

Equity Research  
 Electronic Appliance/China

# TCL Electronics (1070 HK)

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## Company Update

### BUY

UNCHANGED

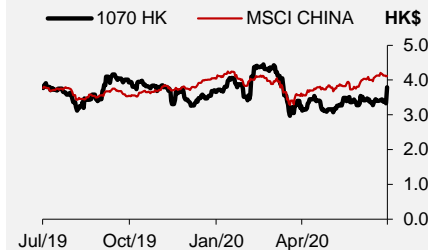
Close price: **HK\$3.79**  
 Target Price: **HK\$5.10 (+35%)**  
 Prior TP: **HK\$5.10**

### Key Data

HKEx code	1070
12 Months High (HK\$)	4.39
12 Month Low (HK\$)	2.77
3M Avg Dail Vol. (mn)	2.99
Issue Share (mn)	2,371.27
Market Cap (HK\$mn)	8,987.13
Fiscal Year	12/2019
Major shareholder (s)	TCL Industries (53.33%)

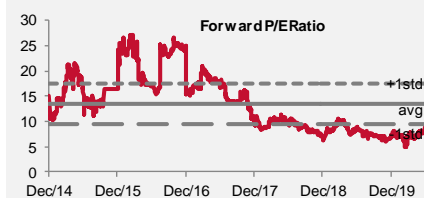
Source: Company data, Bloomberg, OP Research  
 Closing price are as of 30/06/2020

### Price Chart



	1mth	3mth	6mth
Absolute %	13.8	19.6	1.9
Rel. MSCI CHINA %	8.0	4.4	1.6

### PE



### Company Profile

TCL Electronics is a TV manufacturer with a vertically integrated business model. It ranks among top 3 in Global LCD TV market and No. 3 in the PRC.

## Inject smartphone business at start of 5G replacement cycle

- **TCLE proposes to reshuffle its business by disposing ODM business for RMB2.5bn and injecting TCL Communication at RMB1bn. The transactions will allow TCLE better focused on its proprietary brands.**
- **We revise up our FY20E core earnings estimate by 5.7% to HK\$1,156mn on better than expected YTD sales.**
- **Reiterate BUY with TP HK\$5.10 unchanged based on 5x/15x FY21E P/E for TV/Internet business respectively.**

**Inject handset business at the start of 5G replacement cycle.** TCL Electronics (TCLE) announced to dispose 100% its TV set ODM business for RMB2.5bn cash to its parent company TCL Industries (TCLI), and at the same time acquire 100% of TCL Communication Group (TCLC, mainly engaging in handset business) from TCLI at the consideration of RMB1bn cash. Netting off the two transactions, the Company will exchange its ODM business for RMB1bn cash plus the TCL handset and smart hardware business after the reshuffle.

We are **positive** on the business reshuffle plan as it allows the company to **better focus on its proprietary brands and better catch the opportunities in the upcoming 5G handset replacement.** We expect TCL smartphones to cut into the existing sales channels of TCL TV in overseas market (such as Best Buy and Walmart) starting from 2H20E and realize synergies in distribution and marketing. Particularly, TCLC has comparative advantage over its domestic peers (i.e. Xiaomi, Huawei, OPPO, vivo) in terms of more established partnership relationship with major carriers (such as Vodafone, Orange) in North America. In addition, TCL handsets have direct upstream support from CSOT, which bring better control in cost and order management. TCLC has realized turnaround in FY19 with HK\$12,216 mn revenue and HK\$179 mn net earnings.

**We revise up our FY20E core earnings estimate by 5.7% to HK\$1,156mn on better than expected YTD overseas sales.** YTD sales performance in overseas market is better than expected as lockdown stimulates demand for in-house entertainment. We are now expecting 11.4% yoy growth in FY20E turnover to HK\$52,326 mn, revised up 9.9% from HK\$47,627mn. We also factored in this transaction in our model by assuming the deal to be completed by the end of August.

**Reiterate BUY** with TP HK\$5.10 unchanged based on SOTP valuation (5x FY21E P/E for TV segment and 15x FY21E P/E for Internet business).

**Risks:** (1) Unable to complete the transaction; (2) Higher than expected R&D and S&D expenses for TCLC group; (3) lower than expected GPM for TV sets; (4) slower than expected expansion of handset business in overseas market.

### Exhibit 1: Forecast and Valuation

Year to Dec (HK\$ mn)	FY18R	FY19	FY20E	FY21E	FY22E
Revenue	45,582	46,991	52,326	58,336	64,810
Growth(%)	11.7	3.1	11.4	11.5	11.1
Adjusted Net Profit	867	1,030	1,156	1,309	1,612
Growth (%)	45.7	18.9	12.2	13.2	23.2
Diluted EPS (HK\$)	0.382	0.444	0.463	0.524	0.645
EPS growth (%)	12.3	16.3	4.2	13.2	23.2
Change to previous EPS (%)			5.3	(0.4)	
Consensus EPS (HK\$)			0.428	0.538	0.700
ROE (%)	11.9	21.2	9.7	10.4	12.0
P/E (x)		8.5	8.2	7.2	5.9
P/B (x)	0.9	0.8	0.7	0.7	0.6
Yield (%)	5.1	5.6	5.9	6.7	8.3
DPS (HK\$)	0.192	0.212	0.224	0.254	0.313

Source: Bloomberg, OP Research

**Exhibit 2: Earnings Revision**

(HK\$ mn)	FY20E			FY21E			OP Comments
	New	Old	% Chg	New	Old	% Chg	
<b>Revenue</b>	<b>52,326</b>	<b>47,627</b>	<b>9.9</b>	<b>58,336</b>	<b>51,718</b>	<b>12.8</b>	(1) Better than expected sales performance of TV sets in overseas market; (2) assume contribution from TCLC from Sept 2020E, (3) assume disposal of TV ODM business from Sept 2020E.
Gross profit	9,212.0	8,196.9	12.4	11,330.2	8,894.4	27.4	
Gross margin	17.6%	17.2%	0.4	19.4%	17.2%	2.2	Due to higher margin from TCLC (i.e. over 20%)
Opex	(8,274)	(7,345.2)	12.6	(10,216)	(7,794.9)	31.1	Higher R&D expenses for handset business
EBIT	1,453	1,366	6.3	1,639	1,627	0.8	
<b>Adj. Net Profit</b>	<b>1,156</b>	<b>1,094</b>	<b>5.7</b>	<b>1,309</b>	<b>1,309</b>	<b>(0.0)</b>	
Diluted EPS (HK\$)	0.463	0.440	5.3	0.524	0.526	(0.4)	

Source: OP Research

## Financial Summary

Year to Dec	FY18R	FY19	FY20E	FY21E	FY22E
<b>Income Statement HK\$mn</b>					
Television-PRC	44,972	44,492	43,310	35,205	36,578
Television-Overseas	0	626	1,134	1,575	2,078
TCL Communication	0	0	4,699	17,099	20,583
Smart TV Platform & Others	610	1,873	3,183	4,457	5,571
<b>Turnover</b>	<b>45,582</b>	<b>46,991</b>	<b>52,326</b>	<b>58,336</b>	<b>64,810</b>
YoY%	12	3	11	11	11
COGS	(38,630)	(38,821)	(43,114)	(47,006)	(52,167)
<b>Gross profit</b>	<b>6,952</b>	<b>8,170</b>	<b>9,212</b>	<b>11,330</b>	<b>12,643</b>
Gross margin	15.25%	17.39%	17.60%	19.42%	19.51%
Other income	888	1,952	514	525	536
Selling & distribution	(4,477)	(4,939)	(5,234)	(5,834)	(6,333)
Admin	(1,323)	(1,525)	(1,522)	(1,873)	(2,050)
R&D	(722)	(987)	(1,465)	(2,217)	(2,463)
Other opex	(21)	(19)	(52)	(292)	(324)
<b>Total opex</b>	<b>(6,543)</b>	<b>(7,470)</b>	<b>(8,274)</b>	<b>(10,216)</b>	<b>(11,170)</b>
<b>Operating profit (EBIT)</b>	<b>1,298</b>	<b>2,652</b>	<b>1,453</b>	<b>1,639</b>	<b>2,010</b>
Operating margin	2.85%	5.64%	2.78%	2.81%	3.10%
Provisions	(13)	(27)	0	0	0
Finance costs	(98)	(138)	(87)	(87)	(87)
Profit after financing costs	1,187	2,486	1,366	1,552	1,923
Associated companies & JVs	71	38	38	38	38
Pre-tax profit	1,259	2,524	1,404	1,591	1,961
Tax	(227)	(199)	(225)	(256)	(317)
Profit from discontinued operations	0	0	0	0	0
Minority interests	9	(46)	(23)	(26)	(32)
<b>Net profit</b>	<b>1,041</b>	<b>2,279</b>	<b>1,156</b>	<b>1,309</b>	<b>1,612</b>
<b>Adjusted Net Profit</b>	<b>867</b>	<b>1,030</b>	<b>1,156</b>	<b>1,309</b>	<b>1,612</b>
YoY%	46	19	12	13	23
Net margin	1.90%	2.19%	2.21%	2.24%	2.49%
<b>EBITDA</b>	<b>1,266</b>	<b>1,471</b>	<b>1,629</b>	<b>1,775</b>	<b>2,126</b>
EBITDA margin	2.8%	3.1%	3.1%	3.0%	3.3%
<b>EPS (HK\$)</b>	<b>0.382</b>	<b>0.444</b>	<b>0.463</b>	<b>0.524</b>	<b>0.645</b>
YoY%	12	16	4	13	23
<b>DPS (HK\$)</b>	<b>0.192</b>	<b>0.212</b>	<b>0.224</b>	<b>0.254</b>	<b>0.313</b>
<b>Cash Flow HK\$ mn</b>					
<b>EBITDA</b>	<b>1,266</b>	<b>1,471</b>	<b>1,629</b>	<b>1,775</b>	<b>2,126</b>
Chg in working cap	1,217	810	320	198	380
Others	48	119	0	0	0
<b>Operating cash</b>	<b>2,531</b>	<b>2,400</b>	<b>1,949</b>	<b>1,973</b>	<b>2,506</b>
Interests paid	(65)	(108)	(87)	(87)	(87)
Tax	(394)	(75)	(135)	(225)	(256)
<b>Net cash from operations</b>	<b>2,073</b>	<b>2,218</b>	<b>1,727</b>	<b>1,661</b>	<b>2,163</b>
Capex	(129)	(454)	(506)	(564)	(626)
Investments	(900)	(621)	0	0	0
Dividends received	16	38	38	38	38
Sales of assets	396	111	0	0	0
Interests received	62	122	86	94	102
Others	7	(2)	0	0	0
<b>Investing cash</b>	<b>(548)</b>	<b>(806)</b>	<b>(382)</b>	<b>(432)</b>	<b>(487)</b>
<b>FCF</b>	<b>1,525</b>	<b>1,412</b>	<b>1,346</b>	<b>1,229</b>	<b>1,677</b>
Issue of shares	2,019	96	0	0	0
Buy-back	(47)	(10)	0	0	0
Minority interests	(26)	0	0	0	0
Dividends paid	(591)	(455)	(516)	(567)	(672)
Net change in bank loans	(1,812)	648	0	0	0
Others	(33)	(109)	0	0	0
<b>Financing cash</b>	<b>(490)</b>	<b>169</b>	<b>(516)</b>	<b>(567)</b>	<b>(672)</b>
<b>Net change in cash</b>	<b>1,035</b>	<b>1,581</b>	<b>830</b>	<b>662</b>	<b>1,005</b>
Exchange rate or other Adj	(203)	(128)	0	0	0
Opening cash	5,910	6,742	8,195	9,024	9,686
<b>Closing cash</b>	<b>6,742</b>	<b>8,195</b>	<b>9,024</b>	<b>9,686</b>	<b>10,690</b>
<b>CFPS (HK\$)</b>	<b>0.913</b>	<b>0.956</b>	<b>0.691</b>	<b>0.665</b>	<b>0.866</b>

Year to Dec	FY18R	FY19	FY20E	FY21E	FY22E
<b>Ratios</b>					
Gross margin (%)	15.3	17.4	17.6	19.4	19.5
Operating margin (%)	2.8	5.6	2.8	2.8	3.1
Net margin (%)	2.3	4.9	2.2	2.2	2.5
Selling & dist'n exp/Sales (%)	9.8	10.5	10.0	10.0	9.8
Admin exp/Sales (%)	2.9	3.2	2.9	3.2	3.2
Payout ratio (%)	51.8	48.5	48.5	48.5	48.5
Effective tax (%)	19.1	8.0	16.5	16.5	16.5
Total debt/equity (%)	11.3	16.2	15.4	14.5	13.5
Net debt/equity (%)	Net cash	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	1.3	1.3	1.3	1.3	1.3
Quick ratio (x)	0.9	1.1	1.0	1.0	1.0
Inventory T/O (days)	66	51	51	51	51
AR T/O (days)	58	79	79	79	79
AP T/O (days)	108	114	114	114	114
Cash conversion cycle (days)	16	16	16	16	16
Asset turnover (x)	1.7	1.5	1.5	1.6	1.6
Financial leverage (x)	3.1	2.9	2.9	3.0	3.0
EBIT margin (%)	2.8	5.6	2.8	2.8	3.1
Interest burden (x)	1.0	1.0	1.0	1.0	1.0
Tax burden (x)	0.8	0.9	0.8	0.8	0.8
<b>Return on equity (%)</b>	<b>11.9</b>	<b>21.2</b>	<b>9.7</b>	<b>10.4</b>	<b>12.0</b>
<b>ROIC (%)</b>	<b>23.5</b>	<b>49.5</b>	<b>21.9</b>	<b>24.9</b>	<b>30.3</b>
<b>Balance Sheet HK\$ mn</b>					
Fixed assets	1,475	1,659	1,903	2,237	2,646
Intangible assets & goodwill	893	2,024	2,024	2,024	2,024
Associated companies & JVs	1,438	1,430	1,430	1,431	1,431
Long-term investments	129	144	144	144	144
Other non-current assets	302	419	419	419	419
<b>Non-current assets</b>	<b>4,237</b>	<b>5,676</b>	<b>5,921</b>	<b>6,255</b>	<b>6,664</b>
Inventories	6,983	5,401	5,999	6,540	7,258
AR	7,242	10,162	11,315	12,615	14,015
Prepayments & deposits	0	0	0	0	0
Other current assets	3,098	3,888	3,888	3,888	3,888
Cash	6,742	8,195	9,024	9,686	10,690
<b>Current assets</b>	<b>24,066</b>	<b>27,646</b>	<b>30,227</b>	<b>32,729</b>	<b>35,852</b>
AP	11,416	12,080	13,416	14,627	16,233
Tax	56	135	225	256	317
Accruals & other payables	5,152	6,478	7,213	8,042	8,934
Bank loans & leases	1,094	1,729	1,729	1,729	1,729
CB & othe debts	0	0	0	0	0
Other current liabilities	611	734	734	734	734
<b>Current liabilities</b>	<b>18,329</b>	<b>21,156</b>	<b>23,318</b>	<b>25,388</b>	<b>27,948</b>
Bank loans & leases	21	149	149	149	149
CB & othe debts	0	0	0	0	0
Deferred tax & others	78	81	81	81	81
MI	0	357	380	405	438
<b>Non-current liabilities</b>	<b>98</b>	<b>587</b>	<b>609</b>	<b>635</b>	<b>667</b>
<b>Total net assets</b>	<b>9,876</b>	<b>11,580</b>	<b>12,220</b>	<b>12,961</b>	<b>13,901</b>
<b>Shareholder's equity</b>	<b>9,876</b>	<b>11,580</b>	<b>12,220</b>	<b>12,961</b>	<b>13,901</b>
Share capital	2,335	2,363	2,363	2,363	2,363
Reserves	7,540	9,217	9,857	10,598	11,538
<b>BVPS (HK\$)</b>	<b>4.37</b>	<b>4.23</b>	<b>4.90</b>	<b>5.15</b>	<b>5.47</b>
Total debts	1,115	1,878	1,878	1,878	1,878
Net cash/(debts)	5,627	6,319	7,148	7,810	8,815

Source: Company, OP Research

**Exhibit 3: Peer Comparison**

Company	Ticker	Price	Mkt cap (US\$m)	3-mth avg t/o (US\$m)	PER		EPS		3-Yr EPS Cagr (%)	PEG (x)	Div yld Hist (%)	Div yld FY1 (%)	P/B		EV/		Net gearing Hist (%)	Gross margin Hist (%)	Net margin Hist (%)	ROE Hist (%)	ROE FY1 (%)	Sh px 1-mth %	Sh px 3-mth %	
					Hist (x)	FY1 (x)	FY2 (x)	FY1 YoY%					FY2 YoY%	(x)	(x)	Hist								FY1
Tcl Electronics	1070 HK	3.79	1,160	1.3	7.2	6.2	4.2	15.7	47.1	27.2	0.2	6.6	7.8	0.7	0.6	0.8	0.2	Net cash	(34,055.6)	8.0	21.2	10.7	17.3	25.2
HSI		24427.19			10.7	11.4	9.7	-6.7	18.1	7.3	1.57	3.9	3.5	0.98	0.96					9.2	8.4	2.9	5.8	
HSCEI		9758.63			8.1	8.5	7.6	-4.8	12.5	6.1	1.39	4.0	3.9	1.02	0.96					12.6	11.3	-0.8	3.8	
CSI300		4239.86			16.2	13.9	12.0	17.0	15.5	4.9	2.84	2.0	2.2	1.91	1.76					11.8	12.7	6.8	15.4	
<b>Adjusted sector avg*</b>					<b>48.6</b>	<b>38.7</b>	<b>25.1</b>	<b>-36.7</b>	<b>317.2</b>	<b>27.2</b>	<b>1.17</b>	<b>1.0</b>	<b>1.8</b>	<b>4.28</b>	<b>4.06</b>	<b>15.4</b>	<b>68.8</b>	<b>41.6</b>	<b>20.1</b>	<b>4.1</b>	<b>11.5</b>	<b>7.5</b>	<b>6.4</b>	<b>25.5</b>
Xiaomi Corp-B	1810 HK	12.84	39,884	257.2	27.7	24.8	19.0	-77.1	534.0	21.6	1.14	N/A	N/A	2.41	3.25	19.0	102.7	0.0	13.9	4.9	11.4	9.4	5.8	25.9
Skyworth Group L	751 HK	2.17	857	3.6	7.8	7.5	6.1	3.9	23.1	16.8	0.45	N/A	4.5	0.37	0.34	5.8	4.9	34.7	20.1	2.0	4.8	4.8	8.5	34.8
Hisense Visual-A	600060 CH	12.72	2,355	21.4	29.9	26.3	20.4	13.6	29.0	19.2	1.37	0.7	1.1	1.14	1.10	16.1	11.3	0.0	18.0	1.6	4.0	4.3	-5.8	36.3
Sichuan Chang-A	600839 CH	2.88	1,881	23.4	219.8	72.0	72.0	205.3	0.0	N/A	N/A	0.8	0.3	1.05	1.01	17.0	17.1	74.5	11.5	0.1	-2.6	1.5	7.5	5.9
Tcl Technology-A	000100 CH	6.1	11,599	324.4	30.5	23.9	17.5	-78.3	704.7	30.2	0.79	1.7	N/A	2.58	2.71	17.7	N/A	75.3	11.6	3.5	7.3	6.2	12.2	38.7
Skyworth Digit-A	000810 CH	12.02	1,808	26.4	19.7	17.5	14.2	12.8	23.3	17.7	0.99	0.8	1.2	3.23	2.90	17.4	15.4	50.5	22.0	7.1	16.8	16.2	4.2	5.0
Huayi Brothers-A	300027 CH	3.69	1,455	16.2	N/A	27.7	20.5	N/A	N/A	-153.6	N/A	N/A	N/A	2.38	N/A	-4.6	N/A	61.6	25.7	-181.1	-62.8	N/A	-10.7	13.5
Netflix Inc	NFLX US	455.04	200,128	3223.7	106.8	66.5	49.7	-55.3	380.2	41.2	1.61	N/A	N/A	23.80	21.21	72.2	173.4	149.7	38.3	9.3	31.6	38.7	6.8	25.0
Amazon.Com Inc	AMZN US	2758.82	1,376,033	11223.1	117.6	81.7	52.9	-76.4	843.1	43.9	1.86	N/A	N/A	21.09	17.09	35.1	157.0	36.3	41.0	4.1	18.6	10.5	11.6	44.6

\* Outliners and "N/A" entries are excl. from the calculation of averages

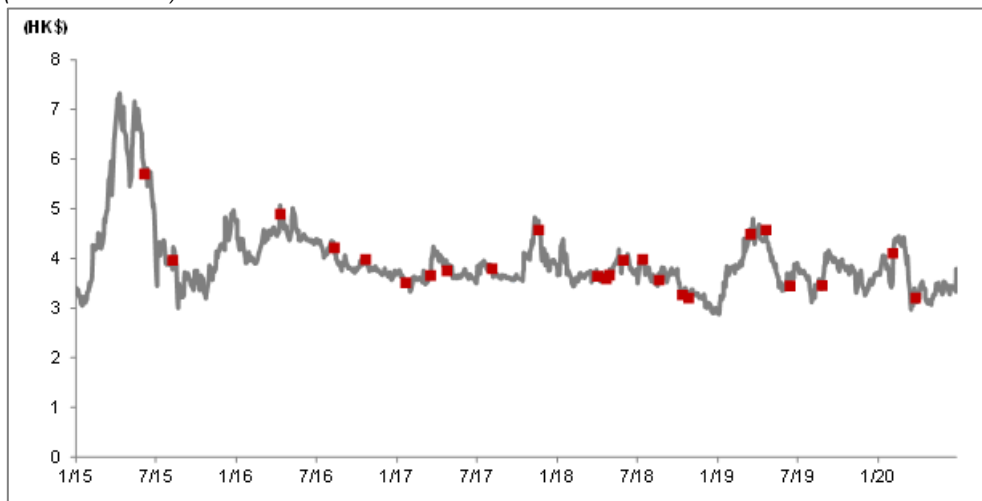
Source: Bloomberg, OP Research

## Our recent reports

Date	Company / Sector	Stock Code	Title	Rating	Analyst
30/06/2020	Yeahka	9923	From payment to Fintech	BUY	Kevin Tam
19/06/2020	Powerlong CM	9909	Moving into the fast lane	NR	Dallas Cai
11/06/2020	Xtep Intl	1368	More promising prospect from FY21E	BUY	Megan Jin
08/06/2020	Edvantage Group	382	Campus capacity enlarged further	BUY	Megan Jin
04/06/2020	S-Enjoy Service	1755	Robust expansion continues	BUY	Megan Jin
04/06/2020	Greentown Services	2869	Placing for new growth initiatives - city services most likely	HOLD	Dallas Cai
28/05/2020	A-Living	3319	Positive read-across from April property sales	BUY	Dallas Cai
25/05/2020	HKBN	1310	Challenging to becoming BN leader	NR	Kevin Tam
18/05/2020	Skyworth	751	The sky getting clear	NR	Kevin Tam
14/05/2020	Ausnutria Dairy	1717	Premium products brought up GPM in 1Q20	BUY	Megan Jin/Dallas Cai
14/05/2020	China Youzan	8083	1Q loss narrowed as economies of scale kicking in	BUY	Dallas Cai
05/05/2020	HKTV	1137	HK based ecommerce on the rise	BUY	Kevin Tam/Megan Jin
23/04/2020	Edvantage Group	382	License fee saving may come earlier	BUY	Megan Jin/Dallas Cai
22/04/2020	361 Degrees Intl	1361	1Q20 retail sales in line	BUY	Megan Jin
21/04/2020	Xtep Intl	1368	1Q20 sales performance better than feared	BUY	Megan Jin/Dallas Cai
20/04/2020	Li-Ning	2331	1Q20 delivered satisfactory retail sales	BUY	Megan Jin/Dallas Cai
16/04/2020	Anta Sports	2020	Robust online FILA sales to drive 1Q20 sales beat	BUY	Dallas Cai/Megan Jin
15/04/2020	China Youzan	8083	FY19 GMV saw growth acceleration	BUY	Dallas Cai
02/04/2020	Greentown Services	2869	FY19 results largely in line	HOLD	Dallas Cai
31/03/2020	TCL Electronics	1070	FY19 results up to expectations	BUY	Dallas Cai
30/03/2020	Li-Ning	2331	A head start in FY20E with resilient operation	BUY	Dallas Cai/Megan Jin
27/03/2020	CH Display OPT	334	Lower order visibility ahead in FY20E	HOLD	Dallas Cai
27/03/2020	ChinaSoft Int'l	354	Cloud business ready to accelerate in FY20E	BUY	Dallas Cai
25/03/2020	Anta Sports	2020	FY20E strive for positive growth	BUY	Dallas Cai/Megan Jin
25/03/2020	China Overseas PPT	2669	FY19 results up to expectations	HOLD	Dallas Cai
23/03/2020	CG Services	6098	FY19 saw solid set of results	BUY	Dallas Cai
20/03/2020	Kingdee Int'l	268	Ambitious cloud target to weigh on FY20E earnings	HOLD	Dallas Cai

## Historical recommendations and target price: TCL Electronics (1070 HK)

(as of 30/06/2020)



DATE	RATING	TP (HK\$)	CLOSE (HK\$)	DATE	RATING	TP (HK\$)	CLOSE (HK\$)
1 09 Aug 2017	BUY	5.70	3.75	9 16 Oct 2018	BUY	5.80	3.38
2 23 Nov 2017	BUY	6.40	4.57	10 30 Oct 2018	BUY	5.80	3.23
3 06 Apr 2018	BUY	4.60	3.64	11 20 Mar 2019	BUY	5.80	4.39
4 26 Apr 2018	BUY	4.60	3.59	12 25 Apr 2019	BUY	5.80	4.57
5 03 May 2018	BUY	4.60	3.53	13 18 Jun 2019	BUY	5.80	3.44
6 04 Jun 2018	BUY	5.60	3.96	14 02 Sep 2019	BUY	5.96	3.35
7 18 Jul 2018	BUY	5.60	3.98	15 10 Feb 2020	BUY	6.10	4.10
8 25 Aug 2018	BUY	5.80	3.47	16 30 Mar 2020	BUY	5.10	3.20

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