

7 November 2014

BYD Electronic (285.HK)

Metal casings may become the mainstream trend

Rating : **Buy**

HONG KONG | TMT | RESEARCH REPORT

Upgrade to Buy

- The third quarter performance of BYD Electronic (BYDE) fell short of expectations. The company is one of the few subsidiaries that are not fully owned by BYD (002594.SH), sharing holding of only about 65.76%. The performance of the company is also highly related to the minority interest of the parent company. According to the 3Q14 report of BYD, BYDE's net profit may just be about 80 to 100 million Yuan in the third quarter, only 15% of that in the 1H14. We think that the declining tendency of the performance is limited by the de-stocking of 3G cellphones and has something to do with the limited contribution of Samsung.
- The penetration rate of metal casing cell phones had reached 15% in 2013. According to the application trend of metal parts in digital cameras, tablets, ultrabooks, etc., we believe that the application of metal casing in mobile phones will also become a mainstream. Samsung, which has the largest share in smart phones, launched two types of mid-level smartphones-Galaxy A5 and Galaxy A3- at the end of this October. They are also Samsung's first smartphone products with metal casings. Based on the wide application of metal cases, we expect that the penetration rate of it will increase to 30%.
- the manufacturers from Taiwan will mainly meet the increasing demand of Apple. The rest non-Apple smart phones will be given by the CNC capacity of manufacturers such as BYD Electronic. It is predicted that the number of CNC will increase from 4000 in 2013 to 5000 in 2014, only next to Catcher, Foxconn and Casetek in Taiwan. The company is projected to be the major beneficiary of the application of metal casings in non-Apple smart phone products like Samsung. Meanwhile, its profitability can be also improved.

Investment Action

The third quarter performance of the company has fallen short of expectations. But with metal casings more and more widely used in Samsung, the biggest mobile phone manufacturer, along with the benchmarking effect of Apple, the application of metal casings will become a mainstream and the company is projected to be the major beneficiary. Even with the market concern of the ceiling effect of smartphone market, the wearable devices will provide sufficient opportunities for the application of metal casings.

As for the valuation, the company has had an average price earnings ratio of 10.8 since its public listing. Considering that the company is the major beneficiary of the application of the metal casings, we grant it 14 times EPS for 2015, the target price can reach 10.78 HKD, with "Buy" rating.

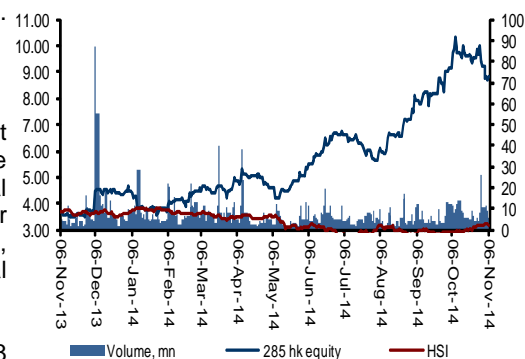
Target Price (HKD)	10.78
Forecast Dividend (CNY)	0.09
Closing Price (HKD)	8.84
Potential Upside	23.3%

Company Description

BYD Electronic (BYDE) is a supplier which provides international advanced level of services of mobile phone parts integration, module production and mobile phone assembly. Currently, its main businesses focus on providing mobile phone manufacturers with handset components and modules (mainly including plastic casing, metal casings, and keypads). It also provides assembly services for handsets.

Company Data

Market Cap. (HKD mn)	19,918
Enterprise Value (HKD mn)	13,674
52 week range (HKD)	3.46 - 10.76
Closing Price in 52 week range	



Major Shareholders

1. BYD Company Limited	65.21%
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Key Financial Summary

FYE	12/12	12/13	12/14F	12/15F
Turnover (CNY mn)	14,091	16,063	19,158	22,026
Net Profit, adj. (CNY mn)	379	648	1,059	1,377
EPS, adj. (CNY)	0.17	0.29	0.47	0.61
P/E (X)	41.3	24.2	14.9	11.5
BVPS (CNY)	3.66	3.92	4.36	4.88
P/B (X)	1.92	1.79	1.61	1.44
DPS (CNY)	0.00	0.03	0.09	0.12
Div. Yield	0.0	0.0	1.34%	1.74%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

Valuation Method

P/E

Research Analyst

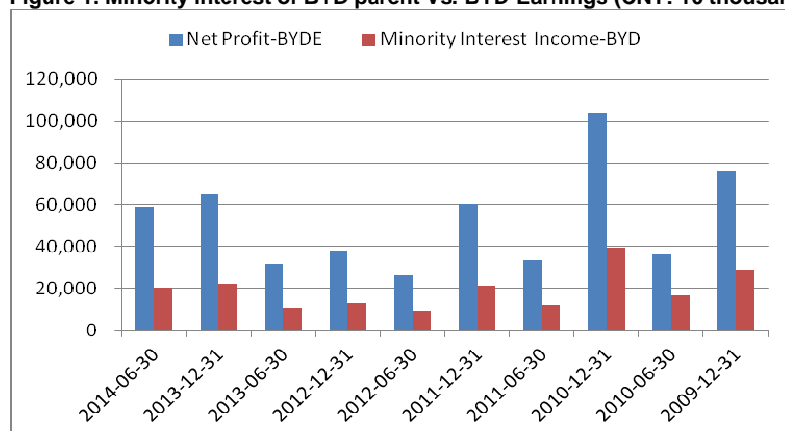
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The third quarter performance may fall short of expectations

After experiencing the continuous lethargy from 2011 to 2012, with the timely strategic transformation of its major clients in the later period, BYD Electronic successfully obtained orders from notable smartphone manufacturers, and therefore stopped the tendency of decline. The company also recorded substantial growth in 2013 and 1H14, with the growth of 71% and 86% respectively.

Nevertheless, we expect that its performance in the third quarter will not reach expectations. The company is one of the few subsidiaries that are not fully owned by BYD, sharing holding of only about 65.76%. The performance of BYDE is highly related to the minority interest of the parent company. According to the 3Q14 report of BYD, BYDE's net profit of the third quarter may just be about 80 to 100 million Yuan, only 15% of the level of that in the H1. We think that the declining tendency of the performance is limited by the de-stocking of 3G cellphones and has something to do with the limited contribution of Samsung.

Figure 1. Minority interest of BYD parent Vs. BYD-Earnings (CNY: 10 thousands)

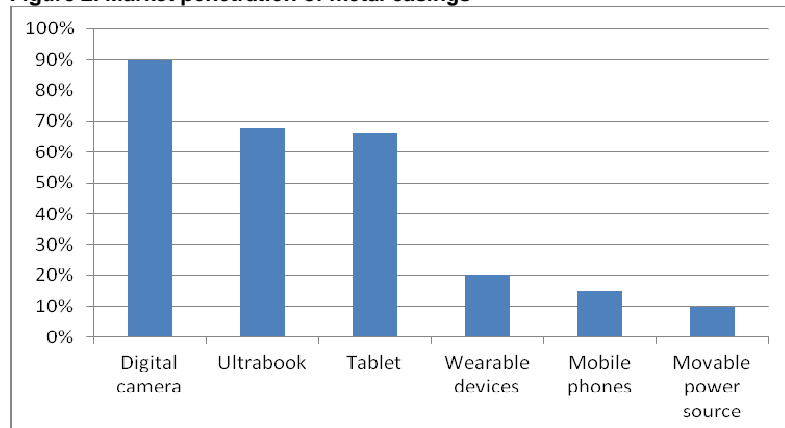


Sources: Company reports, Phillip Securities

The application of metal casings may become the mainstream trend

Metal casing cell phones are the main growth impetus of the company in recent years and it is predicted that the market share will keep growing. Previously, as the leading enterprise, Apple firstly adopted metal parts. Since then, cell phone manufacturers such as HTC, Nokia, Huawei, XIAOMI, also gradually adopted metal parts. The penetration rate of metal casing cell phones had reached 15% in 2013. According to the application trend of metal parts in digital cameras, tablets, ultrabooks, etc., we believe that metal casing cell phones will become a mainstream too.

Figure 2. Market penetration of metal casings



Sources: Phillip Securities

For Samsung, which has the largest share in smart phone markets, however, metal parts were not widely used previously. However, since this August and September, a series of new products of the company started to adopt metal parts. For example,

Samsung Galaxy Alpha and Galaxy Note 4 started to adopt metal frame design. At the end of this October, Samsung also launched two medium smart phones namely Galaxy A5 and Galaxy A3, which are also the first smartphones with full metal casing. It is predicted that Galaxy S6 to be launched in 2015 will also adopt the metal casing. Based on the wider application of metal casing, it is expected that the penetration rate will increase to 30%.

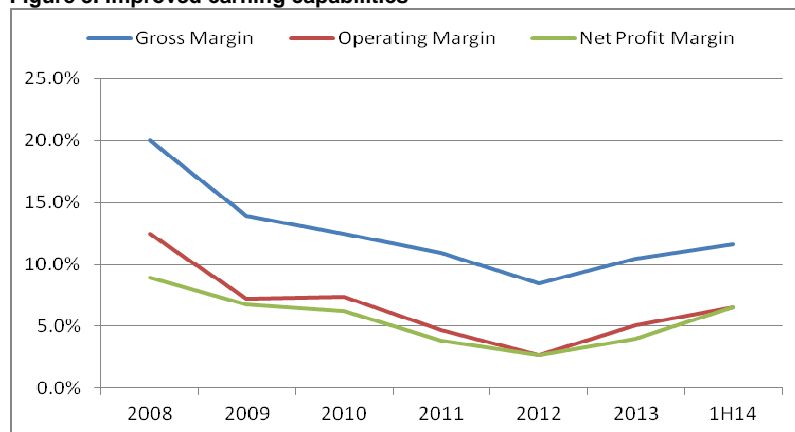
BYD Electronic will become the main beneficiary

In 2013, the company successfully researched and developed plastic-metal hybrid (PMH) technology, realized the combination of metal and plastic at the nanometer level. In upgrading the appearance and the texture, it also greatly improved the signal receiving level of the traditional metal parts, obtained the recognition from the customers and successively won the order of the high-end flagship models from many smartphone manufacturers at home and abroad.

Viewed from the capacity, at present, most CNC machines in the market are used to produce the casings for cell-phones and the demand exceeds the supply. In 2013, CNC machines reached up to 48, 200 sets and it will only increase to 52,600 sets by 9% in 2014. Specifically speaking, the capacity of CNC from most of the manufacturers from Taiwan will mainly meet the increasing demand of Apple and the rest of the non-Apple product series will be provided by the manufacturers such as BYD Electronics. It is predicted that its installed CNC will increase to 5, 000 sets from 4, 000 sets in 2013, only next to Catcher, Foxconn and Casetek in Taiwan. According to our understanding, BYD Electronic is promising to be the main beneficiary of application of non-Apple smart-phone products with metal casings like Samsung.

It is worthy speaking that the unit price of metal casing is mostly above RMB 100.00 Yuan, which is higher than that of plastic shells of a few dozen yuan. Meanwhile, the gross profit margin of the metal casing, namely 20% is also remarkably higher than that of plastic casing, namely 10%, so it will continue to upgrade the overall profit margin of the company.

Figure 3. Improved earning capabilities



Sources: Company reports, Phillip Securities

Catalysts

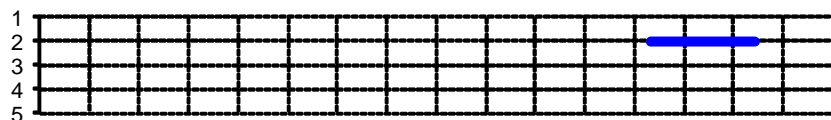
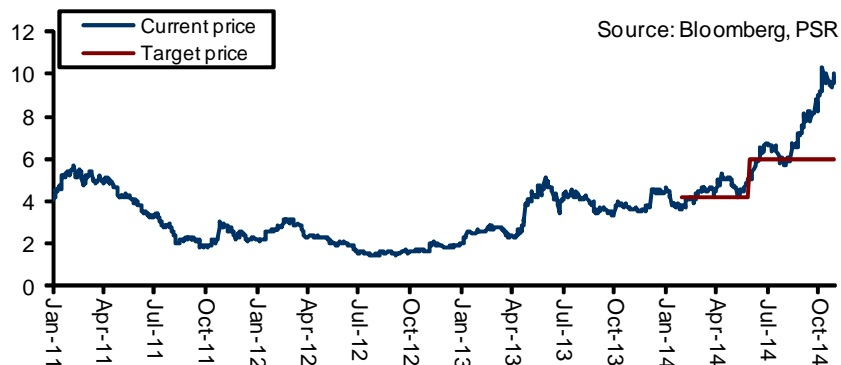
To win more orders from leading brands;
 Metal casings are widely used beyond expectations.

Risks

More fierce competition in the metal casing market.

Periodicity:	2011	2012	2013	2014F	2015F
Valuation Ratios					
Price Earnings	26.0x	41.3x	24.2x	14.9x	11.5x
Price to Sales	1.0x	1.1x	1.0x	0.8x	0.7x
Price to Book	2.0x	1.9x	1.8x	1.6x	1.4x
Dividend Yield	0.8%	0.0%	0.4%	1.3%	1.7%
Per share data(RMB)					
EPS Adjusted	0.27	0.17	0.29	0.47	0.61
Book Value Per Share	3.55	3.66	3.92	4.36	4.88
Dividends Per Share	0.05	0.00	0.03	0.09	0.12
Growth &Margin					
Revenue growth	-4.7%	-11.2%	14.0%	19.3%	15.0%
Gross profit growth	-16.4%	-31.2%	41.1%	29.5%	25.1%
Net profit growth	-41.9%	-37.1%	71.0%	63.4%	30.0%
Gross Margin	10.9%	8.4%	10.5%	11.4%	12.4%
Net Profit Margin	3.8%	2.7%	4.0%	5.5%	6.3%
Dividend Payout Ratio	20.0%	0.0%	9.9%	20.0%	20.0%
Key ratios					
Return on Assets	5.0%	3.1%	5.0%	7.2%	8.5%
Return on Equity	7.8%	4.7%	7.6%	11.3%	13.2%
Effective Tax Rate	10.6%	11.9%	13.7%	12.5%	12.5%
Liability ratio	36.46%	30.57%	36.34%	36.00%	36.00%
Income Statement (RMB:mn)					
Revenue	15,868	14,091	16,063	19,158	22,026
- Cost of Goods Sold	14,138	12,901	-14,383	-16,984	-19,306
Gross Income	1,730	1,190	1,679	2,174	2,720
- Selling, General & Admin Expenses	1,194	994	1,047	1,245	1,454
Operating Income	749	383	814	1,134	1,488
- Interest Expense	0	3	7	9	10
- Net Non-Operating Losses (Gains)	-29	-49	-61	-85	-95
Pretax Income	674	430	752	1,210	1,573
- Income Tax Expense	72	51	103	151	197
Net Income Adjusted*	603	379	648	1,059	1,377

Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

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

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

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