

TCL Communication Tech (2618 HK)

To Overfulfill Annual Target

Hong Kong | TMT | Events Review

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Annual Target to be Overfulfilled

TCL Communication Tech sold 8.286 million cell phones and other products totally in November, rising by 14% year on year. The total sales volume of the last 11 months rose by 32% year on year to 64.917 million. Among them, smart phone accounted for 62% with the increasing share. The Company is expected to overfulfill its guiding target of 40 million. Thanks to the improvement of product structure, the Company's product ASP rises significantly. Additionally, with the release of scale effect, the profitability will also continue to improve.

Benefiting from the Overseas Emerging Markets Continuously

The emerging markets, except those of China, still have a huge alternative space. TCL Communication is also one of the limited brands which will benefit from the tide of replacing functional phones with smart ones. Since the Company mainly worked on these markets in the past, over 90% of smart phone shipment is from overseas markets.

4G Embraces Considerable Opportunities

4G market still has vast development space. Given that operators provide low subsidies, the low-cost 4G cell phones are expected to be more popular. TCL will benefit from this progress, for it enjoys solid channels. Besides, the close cooperation with MTK will help it develop more cost-effective cell phone products. MTK's more competitive SoC processors to be available in the first half of 2015 can accelerate the products to be put into market. In addition, the gross margin of 4G cell phones is 1 to 2 percentage points higher than that of 3G ones.

Major Shareholders Buy in More Shares Positively

Although the Chinese mainland market may be confronted with ceiling effect, TCL Communication works on overseas markets. Its smart phone business is expected to maintain rapid growth. And benefiting from the scale advantage offered by the Chinese mainland industrial chain, the improvement of product structure and scale effect, the profitability will be also improved. It is worth mentioning that major shareholders bought in as many as 7.87% of shares positively in the past three months, showing their optimistic confidence. The Company's average historical P/E is about 10 times. Even if we cautiously grant it 9X 2015EPS, the target price can be HK\$ 10.13. We upgrade it to "Buy" rating.

BUY (Upgrade)

CMP HK\$7.50

TARGET HK\$ 10.13 (+35%)

COMPANY DATA

O/S SHARES (MN) :	1220
MARKET CAP (HK\$BN) :	9.10
MARKET CAP (USDBN) :	1.17
52 - WK HI/LO (HK%) :	6.74 / 10.96
LIQUIDITY 3M (USDMN) :	440
PAR VALUE (HK\$) :	3.06

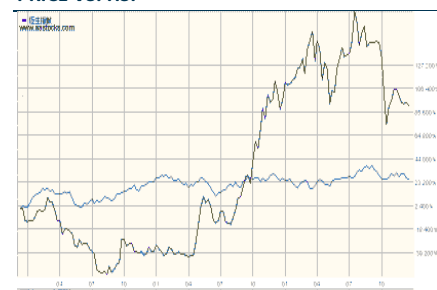
SHARE HOLDING PATTERN, %

TCL Corporation:	58.07
Value Partners Group Limited:	7.03

PRICE PERFORMANCE, %

	1MTH	3MTH	1YR
ABS	-5.86	-21.52	-4.43
REL TO BSE	-2.65	-16.04	-4.44

PRICE VS. HSI



Source: Phillip Securities

KEY FINANCIALS

HK\$ mn	FY12	FY13	FY14E	FY15E
Net Sales	12031	19362	29975	38741
Net Profit	-208	313	1036	1382
EPS, HK\$	-0.19	0.28	0.88	1.13
PER, x	-	27.27	8.55	6.66
BVPS, HK\$	2.06	2.50	3.18	3.84
P/BV, x	3.65	3.00	2.36	1.95
ROE, %	-8.33	11.98	30.71	32.01
Debt/Equity (%)	474	395	376	355

Source: Company reports, Phillip Securities Est.

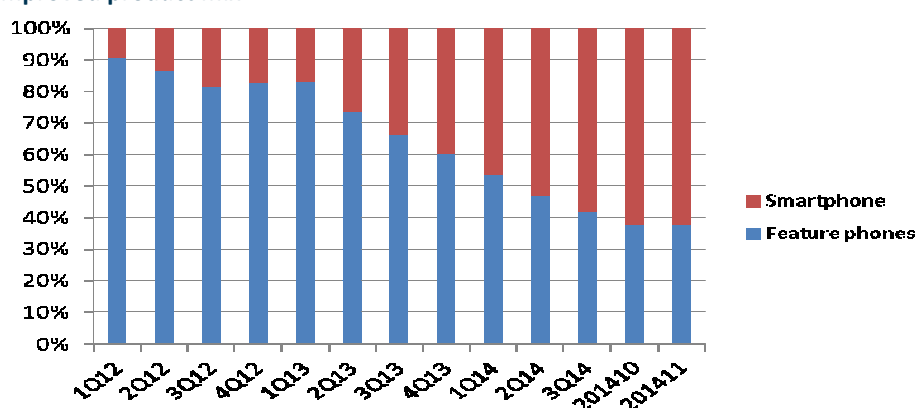
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Annual Target to be Overfulfilled

TCL Communication sold a total of 8.286 million cell phones and other products in November, rising by 14% year on year. 7.511 million ones were sold overseas, increasing by 9% year on year. The sales volume in Chinese market rose substantially by 100% year on year to 775,000. The sales volume of cell phones and other products in the last 11 months rose by 32% year on year to 64.917 million, of which a total of 58.705 million were sold overseas, rising by 32% year on year. A total of 6.212 million were sold in China, rising by 42% year on year.

Among them, the sale volume of smart phones rose substantially by 70% year on year to 5.115 million in November, which accounted for 62% of the total sales volume with the larger share. The total sales volume in the last 11 months rose by 140% year on year to 36.06 million.

Improved product mix



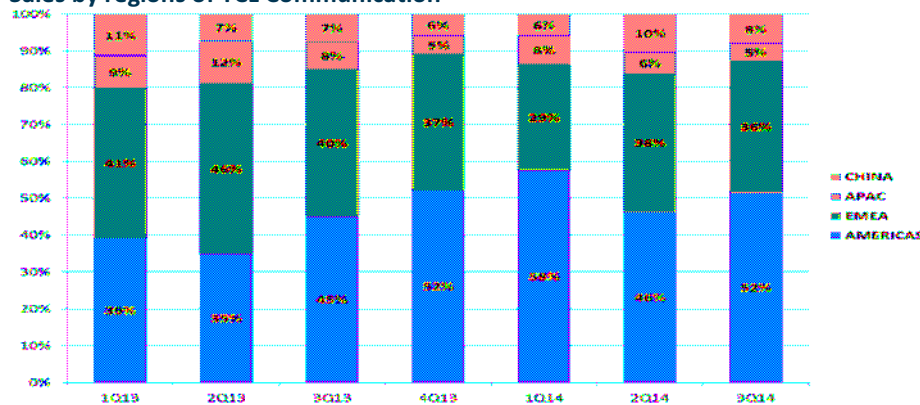
Source: Company reports, Phillip Securities

It is simply estimated that the Company will achieve an annual shipment of 41.18 million which is slightly higher than the guiding target of 40 million if the smart phone shipment of December maintains at the same level as that of November. Thanks to the improvement of product structure, the Company’s product ASP rises significantly. Additionally, with the release of scale effect, the profitability will also continue to improve.

Benefiting from the Overseas Emerging Markets Continuously

After years of development, the permeability of smart phones in Chinese mainland has reached 66%, which is close to or even higher than that of some developed countries. “The ceiling effect” has appeared. However, the emerging markets, except those of China, still have huge alternative space. TCL Communication is also one of the limited brands which will benefit from the tide of replacing functional phones with smart ones. Since the Company mainly worked on these markets in the past, over 90% of smart phone shipment is from overseas markets. Meanwhile, the Company also enjoys the following competitive advantages. First, it works closely with the global operators and distributors (70%+contribution). Second, it boasts of higher cost performance. Third, its brand TCL-Alcatel enjoys fine recognition.

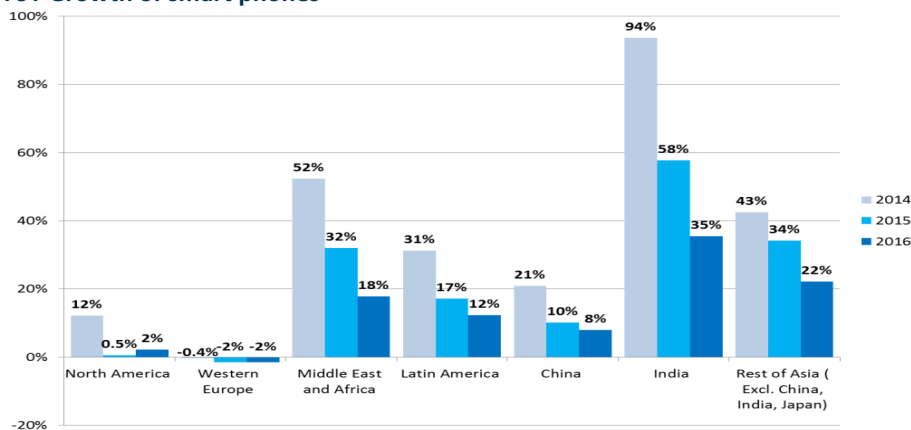
Sales by regions of TCL Communication



Source: IDC, Company reports, Phillip Securities

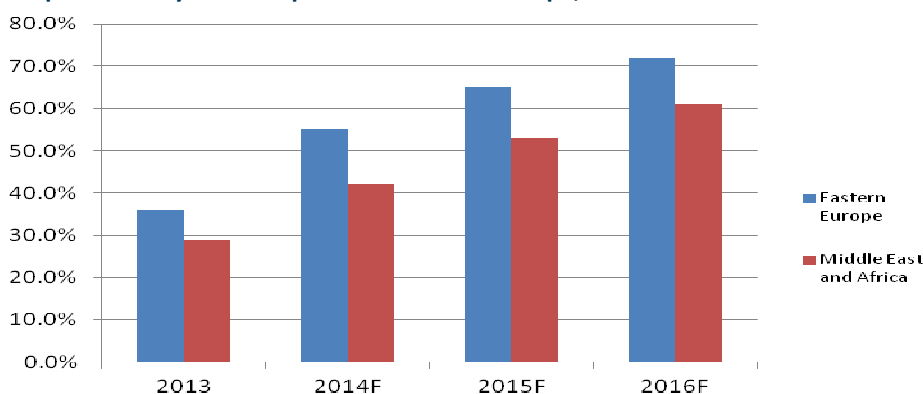
It is worth mentioning that the American markets, whose revenue contribution is over half of the Company’s revenue, facing an opportunity of replacing the functional phones with smart phones in Latin America. Moreover, the Company will have a new cooperator, Sprint, in the North American market and Verizon will be a new potential cooperation partner. Channel development is also expected to improve the Company’s local market share. In addition, markets of Eastern Europe, the Middle East and Africa whose total revenue contribution is about 40% of the Company’s revenue, have low permeability of smart phones. In those regions, the cell phones with a price of less than \$ 200 also gradually occupy the market share of the high-end cell phones. The entry-level smart phones of TCL Communication are only sold at a price of \$ 60 to \$ 80, which is expected to boost it to win the market.

YoY Growth of smart phones



Source: IDC, Gartner, Company reports, Phillip Securities

Low permeability of smart phones in Eastern Europe, the Middle East and Africa



Source: Gartner, Company reports, Phillip Securities

4G Embraces Considerable Opportunities

Despite the fact that the permeability of 4G in markets of Western Europe and Japan is relatively higher (nearly 80%), that of North America is about 50% and China and Russia and other emerging countries is only about 20% to 30%. 4G market still has vast development space. Given that operators provide low subsidies, the low-cost 4G cell phones are expected to be more popular.

We believe TCL Communication will benefit from this progress, for it not only enjoys solid channels. Besides, the close cooperation with MTK will help it develop more cost-effective cell phone products. MTK's more competitive SoC processors to be available in the first half of 2015 can accelerate the products to be put into market. In addition, the gross margin of 4G cell phones is 1 to 2 percentage points higher than that of 3G ones.

Catalyst

Major shareholders buy in more shares positively;
Overseas market expansion better than expected.

Risks

Smart phones didn't replace functional ones in emerging markets as scheduled;
The competition between smart phone manufacturers in emerging markets is more intense.

Financials

Periodicity:	2011	2012	2013	2014F	2015F
Valuation Ratios					
Price Earnings	10.30	-	27.27	8.55	6.66
Price to Book	3.13	3.65	3.00	2.36	1.95
Dividend Yield	3.84%	0.40%	1.33%	4.68%	6.00%
Per share data(HK\$)					
EPS Adjusted	0.73	-0.19	0.28	0.88	1.13
Book Value Per Share	2.40	2.06	2.50	3.18	3.84
Dividends Per Share	0.29	0.03	0.10	0.35	0.45
Growth & Margin					
Revenue growth	22.44%	12.94%	60.93%	54.81%	29.24%
Gross profit growth	19.50%	-9.95%	75.14%	57.55%	27.90%
Net profit growth	13.97%	-125.98%	-	231.12%	33.39%
Gross Margin	21.86%	17.43%	18.96%	19.30%	19.10%
Operating Margin	5.56%	-1.72%	2.21%	3.89%	3.99%
Net Profit Margin	7.51%	-1.73%	1.62%	3.46%	3.57%
Dividend Payout Ratio %	40.09%	0.00%	36.00%	40.00%	40.00%
Key ratios					
Return on Assets	6.09%	-1.52%	2.28%	6.34%	6.90%
Return on Equity	32.74%	-8.33%	11.98%	30.71%	32.01%
Liability ratio	80.94%	82.56%	79.80%	79.00%	78.00%
Effective Tax Rate	-	-	-	10.00%	10.00%
Income Statement(HK\$: mn)					
Revenue	10,653	12,031	19,362	29,975	38,741
- Cost of Goods Sold	8,325	9,935	15,690	24,190	31,341
Gross Income	2,328	2,097	3,672	5,785	7,400
- Selling, General & Admin Expenses	1,912	2,572	3,643	5,246	6,663
Operating Income	593	-206	428	1,165	1,546
- Interest Expense	140	166	105	85	98
- Net Non-Operating Losses (Gains)	-196	-272	-112	-82	-100
Pretax Income	783	-188	298	1,162	1,548
- Income Tax Expense	-17	32	-18	116	155
Income Before XO Items	801	-220	316	1,045	1,393
- Minority Interests	1	-12	3	9	11
Net Profit	800	-208	313	1,036	1,382

Source: Company reports, Phillip Securities

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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