

# Coolpad Group (2369.HK)

## Building Mobile Internet Ecosphere with Promising Future

Hong Kong | TMT | Company report

6 Jul 2015

LeTV will contribute RMB 2.18 billion to hold 18% of Coolpad shares, becoming the second largest shareholder. At the end of 2014, Coolpad announced to form a joint venture with Qihoo 360. The Company's top priority is to convert itself into an Internet operator. Generally speaking, LeTV will win the mobile phone industry chain and enrich its terminal products from the cooperation, while Qihoo can obtain the access to the Internet traffic. Coolpad's varied product mixes, 40 million sets of shipment, and 6000 patents provide a basis for the mobile Internet platform. With Qihoo's security APPs, 360 OS and LeTV's video contents, the Company is no longer simply a hardware vendor. The three parties are expected to build up a mobile Internet ecosphere consisting of "terminal + APP + platform + contents".

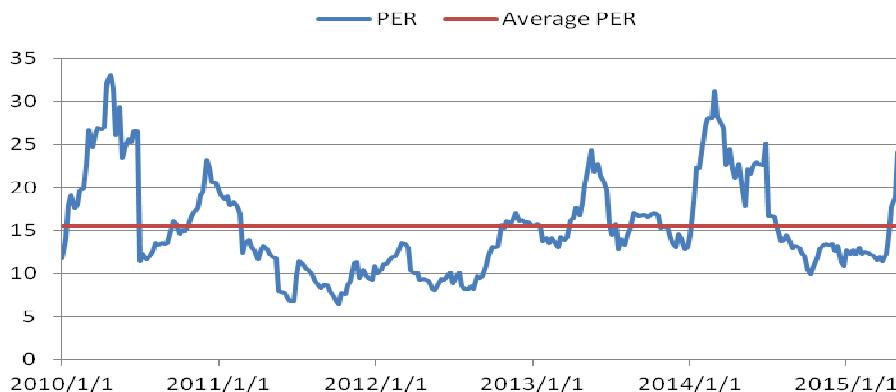
For the e-business channel where Coolpad is in collaboration with Qihoo, the Company will have two brands on the market, Qiku and Dazen, which will be commercially available in a few months. Importantly, the two branded mobile phones will be pre-installed with 360 OS, enabling users to clean any pre-installed software so that users can freely select the software they prefer. What's more, 360 OS will improve the system speed by three times, with standby time extending by 40% and saving traffic by 50%. Since 360 OS can overcome or mitigate Android's shortcomings, we anticipate that it will be accepted on the market. Overall, the Company will reach a total shipment of at least 4500 sets in 2015.

Coolpad's wireless application services will improve further by taking advantage of Qihoo's software APP and LeTV's contents and platform, and are likely to achieve a double growth in the mid-term. Considering the high profitability of the wireless application services, we anticipate that the services will become the Company's main profit source, contributing about 30% to its total profit.

### Building Mobile Internet Ecosphere with Promising Future

Although its mobile phone business enjoys advantages in patent ownership, supply chain and after-sales services, Coolpad may have a hard time in the context of reduced subsidy by the operators and intense price war in the mobile phone industry. To get out of the difficult situation, the Company has carried out the cooperation with Qihoo and LeTV in order to build up the mobile Internet ecosphere, aiming to turn into an Internet operator. Meantime, its profit will come mainly from wireless application services, and it will be no longer a hardware vendor in the future.

#### Historical P/E valuation



Source: Bloomberg, Phillip Securities (HK) Research

### Buy (Upgrade)

CMP: HKD 2.59  
(Closing price as at 2 July 2015)  
TARGET: HKD 3.59 (+38.6%)

#### COMPANY DATA

O/S SHARES (MN) :	4,335
MARKET CAP (HKDMN) :	11,229
52 - WK HI/LO (HKD):	3.28/ 1.25

#### SHARE HOLDING PATTERN , %

Guo Deying :	38.94
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#### PRICE PERFORMANCE , %

	1M	3M	1Y
Coolpad Group	-15.08	75.00	18.81
HSI	-10.11	71.02	7.12

#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

HKD mn	FY13	FY14	FY15E	FY16E
Net Sales	19624	24901	28254	32370
Net Profit	348	514	803	1182
EPS, HKD	0.08	0.12	0.19	0.28
PER, x	31.2	21.6	13.6	9.3
BVPS, HKD	0.65	0.78	0.95	1.20
P/BV, x	3.98	3.32	2.73	2.16
ROE, %	13.5	16.8	21.6	25.6
Debt/Equity (%)	264.4	282.3	270.4	270.4

Source: Company reports, Phillip Securities Est.

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Given this, Coolpad may face the re-valuation. Its conventional mobile phone manufacturing may face the growth bottleneck, or have the difficulty gaining profit, but the business is expected to achieve stable growth on the platform of the ecosphere. We value it as 10 times of the 2016EPS. For the emerging wireless application services, which experience a fast growth and a high profitability, we grant it 20 times of the 2016EPS. Altogether, we set a target price of HK\$3.59, and give it a “Buy” rating. (Closing price as at 2 July 2015)

### Coolpad Joins Hands with LeTV to Create a New Mobile Internet Ecosphere

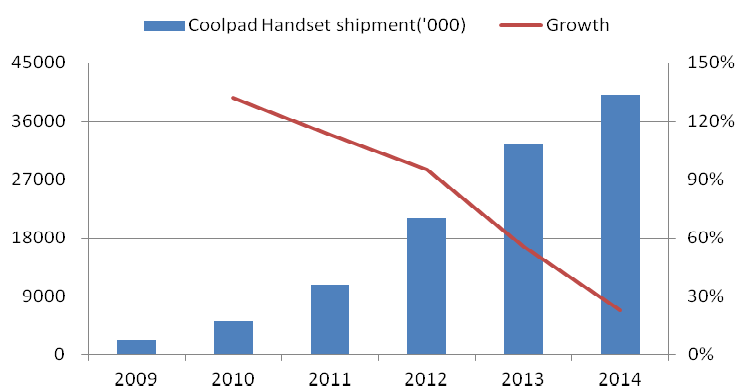
On June 28, Coolpad announced that the controlling shareholder informed the Board of Directors that they sold 18% of the Coolpad shares to Leview Mobile HK Limited (one of the LeTV’s subsidiaries). Once the transaction is completed, LeTV contributed RMB 2.18 billion to hold 18% of Coolpad shares, becoming the second largest shareholder, while Guo Deying continues to hold the remaining 20.3% of Coolpad shares, not the controlling shareholder any more. At the end of 2014, Coolpad announced to form a joint venture with Qihoo 360, with the two holding 50.5% and 49.5% of the JV shares respectively but in joint control.

In our opinion, the cooperation programs with Qihoo and LeTV were two moves Coolpad made to get out of the difficulties as the operators reduced subsidies and the price war was intensifying. Now, the Company’s top priority is to convert itself into an Internet operator. Generally speaking, LeTV will win the mobile phone industry chain and enrich its terminal products from the cooperation, while Qihoo can obtain the access to the Internet traffic. Coolpad’s varied product mixes, 40 million sets of shipment, and 6000 patents provide a basis for the mobile Internet platform. With Qihoo’s security APPs, 360 OS and LeTV’s video contents, the Company is no longer simply a hardware vendor. The three parties are expected to build up a mobile Internet ecosphere consisting of “terminal + APP + platform + contents”.

### Terminal Shipments are Likely to Bottom Up

In the wake of the financial crisis, and to go with the trend of smart phones, Coolpad’s mobile phone shipments and the performance have increased rapidly and peaked in 2014. But as the operators reduced their subsidy, the Company’s terminal business faces the declining.

#### Handset shipment of Coolpad



Source: Company reports, Phillip Securities (HK) Research

To overcome the situation, the Company has adjusted its strategies in branding and channel development. Now it has three brands, which are Coolpad, IVVI and Dazen, targeting low-end, mid-end and high-end customers and relying on operators, retailers and e-business companies respectively. Specifically, the proportion of the shipments to the operators will fall from 80%+ to 50%, and then remain stable. The brand IVVI takes the form of joint shareholding, i.e., 60% for the Company and 40% for officers and tier-one agency. The share incentives may drive the expansion of its market shares soon.

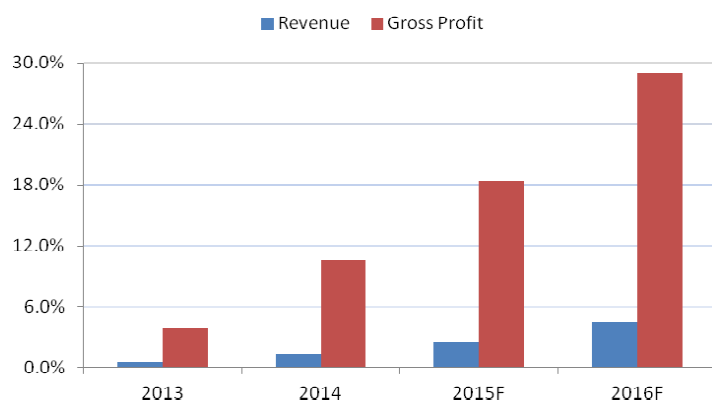
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## Wireless Application Services may Become the Primary Profit Driver

According to its 2014 financial report, the Company's revenue from the wireless application services grew fastest by 2.3 times to HK\$349 million, consisting of software pre-installation, APP revenue sharing and ads, which contribute 40%+, 40%+ and 10%+ respectively. It is worth mentioning that the services have a gross margin of up to 90%, contributing 24% of the gross margin in H2 of 2014. Therefore, although the revenue contribution only accounted for 1.4% of the total in 2014, it was one of the primary sources of the profits.

We believe that Coolpad's wireless application services will improve further by taking advantage of Qihoo's software APP and LeTV's contents and platform, and are likely to achieve a double growth in the mid-term. Considering the high profitability of the wireless application services, we anticipate that the services will become the Company's main profit source, contributing about 30% to its total profit.

### Increased contribution by wireless application services



Source: Company reports, Phillip Securities (HK) Research

## Catalyst

Monthly shipment increases better than expected;  
Transformation strategy progresses smoothly, with the better-than-expected profit of wireless application services.

## Risks

Mobile phone price war is intensifying.  
The strategic cooperation remains at a standstill.

## Financials

Periodicity:	2012	2013	2014	2015F	2016F
<b>Valuation Ratios</b>					
Price Earnings	33.64	31.20	21.58	13.63	9.25
Price to Book	4.50	3.98	3.32	2.73	2.16
Dividend Yield	0.58%	0.77%	0.39%	0.77%	1.16%
<b>Per share data(HKD)</b>					
EPS Adjusted	0.08	0.08	0.12	0.19	0.28
Book Value Per Share	0.58	0.65	0.78	0.95	1.20
Dividends Per Share	0.02	0.02	0.01	0.02	0.03
<b>Growth &amp; Margin</b>					
Revenue growth	95.61%	36.67%	26.89%	13.47%	14.57%
Gross profit growth	59.04%	47.11%	19.21%	17.87%	23.52%
Net profit growth	19.98%	6.89%	47.70%	56.23%	47.20%
Gross Profit Margin	11.98%	12.89%	12.11%	12.58%	13.57%
Net Profit Margin	2.27%	1.77%	2.06%	2.84%	3.65%
Dividend payout Ratio %	19.30%	24.10%	8.33%	10.53%	10.71%
<b>Key ratios</b>					
Return on Assets	4.16%	3.83%	4.48%	5.74%	6.92%
Return on Equity	14.17%	13.45%	16.76%	21.56%	25.63%
Liability ratio	70.22%	72.56%	73.84%	73.00%	73.00%
Effective Tax Rate	22.45%	20.37%	15.32%	17.50%	17.50%
<b>Income Statement(HKD: mn)</b>					
<b>Revenue</b>	<b>14,359</b>	<b>19,624</b>	<b>24,901</b>	<b>28,254</b>	<b>32,370</b>
- Cost of Goods Sold	12,639	17,094	21,885	24,699	27,979
<b>Gross Profit</b>	<b>1,720</b>	<b>2,530</b>	<b>3,016</b>	<b>3,555</b>	<b>4,391</b>
- Selling, General & Admin Expenses	1,552	2,286	2,682	2,967	3,399
Operating Income	373	456	663	958	1,417
- Interest Expense	55	23	87	85	85
Pretax Income	418	437	607	973	1,432
- Income Tax Expense	94	89	93	170	251
<b>Net Profit</b>	<b>326</b>	<b>348</b>	<b>514</b>	<b>803</b>	<b>1,182</b>

Source: Company, Phillip Securities (HK) Research Estimates  
(Financial figures as at 2 July 2015)

**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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