

Tongda Group

Bringing in strategic investor

to summarize...

- Templeton became strategic investor with 6.3% stake in Dec this year
- 2H12F forecast slightly revised; 2013F downward adjusted on factory delay
- Handset segment to delay high growth to 2014F at HK\$3,250m
- Remain BUY on solid technical background in growing China electronic market
- TP down to HK\$0.539 on lowered projection; Targets 8.9x FY12/12F P/E

Templeton became strategic investor with 6.3% stake in Dec this year. Earlier this month, Templeton Strategic Emerging markets Funds acquired a block of 300m shares at HK\$0.310 per share, which represented 6.3% shares that became substantial shareholder of the company, according to the management. At the same time, Chairman Wang Yanan has an additional derivative interest of 300m shares with effective period from Dec 2015 to Jan 2016, which is a put option granted to Templeton embedding an unspecified / undisclosed required return for the fund. In fact, management indicated Templeton has visited all their production plants and essentially met all of their key managements. While there is a put option, we still believe the fund gave the company and the industry a vote of confidence. Table 1 shows shareholder structure of Tongda by latest applicable date.

Table 1. Templeton became a strategic shareholder of Tongda in Dec 2012

| | % without exercising options | % upon exercising put option |
|----------------------|------------------------------|------------------------------|
| Chairman Wang Yanan | 51.3% | 57.6% |
| Templeton Asset Mgmt | 6.3% | 0.0% |
| Public and others | 42.4% | 42.4% |
| Total | 100.0% | 100.0% |

Source: SBI E2-Capital

2H12F forecast slightly revised; 2013F downward adjusted on factory delay.

Table 2 shows forecast changes on turnover details and net profit for 2012F and 2013F. Adjustments to 2H 2012F partly reflect slower-than-expected rebound of China economy. As for 2013F, management indicated that partly due to personnel change in Chinese government, the company is yet to confirm receiving a specified land piece in Xiamen for handset production. While current handset capacity can be utilized to meet increasing demand from domestic brand names, a target of around 50% handset capacity expansion have to be deferred to 2014F, which negatively affect growth potential of handset segment for 2013F.

Table 2. Major forecast changes for 2012F and 2013F

| HK\$m | Pre. 12F | Adj. 12F | Pre. 13F | Adj. 13F |
|-----------------------|----------|----------|----------|----------|
| Total turnover | 3,916 | 3,664 | 5,493 | 4,469 |
| Handset | 2,000 | 1,800 | 3,250 | 2,275 |
| Electrical appliances | 784 | 700 | 941 | 800 |
| Notebook computer | 584 | 550 | 701 | 660 |
| Light guide plate | 54 | 120 | 108 | 240 |
| Others | 494 | 494 | 494 | 494 |
| Net profit | 300 | 288 | 431 | 361 |

Source: SBI E2-Capital

| Ticker | 0698 HK |
|------------------------|----------------|
| Rating | BUY |
| Price (HK\$) | 0.395 |
| Target Price (HK\$) | 0.539 (+36.5%) |
| 12m Price Range (HK\$) | 0.208 - 0.410 |
| Market cap. (US\$m) | 241.2 |
| Daily t/o (US\$m) | 0.20 |
| Free float (%) | 43.4 |

Financial summary

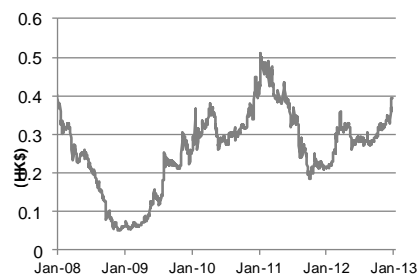
| Year to Dec | 10A | 11A | 12F | 13F | 14F |
|--------------------|-------|-------|-------|-------|-------|
| Turnover (HK\$m) | 2,348 | 3,147 | 3,664 | 4,469 | 5,894 |
| Net Profit (HK\$m) | 201 | 250 | 288 | 361 | 509 |
| EPS (HK\$) | 0.044 | 0.053 | 0.067 | 0.084 | 0.119 |
| P/E (x) | 9.4 | 7.5 | 6.5 | 5.2 | 3.7 |
| P/B (x) | 1.16 | 1.01 | 0.91 | 0.81 | 0.70 |
| EV/EBITDA (x) | 5.9 | 4.3 | 3.5 | 3.2 | 2.1 |
| Yield (%) | 4.6 | 4.3 | 5.1 | 6.4 | 9.0 |
| ROE (%) | 13.2 | 14.0 | 14.2 | 15.7 | 19.2 |
| ROCE (%) | 12.4 | 15.1 | 15.5 | 17.4 | 21.1 |
| N. Gear. (%) | 14.0 | 17.5 | 7.2 | 12.5 | 2.6 |

Source: SBI E2-Capital

| | 12F | 13F | 14F |
|---------------------------|-------|-------|-------|
| Consensus EPS (HK\$) | 0.066 | 0.084 | 0.103 |
| Previous earnings (HK\$m) | 300 | 431 | 528 |
| Previous EPS (HK\$) | 0.071 | 0.104 | 0.127 |

Price performance

| Year to Dec | 1m | 3m | 12m |
|--------------------------|------|------|------|
| Relative to HSI (%) | 14.6 | 25.0 | 51.8 |
| Actual price changes (%) | 17.9 | 36.2 | 83.7 |



Source: Bloomberg

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Handset segment to delay high growth at 2014F. Table 3 shows our revised sales forecast while Table 4 shows revised gross profit breakdown. As discussed, handset sales assumption for 2013F was largely revised down to reflect delay in factory preparation. For instance, base on HK\$32.5 per set at 70m sets for 2013F, sales of handset segment would be HK\$2,275m for the year. If land certificate is to be successfully released by the end of Q1 next year, construction and equipment adjustment could be possibly done in 2H. As such, the management may be able to deliver 100m sets capacity and sales of handset cases in 2014F. Assuming ASP to be stable on increasing product complexity provided by Tongda (which includes innovative features such as built-in modules on handset cases), segment sales income would increase sharply in 2014F to HK\$3,250m. On the other hand, while we generally revise down sales in handset, electrical appliances and notebook computers, light guide plate sales is adjusted up. As for 2012F, 2013F and 2014F, we expect sales to go up quickly on increasing orders from Chinese brand names. Although profit margin might be relatively lower compared to Japanese customers as planned in the past, current sales channels may provide sizeable contracts starting from HK\$100m+ in 2012F.

Table 3. Revised sales forecast

| HK\$m | FY12/10A | FY12/11A | FY12/12F | FY12/13F | FY12/14F |
|-------------------------------------|----------|----------|----------|----------|----------|
| Total turnover | 2,348 | 3,147 | 3,664 | 4,469 | 5,894 |
| Electrical fittings revenue | 1,875 | 2,654 | 3,170 | 3,975 | 5,400 |
| Handset | 951 | 1,420 | 1,800 | 2,275 | 3,250 |
| Electrical appliances | 603 | 784 | 700 | 800 | 894 |
| Notebook computers | 322 | 449 | 550 | 660 | 776 |
| Light guide plate | 0 | 0 | 120 | 240 | 480 |
| Ironware parts | 330 | 377 | 377 | 377 | 377 |
| Communication facilities and others | 143 | 117 | 117 | 117 | 117 |

Table 4. Revised gross profit breakdown

| HK\$m | FY12/10A | FY12/11A | FY12/12F | FY12/13F | FY12/14F |
|--------------------------------|----------|----------|----------|----------|----------|
| Handset | 190 | 305 | 387 | 478 | 683 |
| Electrical appliances | 105 | 149 | 130 | 148 | 165 |
| Notebook computers | 72 | 108 | 132 | 152 | 178 |
| Light guide plate | 0 | 0 | 9 | 36 | 96 |
| Others | 40 | 43 | 50 | 50 | 50 |
| <u>Gross margin estimation</u> | | | | | |
| Handset | 20.0% | 21.5% | 21.5% | 21.0% | 21.0% |
| Electrical appliances | 17.5% | 19.0% | 18.5% | 18.5% | 18.5% |
| Notebook computers | 22.5% | 24.0% | 24.0% | 23.0% | 23.0% |
| Light guide plate | n.a. | n.a. | 7.5% | 15.0% | 20.0% |

Source: SBI E2-Capital

Remain BUY on solid technical background in growing electronic market in China; TP down to HK\$0.539 on lowered short-term projection. We value Tongda with discounted cash flow model at 17.5% discount rate and the new target price is HK\$0.539 per share, which represents 8.9x and 7.1x FY12/12F and FY12/13F P/E based on HK\$288.4m and HK\$360.7m net profit for the respective years. Table 5 and Table 6 on the next page show profit and loss forecast as well as balance sheet items respectively. As a High New Technology Enterprises subject to certain dividend tax, Tongda effective tax rate was 15%+. Noted that Tongda conducted large portion of handset business through a 75% subsidiary and subjected to considerable MI, which were estimated to be HK\$31.5m and HK\$39.8m respectively for 2012F and 2013F.

Table 5. Profit and loss forecast (Full-year)

| HK\$m | FY12/10A | FY12/11A | FY12/12F | FY12/13F | FY12/14F |
|--|-----------|-----------|-----------|-----------|-----------|
| Revenue | 2,348.3 | 3,147.1 | 3,663.8 | 4,468.9 | 5,893.7 |
| Cost of goods sold | (1,940.7) | (2,541.8) | (2,956.3) | (3,605.3) | (4,721.3) |
| Gross profit | 407.6 | 605.3 | 707.6 | 863.6 | 1,172.4 |
| Operating expenses | (145.4) | (217.3) | (274.4) | (334.6) | (441.3) |
| Operating profit | 262.1 | 388.1 | 433.2 | 529.0 | 731.1 |
| Share of profit of an associate and JV | 2.6 | 2.1 | 0.9 | 0.0 | 0.0 |
| Finance costs | (20.3) | (53.3) | (45.5) | (43.5) | (45.0) |
| Profit before tax | 244.5 | 336.9 | 388.6 | 485.5 | 686.1 |
| Income tax expense | (34.2) | (77.4) | (68.0) | (85.0) | (120.1) |
| Total profit | 210.2 | 259.5 | 320.6 | 400.5 | 566.0 |
| Net profit | 200.9 | 250.3 | 288.4 | 360.7 | 509.1 |
| Reported EPS (HK\$) | 0.044 | 0.053 | 0.061 | 0.076 | 0.107 |

Source: SBI E2-Capital

Table 6. Balance sheet items

| HK\$m | FY12/10A | FY12/11A | FY12/12F | FY12/13F | FY12/14F |
|--|----------|----------|----------|----------|----------|
| Non-current assets | 1,177.7 | 1,327.2 | 1,277.0 | 1,314.0 | 1,480.6 |
| Property, plant and equipment | 957.0 | 1,077.6 | 1,061.2 | 1,100.9 | 1,270.5 |
| Investment property | 47.0 | 51.0 | 51.0 | 51.0 | 51.0 |
| Prepayments | 56.4 | 59.1 | 49.4 | 47.6 | 45.7 |
| Investment in associates | 34.4 | 47.0 | 47.9 | 47.9 | 47.9 |
| Other assets | 83.0 | 92.5 | 67.6 | 66.7 | 65.6 |
| Current assets | 1,838.8 | 2,411.5 | 2,765.5 | 3,233.5 | 3,700.7 |
| Inventories | 472.2 | 672.9 | 663.5 | 916.9 | 958.7 |
| Trade and bills receivables | 1,019.7 | 1,303.9 | 1,506.7 | 1,921.5 | 2,115.3 |
| Pledged deposits | 39.1 | 57.4 | 0.0 | 0.0 | 0.0 |
| Cash and cash equivalents | 183.7 | 253.8 | 495.3 | 295.2 | 526.6 |
| Other current assets | 124.0 | 123.5 | 100.0 | 100.0 | 100.0 |
| Non-current liabilities | 197.1 | 278.4 | 294.2 | 274.2 | 274.2 |
| Interest-bearing bank borrowings | 169.8 | 236.9 | 260.0 | 240.0 | 240.0 |
| Other non-current liabilities | 27.4 | 41.5 | 34.2 | 34.2 | 34.2 |
| Current liabilities | 1,156.8 | 1,545.1 | 1,597.1 | 1,828.4 | 2,036.2 |
| Trade and bills payables | 655.9 | 857.2 | 924.6 | 1,149.6 | 1,308.1 |
| Accrued liabilities and other payables | 92.1 | 122.8 | 120.2 | 156.4 | 205.8 |
| Tax payable | 124.4 | 162.3 | 162.3 | 162.3 | 162.3 |
| Interest borrowings | 282.4 | 402.6 | 390.0 | 360.0 | 360.0 |
| Other current liabilities | 2.1 | 0.1 | 0.0 | 0.0 | 0.0 |
| Total equity | 1,662.5 | 1,915.1 | 2,150.8 | 2,444.5 | 2,870.5 |
| MI | 46.5 | 56.9 | 88.4 | 128.2 | 185.1 |

Source: SBI E2-Capital

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