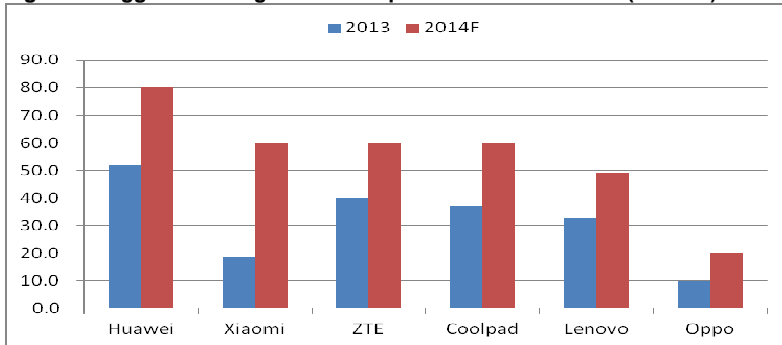


Source: Company reports; PSR

The growth of smartphone in 2H14 may speed up

Although the growth of phone shell business slowed down in the first half of year, we expect that it will speed up in the second half of year. The 4G business of China Mobile is on the trend of steady increasing, and the number of clients in the first half of year was only about 13.94 million, but the monthly growth of July increased by over 10% to 6.5 million. Looking into 2H14, China Telecom and China Unicom will accelerate the 4G construction and will provide pre-commercial service in 16 cities, more alternative terminals and the 4G tariff that is hopeful to decrease again may stimulate the shipment of 4G cellphones. Meanwhile, the market shares of its major clients such as Huawei, Lenovo, Xiaomi and Coolpad are further rising, which planned the annual growth of 50% to 220% respectively, and completed the annual target of 43% to 65% in the first half of year.

Figure 3. Aggressive targets of smartphone vendors in 2014 (m units)



Source: PSR

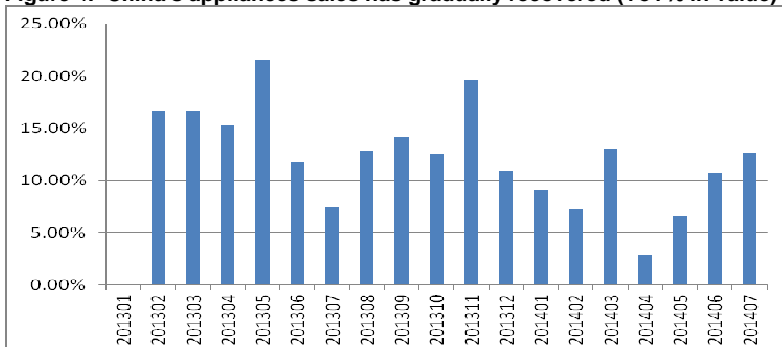
In addition, the company has also built new plants in Xiamen, and the plants are expected to go into operation in September. What is worth mentioning, the company is vastly investing in metal shell production capacity, the number of CNC machines will increase from 200 in 2013 to 500 at the end of this year, and the metal shell enjoy more attractive selling price and profitability in general. Therefore, the cellphone shell business of the company will be improved both in production capacity and product structure.

Electric appliance shell business is hopeful to recover

After the global financial crisis in 2008, China has launched a series of household appliance subsidy programs, and the stimulation policy of 4 trillion yuan made the demand for household appliances released in advance. The related business of Tongda realized the fast growth of 176% and 35% in 2009 and 2010 respectively, but the income of household appliance shell continued to decrease in the past two years because of the withdrawal of relative subsidy policies.

In 1H14, although domestic real estate market became sluggish, the electric appliance shell business of Tongda vastly increased by 20%, and the latest data of July shows that the selling of household appliances in inland continues to improve. What is worth mentioning, China may launch subsidy programs to encourage the wider use of energy-efficient household appliances, and household appliance industry is hopeful to continue the trend of recovery, and the company will also benefit from it.

Figure 4. China's appliances sales has gradually recovered (YoY% in value)

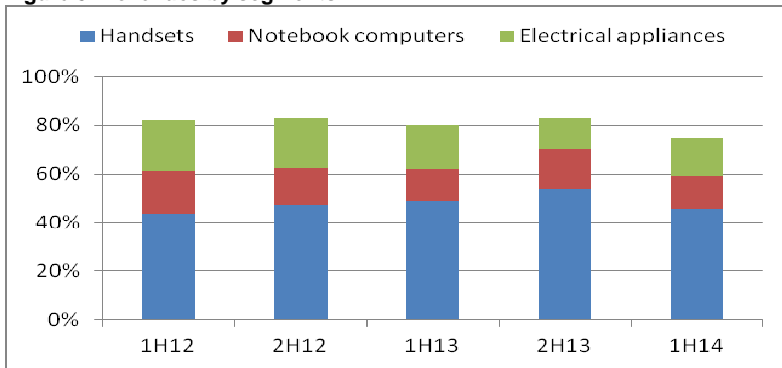


Source: PSR

Auto parts may become the new driving force

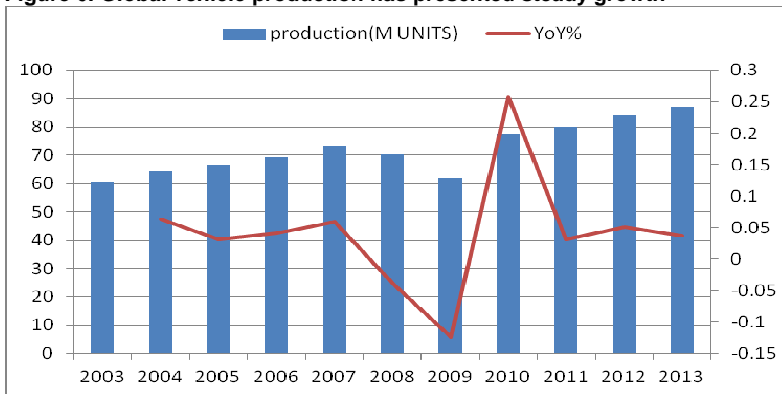
In the past 10 years, it was the diversified business structure of cellphones, laptops and electric appliances that ensured the solid growth of the company. However, the company starts to disperse the business into the production of auto parts this year, and produces decoration parts for a Sino-US joint automobile brand set up in Shanghai from the beginning of this year. We think that this action aims to relieve the downturn of laptops and other businesses. The auto industry is always on the trend of steady growth, and the annual production of 90 million cars shows that the market witnesses broad prospect. In addition, auto parts also provide good profitability, and the gross profit margin of over 30% far exceeds the current level of about 20% of the company. Therefore, we expect that the auto parts are hopeful to become the new growth impetus of the company.

Figure 5. Revenues by segments



Source: Company reports; PSR

Figure 6. Global vehicle production has presented steady growth



Source: OICA, PSR

Catalyst

New plants are put into operation;
To win more smartphone vendors.

Risks

Price pressure by intensified competition of smartphone vendors;
New plants are not put into operation as expected.

Periodicity:	2011	2012	2013	2014F	2015F
Valuation Ratios					
Price Earnings	20.0x	16.9x	14.5x	11.8x	9.5x
Price to Book	2.7x	2.4x	2.1x	1.9x	1.6x
Dividend Yield	1.6%	1.9%	2.3%	3.2%	3.7%
Per share data(HK\$)					
EPS Adjusted	0.054	0.064	0.075	0.092	0.113
Book Value Per Share	0.397	0.441	0.525	0.582	0.660
Dividends Per Share	0.017	0.020	0.025	0.035	0.040
Growth & Margin					
Revenue growth	34.02%	8.29%	6.42%	29.71%	26.62%
Gross profit growth	48.52%	20.70%	9.22%	35.59%	28.82%
Net profit growth	24.57%	19.85%	20.00%	31.11%	31.36%
Profitability Ratios					
Gross Margin	19.2%	21.4%	22.0%	23.0%	23.4%
Operating Margin	11.5%	13.1%	12.9%	14.1%	14.5%
Net Profit Margin	8.0%	8.8%	9.9%	10.0%	10.4%
Dividend Payout Ratio %	31.8%	31.8%	33.5%	38.2%	35.2%
Key ratios					
Return on Assets	7.4%	7.6%	8.1%	8.8%	9.7%
Return on Equity	14.4%	15.2%	15.2%	15.4%	16.4%
Balance Sheet Ratios					
Liability ratio	48.77%	47.84%	45.27%	41.14%	40.00%
Effective Tax Rate	23.0%	16.8%	11.1%	13.0%	13.0%
Income Statement(HK\$: mn)					
Revenue	3,147	3,408	3,627	4,705	5,957
- Cost of Goods Sold	2,542	2,677	2,829	3,622	4,563
Gross Income	605	731	798	1,082	1,394
- Selling, General & Admin Expenses	254	295	357	447	566
Operating Income	361	448	468	665	865
- Interest Expense	53	49	52	55	62
Pretax Income	337	401	415	600	793
- Income Tax Expense	77	67	46	78	103
Income Before XO Items	260	334	369	522	690
- Minority Interests	9	34	9	50	70
Net Profit	250	300	360	472	620



PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005