

Standing out from the crowd

- We expect investors to focus on China smartphones, tablets, components, and mobile Internet/services in 2014
- On our forecasts, smartphone and tablet shipments will grow by 43% and 42% YoY, respectively
- Our top stock picks for 2014 are: Mediatek, SK Hynix, Tencent, Lenovo and Sunny Optical

China Tech Food Chain

■ Positive (unchanged)

■ Neutral

■ Negative

How do we justify our view?



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and the Daiwa Tech Team

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■ What's new

In this report, we look at the emerging eco-system in the China tech food chain, and likely changes in the competitive landscape in 2014 as companies across the major sectors — smartphones, tablets, components and mobile/Internet services — upgrade product specs and enter into new alliances in a bid to stand out from the crowd.

■ What's the impact

For 2014, we forecast TV shipments to rise by 7% YoY, PC shipments to increase by 5% YoY, smartphone shipments to grow by 43% YoY, and tablet shipments to rise by 42% YoY.

China smartphone sector. We forecast the China smartphone makers to account for more than 45% of smartphone shipments globally for 2014, with Lenovo (992 HK, HKD8.79, Buy [1]), Xiaomi Technology (Xiaomi) (Not listed), TCL (Not rated) and Oppo (Not listed) outperforming the top-10 players in shipment growth.

China tablet sector. In our view, price competition will be fierce between the white-box players (using Rockchip and Allwinner ICs) and local brand players (leveraging ICs from Mediatek [2454 TT, TWD426, Buy (1)] and RDA Microelectronics [RDA] [Not rated]). We do not believe Intel will gain share in the China tablet market without providing turnkey services and a viable version of the Android OS. We forecast China tablet shipment growth of 42% YoY, from 100% YoY for 2012. In our opinion, highly integrated IC players, such as Mediatek and Spreadtrum Communications (Not rated), are well placed to benefit over the long term from strong system-on-a-chip (SOC) demand.

China components sector. For 2014, we forecast: 1) mobile DRAM shipments to rise by 186% YoY, 2) more than 40% of smartphones shipped by China players to adopt quad-core application processors (AP) and 30% to adopt octa-core ICs, and 3) 8MP camera modules to feature in more than 30% of smartphones (5MP modules are now dominant, with a 30-35% share). We believe mobile DRAM providers (SK Hynix (000660 KS, KRW31,500, Buy [1]), AP providers (Mediatek), and camera-module players (Sunny Optical Technology [2382 HK, HKD6.69, Buy (1)]) will benefit the most from component upgrades.

China smartphone Internet/service/content sectors. We

expect the business opportunity from 4G licensing for smartphone Internet players to pick up next year. Look for China technology, media, and telecoms (TMT) and Internet players to step up their cooperation with local smartphone makers; we view Xiaomi, Lenovo, and Tencent (700 HK, HKD41.2, Buy [1]) as major players in this regard.

■ What we recommend

Top picks: 1) SK Hynix, which should benefit from strong mobile DRAM shipment growth, 2) Mediatek, the leader in China in smartphone ICs, 3) Lenovo, a leader in China mobile products, 4) Sunny Optical, which should benefit from product upgrades, and 5) Tencent, which should realise strong revenue growth from its mobile social platform.

Key stock calls

	New	Prev.
MediaTek (2454 TT)		
Rating	Buy	Buy
Target	480.00	480.00
Upside	▲ 12.7%	
SK Hynix (000660 KS)		
Rating	Buy	Buy
Target	40,000	40,000
Upside	▲ 27%	
Lenovo Group (992 HK)		
Rating	Buy	Buy
Target	9.90	9.90
Upside	▲ 12.6%	
Sunny Optical Technology (2382 HK)		
Rating	Buy	Buy
Target	11.60	11.60
Upside	▲ 73.4%	
Tencent Holdings (700 HK)		
Rating	Buy	Buy
Target	500.00	500.00
Upside	▲ 21.6%	

Source: Daiwa forecasts.

Sector stocks: key indicators

Company Name	Stock code	Share Price	Rating		Target price (local curr.)			EPS (local curr.)					
			New	Prev.	New	Prev.	% chg	FY1			FY2		
								New	Prev.	% chg	New	Prev.	% chg
AAC Technologies	2018 HK	31.50	Underperform	Underperform	31.00	31.00	0.0%	2.106	2.106	0.0%	2.012	2.012	0.0%
Lenovo Group	992 HK	8.79	Buy	Buy	9.90	9.90	0.0%	0.078	0.078	0.0%	0.094	0.094	0.0%
MediaTek	2454 TT	426.00	Buy	Buy	480.00	480.00	0.0%	19.962	19.962	0.0%	25.464	25.464	0.0%
SK Hynix	000660 KS	31,500	Buy	Buy	40,000	40,000	0.0%	3,491	3,491	0.0%	4,472	4,472	0.0%
Sunny Optical Technology	2382 HK	6.69	Buy	Buy	11.60	11.60	0.0%	0.482	0.482	0.0%	0.714	0.714	0.0%
Tencent Holdings	700 HK	411.20	Buy	Buy	500.00	500.00	0.0%	9.116	9.116	0.0%	11.765	11.765	0.0%

Source: Daiwa forecasts

Standing out from the crowd in 2014

Sector-by-sector summary

In this section, we summarise our expectations for 2014 across the major sectors of the China tech food chain. Inside the report, we expand on our assumptions for the major sectors and highlight 17 major players across the food chain.

Improvements to the specifications of mobile devices will likely be a recurring theme next year, chiefly in terms of the APs and displays used in smartphones, as well as the amount of DRAM and the pixel count of camera modules used in phones and tablets.

The imminent arrival of 4G in China, meanwhile, promises to create new opportunities for content providers to monetise their offerings in 2014, and opens up the door to closer collaboration between content and hardware players. With market competition intensifying, such alliances, if successful, could give companies an edge over rivals — enhancing the functionality and perceived value of devices while also expanding the addressable market for content.

China Smartphone Sector

- 1) We continue to expect strong (43% YoY growth) China smartphone shipments (615m units) for 2014.
- 2) The China smartphone makers should account for more than 45% of global smartphone shipments in 2014, on our forecasts.
- 3) We believe 40% of China smartphone shipments will have adopted quad-core APs and 30% will have octa-core ICs, which could lead to market-share erosion for Apple and Samsung Electronics (SEC) in China and other emerging markets from next year.
- 4) We expect China's top-10 players in aggregate to account for 61% of the country's total smartphone shipments in 2014 (vs. 57% in 2013E).

Of the top-10 global players, we expect Lenovo, Xiaomi, TCL, and Oppo to do the best in terms of shipment growth in 2014.

China Tablet Sector

- 1) We forecast China tablet shipments to reach 170m units for 2014, up from 110-120m units for 2013E, indicating 80% YoY growth for 2013 and about 42% YoY growth for 2014.
- 2) According to our market research, the China white-brand tablets are 40-50% cheaper than the global brands.
- 3) We forecast 80% of China's white-brand tablets to have a Wi-Fi function (the remaining 20% should have 3G baseband) in 2013, and 68% in 2014.
- 4) We expect the currently fierce competition to become even more severe in 2014.
- 5) Android, not Apple, should dominate (in terms of shipments and sales) the China tablet makers next year, because: 1) the size of the Android smartphone and TV markets attracting local applications, software developers, and tablet makers, 2) Android is free and a relatively open platform, and 3) there are no attractive cheap AP offerings.

We believe high integrated-IC players, such as Mediatek and Spreadtrum, are well-positioned to benefit over the long term from high SOC demand.

China Components Sector

- 1) We forecast China's mobile DRAM shipments to increase by 186% YoY for 2014, on the back of strong demand for higher memory content.
- 2) For 2014, we forecast more than 40% of the smartphones shipped by China players to use quad-core APs and 30% to use octa-core ICs.
- 3) Smartphones with displays of 4.5" and using FWVGA/QHD displays are likely to become the mainstream in 2014. We expect the mainstream smartphone displays to use QHD, and full HD, resolution, compared with lower-resolution WVGA or below used currently.
- 4) Mainstream China camera modules should move to 8MP in 2014. We forecast smartphones with such modules to account for more than 30% of shipments next year, while 5MP modules have dominated in 2013 (30-35% of the total market).
- 5) China touch-panel players seeking improvements in thickness, weight, and strength.

We believe mobile DRAM providers (SK Hynix), AP providers (Mediatek), and camera-module players (Sunny Optical) will benefit the most from components upgrades.

China Mobile Service/Internet Sector

1) We expect the business opportunity from 4G licensing for smartphone Internet players to accelerate next year.

2) We see the following key Internet themes and sector players benefiting: i) server and cloud computing providers, ii) mobile advertising, iii) mobile ecommerce iv) mobile gaming, v) online-video services, and vi) mobile instant messaging (IM) services.

3) China's Internet companies are likely to intensify their cooperation with domestic smartphone makers. Their goal is to provide mobile Internet services as a way of attracting end-users and add value to their hardware offerings. We expect closer ties between the China TMT and Internet sectors.

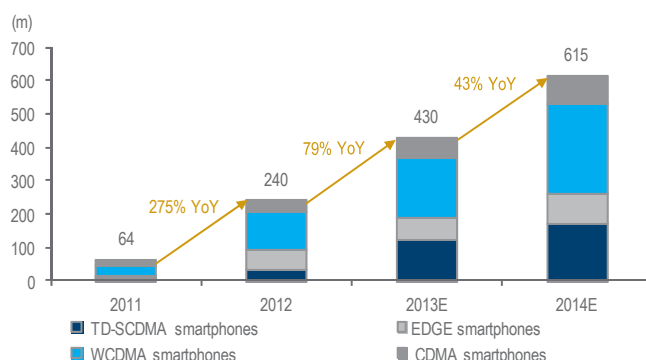
We see Xiaomi and Lenovo as well-positioned to provide services or cooperate with Tencent, Baidu, or Alibaba in order to secure a large addressable TMT market.

China Smartphone Sector

Shipment growth of 43% YoY for 2014E

We forecast China's smartphone shipments to rise by 43% YoY for 2014, with the China players recording total smartphone shipments of 615m units, up from 430m units for 2013E (compared with 240m for 2012 and 64m for 2011). We expect China's smartphone makers to account for more than 45% of global smartphone shipments next year, up from 40% for 2013E.

China smartphone shipments



Source: Daiwa forecasts

We reaffirm our Positive sector rating, on the favourable trends we see heading into 2014. We expect **Mediatek** to retain its market dominance in semiconductors. Meanwhile, we like the leading China smartphone brands, especially **Lenovo** for its leading position among China's smartphone brands.

China players should gain significant market share from global players in 2014

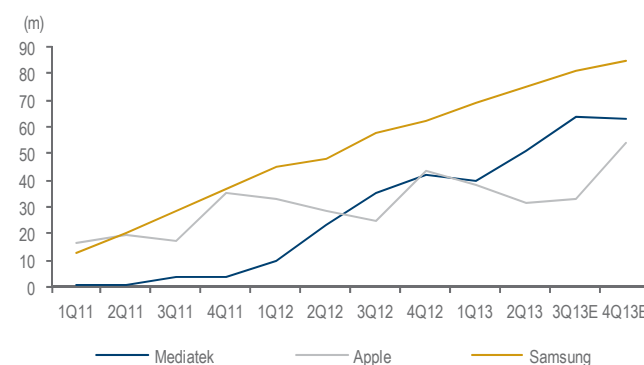
China smartphone makers look set to challenge the global brands in 2014, as many of their smartphones are likely to have octa-core ICs and 4-5" displays and be priced at CNY2,000 (about USD330).

- 1) We believe global second-tier smartphone brand names (eg, HTC, Nokia, and Motorola) will lose market share in 2014, as they have done YTD in 2013.
- 2) Global first-tier smartphone players (Apple and SEC) could lose market-share in China and other emerging markets due to increased ASP competition.

China smartphone shipments increased sharply over 2011-13 on the back of attractive smartphones being rolled out with attractive price-performance profiles, resulting in consumer demand moving from feature phones to smartphones. We believe the integrated solutions offered by the smartphone-IC suppliers have been the main driver of the mass-produced, low-priced, high-spec products (as reflected by the rapid growth of Mediatek's smartphone IC shipments since 2012, with the company offering integrated baseband and APs, supporting high-spec hardware features).

Global smartphone brands are under increasing pressure from the mid-range to low-end makers offering competitive specs and attractively priced smartphones, with the latter supported by China smartphone-IC suppliers and local components makers. For example, Xiaomi's low-cost smartphone (HongMi) is priced at about USD130, while prices for Apple's iPhone 5C start at USD549.

Smartphone shipments: China vs. global brands



Source: Companies, Daiwa forecasts

■ Xiaomi smartphone vs. global and China high-end smartphones

	Xiaomi Mi3	Xiaomi Hongmi	Meizu MX3	BBK Vivo X3	Huawei Honor 3	Coolpad 9970	Apple iPhone5S	Apple iPhone5C	Samsung Galaxy Note 3
									
Global launch	13-Sep	13-Aug	13-Sep	13-Sep	13-Sep	13-Sep	13-Sep	13-Sep	13-Sep
OS	MIUI V5/ Android 4.2.1	MIUI V5/ Android 4.2.1	Flyme 3.0	Android 4.2	Android 4.2	Android 4.2	iOS7	iOS7	Android 4.3
Display	5.0"	4.7"	5.1"	5.0"	4.7"	5.9"	4.0"	4.0"	5.7"
Resolution	1920*1080 (HD 441ppi)	1280*720 (HD720 312ppi)	1800*1080 (415 ppi)	1280*720 (HD720 294ppi)	1280*720 (HD720 312ppi)	1920*1080 (HD 373ppi)	1136*640 (Retina 326 ppi)	1136*640 (Retina 326 ppi)	1920*1080 (HD 386ppi)
Processor	TD/W: Nvidia Tegra4 CA-15 quad-core 1.8GHz/ W: Qualcomm800 MSM8974AB quad-core 2.3GHz	Mediatek MT6589T CA7 quad-core 1.5GHz	Samsung Exynos 5410 octa-core 1.6GHz	Mediatek MT6589T CA7 quad-core 1.5GHz	Hisilicon K3V2E quad-core 1.5GHz	Nvidia Tegra 4 quad-core 1.8GHz	Apple A7 Dual-core 1.6GHz	Apple A6 Dual-core 1.3GHz	LTE: 2.3GHz Qualcomm quad- core/3G: 1.9GHz Exynos 5 quad- core*2 (CA15 1.9GHz+CA7 1.3GHz)
Network	WCDMA/TD- SCDMA/CDMA	TD-SCDMA (Planned WCDMA)	WCDMA	WCDMA	WCDMA	CDMA	WCDMA/CDMA/FDD- LTE/TD-LTE	WCDMA/CDMA/FDD- LTE/TD-LTE	LTE/WCDMA
Memory- Storage	16/64GB	4GB	16GB	16GB	8GB	16GB	16/32/64GB	16/32GB	32/64GB
Memory- RAM	2GB	1GB	2GB	1GB	2GB	2GB	2GB	1GB	3GB
Weight	145g	158g	143g	150g	138g	n.a.	112g	132g	168g
Thickness	8.1mm	9.9mm	9.1mm	5.95mm	9.9mm	7.9mm	7.6mm	8.97mm	8.3mm
Camera	Rear: 13MP Front: 2MP	Rear: 8MP Front: 1.3MP	Rear: 8MP Front: 2MP	Rear: 8MP Front: 5MP	Rear: 13MP Front: 1MP	Rear: 13MP Front: 2MP	Rear: 8MP Front: 1.2MP	Rear: 8MP Front: 1.2MP	Rear: 13MP Front: 2MP
Pricing (CNY)	1,999(16GB), 2,499 (64GB)	799	2499	2,498	1,999	3,980	USD649/749/849	USD549/649	USD700(32GB)

Source: Companies, Daiwa

Big displays and octa-core solution should be ready in 2014

For 2014, we forecast 40% of the smartphones shipped by China players to use quad-core APs and 30% to use octa-core ICs, and more than 20% of the smartphones shipped to have 4.7" displays. We understand that Mediatek's rollout of power-efficient octa-core smartphone ICs has met with a good response in China, signalling that the technology gap between the China smartphone makers and global peers is narrowing, while the price gap has not narrowed.

■ China smartphone IC shipments and market share

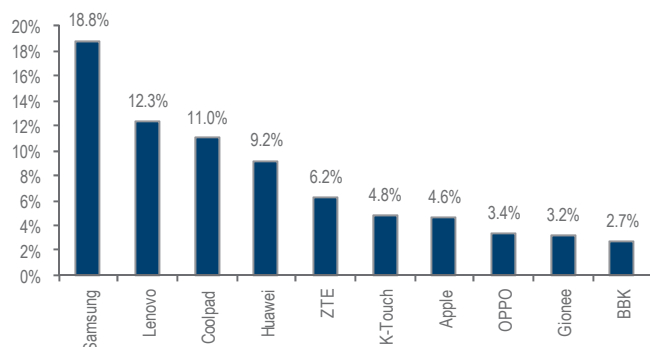
(m)	2011	2012	2013E	2014E
Mediatek	9	108	215	300
Spreadtrum	-	30	80	120
MStar	-	1	0	0
Coolsand/RDA	-	-	5	30
Qualcomm	45	90	130	160
Others	10	11	-	5
Totals	64	240	430	615
Market share (%)	2011	2012	2013E	2014E
Mediatek	14	45	50	49
Spreadtrum	-	13	19	20
MStar	-	0	-	-
Coolsand/RDA	-	-	1	5
Qualcomm	70	38	30	26
Others	16	5	-	1
Totals	100	100	100	100

Source: Companies, Daiwa

Further market share concentration likely among top-10 China players

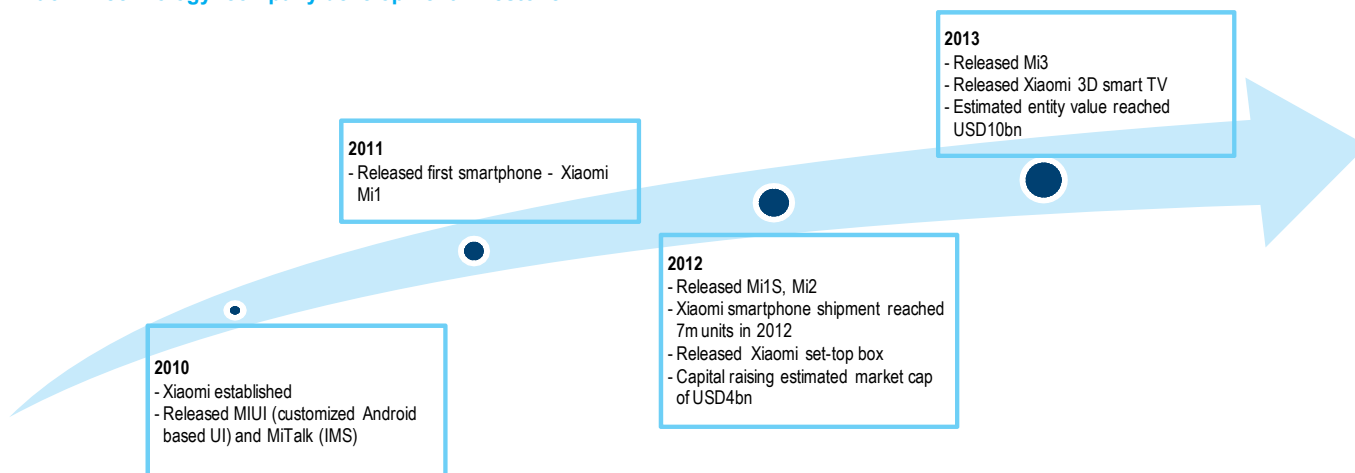
We forecast China's top-10 smartphone companies combined to account for 60% of the country's total smartphone shipments for 2014 (up from 57% for 2013E). Our market research indicates that Lenovo, Xiaomi, TCL, and Oppo should see solid shipment growth. Among the OEMs, LongCheer, Wingtech, and Huaquin appear likely to build on their leading positions.

China smartphone market share by shipments in mid-2013



Source: SINO

Xiaomi Technology: company development milestone



Source: Daiwa Capital Market

Shipments for China's top-10 players

(m units)	2011	2012	2013E	2014E
Huawei	15	33	45	60
ZTE	14	27	40	52
Lenovo	5	28	40	60
Coolpad	9	15	25	35
TCL Communication	3	12	20	35
Xiaomi	1	7	20	40
Gionee	2	12	18	26
OPPO	2	7	13	23
BBK	1	5	12	20
Tianyu	1	5	10	16
Top-10 players' shipments	53	151	243	367
Total China smartphone shipments	64	240	430	615
Top-10 players' shipment share (%)	83	63	57	60

Source: Companies, Daiwa estimates and forecasts

China Tablet Sector

42% YoY rise in shipments for 2014E

Our market research suggests that in 1Q13, China's tablet shipments amounted to 28m units, more than 90% of which were by white-brand companies. Given this, we forecast China tablet shipments of about 120m for 2013, up from 60m units for 2012, and 170m units for 2014, representing growth of 100% YoY for 2013 and 42% YoY for 2014.

We are positive on the outlook for Mediatek given its leading position as a provider of Android-based chips for smartphones, tablets, and TVs in the China market.

Prices of China white-brand tablets are 50-60% of those of global brand players

Our market research suggests that the FOB price of a mainstream China tablet (with a 7" display and Wi-Fi) is about USD50, which suggests the retail price is about USD70 (with a bill-of-materials cost of USD35). This means the retail prices of tablets from the China white-brand players are 50-60% of those of the international brand players (eg, tablets with a 7" display and Wi-Fi from Acer, Asustek, and Lenovo are priced at USD119-149).

We attribute the China white-brand tablet players' low costs to their high leverage in local components resources, such as chipsets, panels, casings, and camera modules.

Some 80% of China tablets likely to sport Wi-Fi in 2013, falling to 68% for 2014E

Based on our research, we forecast 80% of China white-brand tablets to have Wi-Fi (the remaining 20% should have 3G baseband) for 2013, and 68% for 2014 (with 3G tablets' share rising on the back of falling prices). We forecast Mediatek to account for a more

than 60% share of the tablets using 3G in 2013 and in 2014. Among Wi-Fi tablets, we expect Allwinner and Rockchip to dominate this year, and lose some market share in 2014. We note that some China local brand players prefer Mediatek for their integrated chip offerings.




Costs should fall in 2014 on fierce chip-price competition and high integration

Rockchip and Allwinner (Rockchip is the first company in China to use 28nm chips and could replace Allwinner in 2014 as the largest provider of tablet APs), expect their shipments to reach about 80m units combined for 2013 and more than 100m combined units for 2014.

Meanwhile, we note that Mediatek (with its MT8125 MT8135 and MT8389 chips), Spreadtrum, and RDA plan to enter the tablet-AP market this year (Spreadtrum and RDA by the end of 4Q13) by leveraging their in-house Wi-Fi and baseband chipset offerings. We expect fierce price competition in the tablet-AP market in 2014.

We forecast the price of dual-core chips for tablets to drop by about 30% YoY for 2014. Meanwhile, we forecast Mediatek's share of the tablet-AP market to be about 18% for 2013 and 30-35% for 2014, with 21.6m shipments for 2013 and 60m shipments for 2014.

■ China manufactured tablet PCs

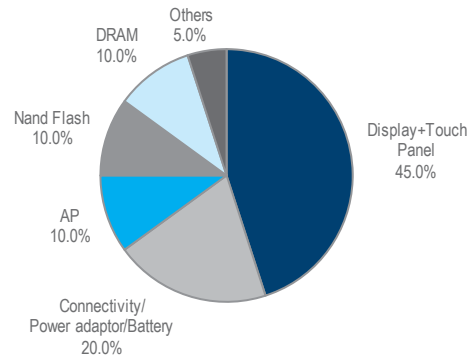
	Lenovo A3000	Koobee U55GT	Colorfly E708 Q1
			
Global launch	Apr-13	Jan-13	Aug-13
OS	Android4.2	Android4.2	Android4.2
Display	7.0"	7.9"	7"
Resolution	1024x600	1024x768	1280x800
Processor	MT8389 CA-7 Quad-core 1.2GHz	MT8389 CA-7 Quad-core 1.2GHz	Allwinner A31S CA-7 Quad-core 1GHz
Network	WCDMA	WCDMA	Wi-Fi only
Memory-Storage	8/16/64GB	16/64GB	8GB
Memory-RAM	1GB	1GB	1GB
Weight	345g	360g	241.1g
Thickness	11mm	7.4mm	8.2mm
Camera	Rear: 5MP Front: 0.3MP	Rear: 5MP Front: 2MP	Front: 0.3MP
Pricing (CNY)	1,100(8GB), 1,300(16GB)	999	399

Source: Companies, Daiwa

Android dominates the China tablet market, just as it does in smartphones

Our research suggests Android will remain the dominant OS on China tablets, as well as being used for smartphones and TVs, over the next few years. This is because: 1) the size of the Android smartphone and TV markets (number of end users) is considerable, attracting local application developers, software developers, and tablet makers, 2) the Windows RT OS requires a licence fee, while Android is free and a relatively open platform, and 3) there are no attractive and cheap AP offerings, as Rockchip, Allwinner, Spreadtrum, and Mediatek have not been approved by Microsoft as Windows RT AP providers.

China tablets: cost structure



Source: Daiwa

BOM cost comparison

(USD)	Notebook	Netbook (Intel)	Netbook (ARM)	China tablet PC	Apple - iPad 4 (16GB with 4G)	Apple - iPad mini (16GB Wi-Fi)	Galaxy Tab 16GB	Ultrabook (mid- to low-end)	Ultrabook (high-end)
Display	43	33	33	15-20	127	80	70.87	43	53
CPU	110	40	12	5-6	23	13	8.84	120	160
DRAM	35	10	10	7-8	13.9	15.5	4	20	20
HDD (250GB)	35	5	5		16.8		25	35	65
Wireless Module	8	6	6	4	41.5	0	28.12	8	8
Instant-on OS + SSD(16GB)	0	0	0	0	0	0	0	30	30
Battery (6 cells)	29	4.5	4.5	4	32	13.5	10.6	29	39
Keyboard	4	0	0	0	0	0	0	4	4
Optical drive	25	0	0	0	0	0	0	25	0
Thermal	3	0	0	0	0	0	0	3	3
Others									
Chipset	36	24	24	3	10	7.5	5.51	36	36
PCB	13	8	8	5	50.5	26	15.22	13	13
Casing	30	15	15					55	110
Power adapter	6	3.36	3.36				7.95	6	6
Connectors	23	15	15	2	5.5	6	9.35	23	23
Others	15	10.5	10.5		27.35	26	29.11	15	15
Total	415	174.4	146.4	45	347.6	187.5	214.6	435	555

Source: Daiwa estimates

China Components Sector

Spec upgrades

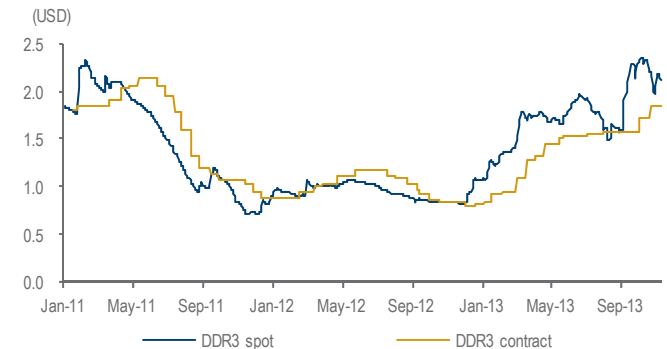
China's handset-components makers should see strong business growth in 2014, driven by robust smartphone shipment growth of 43% YoY (on our forecasts) and components spec upgrades. We think spec upgrades will accelerate in terms of memory, baseband, displays, camera modules, and touch panels, and believe China will gradually adopt antenna and fingerprint technology, in the context of likely 4G and LTE licence releases and its adoption by global brands.

Active spec upgrades in prospect in 2014 underpin our Positive view on the China Handset Food Chain. Our top picks on the back of the upgrade theme are: 1) **SK Hynix**, which stands to benefit from strong memory-content growth, 2) **Mediatek**, the leader in China in smartphone-IC offerings, and 3) **Sunny Optical**, which should benefit from camera module product upgrades

Memory-content demand to rise by more than 150% YoY for 2014E

Memory-content demand to rise by more than 150% YoY for 2014E on the back of our forecast for 43% YoY growth in shipments of China smartphones and a doubling YoY of the average memory content per device. The growth in memory content should be driven by large displays, high-density solutions, more APP content, and increasing frequency in core ICs. We forecast mainstream memory content to be 16GB ROM+2GB RAM and 16GB +1 GB RAM in 2014 (compared with 4GB ROM+1GB RAM [DDR 2/mobile DRAM] and 4GB ROM+512MB RAM in 2013).

Global DRAM price (2Gb)



Source: DRAMeXchange

The rise of quad-core and octa-core smartphones in 2014

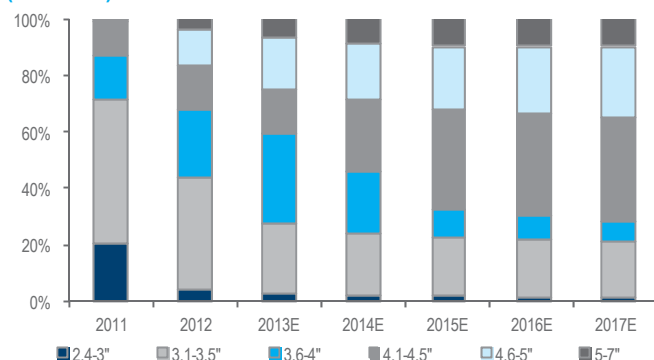
For 2014, we forecast more than 40% of smartphones shipped by China players to use quad-core APs (AP) and 30% to have octa-core ICs. This should help China players narrow the technology gap with global brands and offer more competitive handset pricing and performance.

Also, our industry research indicates that Mediatek's Cortex A7 MT6592 IC has impressive clock speeds (1.7-2GHz), and low power consumption, as it can move between running single and multiple cores simultaneously. Thus, the MT6592 should help China smartphone makers gain access to the mid-range and high-end large-screen smartphone segments, and help Mediatek to receive more orders in China and globally.

Smartphones with displays of more than 4.5" and QHD likely to become mainstream in 2014

We expect most displays for China smartphones to be at least 4.5" (4.5-5" mainly for FWVGA, 5" displays for QHD/HD) in 2014, compared with displays of 3.5-4" in 2013. We believe mainstream resolution smartphones will move to using FWVGA, QHD, and full HD screens, compared with WVGA or lower-resolution displays currently.

■ **China: smartphone shipment breakdown by display size (2011-17E)**

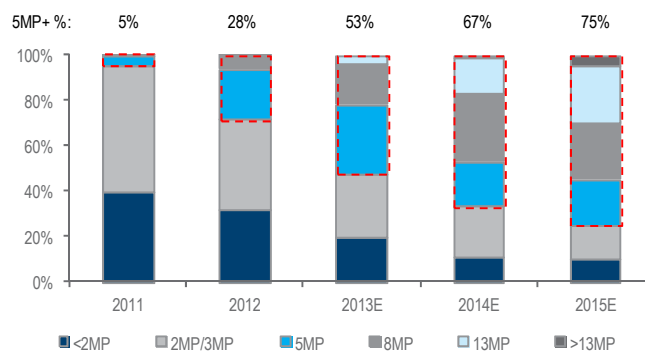


Source: Topology Research Institution, handset makers

Mainstream camera modules should move to 8MPs in 2014

We forecast smartphones with these modules to account for more than 30% of shipments next year: those with 5MPs have been dominant in 2013 (30-35% share of the total market). We foresee strong demand growth next year for high-frame-rate (HFR) camera modules, which offer improved gesture control and facial recognition.

■ **CCM shipment mix of Sunny Optical, a leading camera module supplier in China**

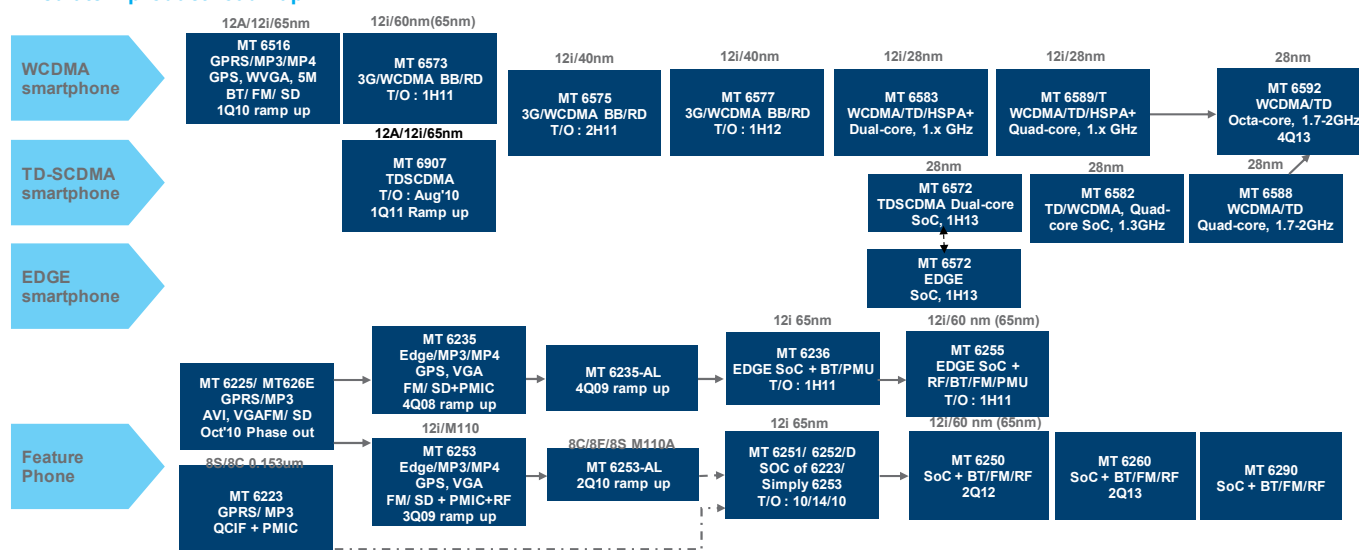


Source: Company, Daiwa forecasts

Touch-panel players seeking improvements in thickness, light, and strength

O-Film (Not rated) believes it can provide 0.6mm ultra-thin touch panels in 2014. Extra features, including hovering touch, anti-fingerprint, anti-stain and antibacterial abilities, should also emerge in China next year, in our view. For notebook PCs, the company is developing a metal-mesh solution, which it believes has better cost efficiency than an ITO touch sensor, and a shorter time to market, although there are questions in the market about its product quality and production yields.

■ **Mediatek: product roadmap**



Source: Daiwa

China Mobile Service/Internet sector

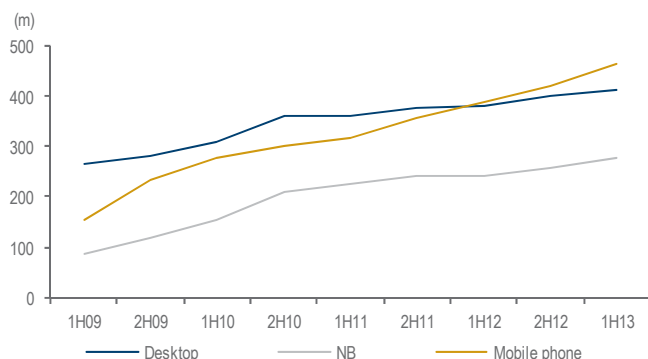
Promising business growth for TMT

China's Ministry of Information Industry (MII) has said it expects 4G licences to be issued before the end of this year. We expect the rollout of 4G to create significant opportunities for the leading smartphone content and service providers over the long term.

The emergence of a 4G market in China heralds an increase in available bandwidth and the likelihood of further growth in the number of end-users for device manufacturers and service providers. On our forecasts, China should have 450m 3G/4G smartphone users by the end of 2014, and close to 1bn by 2020. The country is already seeing rapid growth in the number of 3G smartphone users (we forecast 3G smartphone shipments to double YoY to 360m units for 2013), and we expect 4G to provide further impetus to consumers' adoption of mobile Internet devices.

We think the emergence of a 4G market in China will create long-term business opportunities for players in a range of segments in the TMT segment.

China Internet user base by access channel



Source: CNNIC

4G to spur mobile Internet devices and demand for services

Among the likely beneficiaries of China's 4G rollout, we favour: 1) Tencent (expanded opportunities to monetise mobile Internet usage through WeChat and games), and 2) Lenovo (a leading player in China smartphones and server/cloud computing).

In our view, 4G licensing will present limited opportunities for China's smartphone makers in 2014. We forecast these companies to ship no more than 20m 4G/LTE smartphones next year, given the country's fledgling 4G/LTE infrastructure and supply chain. We forecast domestic demand for such handsets to total no more than 60m units for 2014, leaving global brands with the bulk of the market initially (about 40m, on our forecasts). In the first two years of China's 4G rollout, we believe domestic demand will centre largely on base-station equipment suppliers; so far, the country's has 4G/LTE base stations in only 16 cities.

Six segments that stand to benefit from 4G over the long term

On a longer-term view, we expect the following segments to benefit from China's 4G rollout:

- 1) server and cloud computing providers — leading players include Lenovo, Xiaomi, Alibaba, and Baidu;
- 2) mobile advertising — iResearch forecasts that online advertising revenue could top CNY200bn in 2015, driven by video advertising and keyword advertising;
- 3) the mobile e-commerce market — China's Ministry of Commerce expects the country to have the world's largest e-commerce market by 2015 (leading players include Taobao, Dangdang, 360Buy and Suning);
- 4) mobile gaming — games are already an effective way of monetising the rise of Internet usage on mobile devices (the leading players are Tencent and Qihoo);
- 5) online video services — leading players such as Youku Tudou, Tencent, iQiyi, and Sohu appear to be moving towards profitability; and
- 6) mobile instant messaging (IM) services — platforms such as Tencent's WeChat are seeing rapid growth in subscribers.

Smartphone Internet players

Global service providers have China in their sights. Global players are seeking to appeal to users in the China market by offering features tailored to it. Apple, for example, has progressively added Chinese-language capabilities to iOS (both character recognition and its Siri voice assistant), as well as adding software hooks to China-centric services (Tencent QQ and Weibo).

China's Internet service providers are tailoring their services to mobile users. Many of China's Internet companies are tailoring their services to mobile users, and we expect the likes of Baidu, Alibaba, Tencent, and Qihoo to intensify their co-operation with domestic smartphone makers in the future. Stronger ties between the TMT segments should allow service providers to attract more end-users and smartphone makers to add value to their hardware offerings.

China's smartphone makers are keen to secure users through their own user interfaces (UI) and applications tailored to the domestic market. Wary of allowing further fragmentation of the Android platform, Google faces a challenge to maintain the quality and compatibility of software while keeping domestic handset makers on-side.

To date, however, licence-free Android OS installations — those not qualified by Google and thus ineligible to integrate various Google services — are ahead of the pack in terms of the installed base, as China's smartphone market expands.

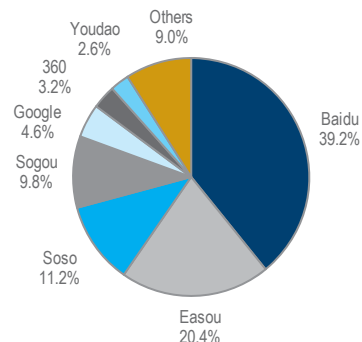
Search engine providers in China

	PC search engine	Mobile search engine	PC browser	Mobile browser
PC search company				
Google	V	V	V	V
Baidu	V	V	V	V
Tencent (Soso)	V	V	V	V
Sogou	V	V	V	V
Qihoo 360	V	V	V	V
Mobile search company				
Easou	V	V		
Yicha		V		
Roboo		V		V
Youdao		V		

Source: Daiwa

Note: V = the provider offers the service

Mobile search engine market shares in China (2Q13)



Source: iiMedia

Xiaomi's business model covers the production of hardware (the Xiaomi smartphone), software and content (its IM apps, MiTalk, and cloud-storage services), and social networking services, backed by its MIUI OS. The company aims to provide a refined UI for Android smartphone users through its MIUI platform (launched in 2010).

A weekly stream of software updates is provided that encourages close interaction between the company and the sizeable base of users of its products: Xiaomi claimed to have more than 10m users early this year. Xiaomi believes the MIUI OS provides a platform for the further adoption of its app, content, service, and community service businesses within a self-developed ecosystem.

Xiaomi's MIUI OS



MiTalk: Xiaomi's instant messenger APP

Xiaomi's APP store

Source: Company website

Alibaba likely to work with other smartphone players, having already co-operated with Tienyu, Acer, and Haier. Alibaba, the operator of Taobao Marketplace and Alipay (the country's largest third-party online payment service), has invested in a cloud-computing service. The company's subsidiary, Alibaba Cloud Computing, launched its own smartphone OS, AliCloud OS (also known as Aliyun), on a K-Touch (local China handset brand) smartphone in 2011. The OS is fully compatible with Android applications and incorporates the cloud-storage services offered by Alibaba Cloud Computing.

Alibaba is working on developing an alternative to the pure Android OS. Its OS has expanded to encompass co-operation with hardware companies such as Haier. Google has taken a keen interest in these developments, citing concerns about intellectual-property infringements in app stores with the Alibaba OS and, more broadly, attempting to define what can be promoted as Android-compatible.

Localised content and UIs have been well received in China, where, because overseas services are forbidden, the use of software that is also available globally usually trails that of domestic equivalents (eg, Weibo instead of Facebook and Twitter, instant messenger Tencent QQ, instead of, say, MSN, and localised online stores instead of the Android market/Apple App Store).

China smartphone supply chain directory

Smartphone ICs	BBG code	Description	Product
Qualcomm	QCOM US	Qualcomm is the world's largest fabless semiconductor producer, with leading technology in wireless communication.	MSM 8974/8x30/8226/8x12/8x10
Mediatek	2454 TT	Mediatek is Asia's largest fabless company providing handset ICs and is the world's largest TV IC provider after acquiring Mstar Semiconductor.	MT 6589/6572/6582/6592/6588/6290
MStar	3697 TT	Mstar Semiconductor is a premier IC-design house supplying display-related products and the communication market.	n.a
Spreadtrum	SPRD US	Spreadtrum was founded in Shanghai and Silicon Valley as a fabless company providing baseband, RF, and processor solutions for wireless communication.	SC 3550/8825C/6825C/7710/6281/7711
RDA	RDA US	RDA is a IC fabless company that designs RF and mixed-signal wireless SOC semiconductors, including baseband, Bluetooth, Wi-Fi, and power amplifiers, etc.	RDA 8810/8850/8860/8880/8890/8820
HiSilicon	Not listed	HiSilicon was established in 2004 and provides communication solutions. It was preceded by ASIC Design Center of Huawei Technologies, which was founded in 1991.	K3V2/Hi3611
Rockchip	Not listed	Rockchip was established in 2001 in Fuzhou, China. It is a fabless company focused on mobile Internet SOC solutions, mainly for Android tablets, Android TV sets (Smart TV), e-books, and Wi-Fi/ Bluetooth audio solutions.	RK3188/RK3066
Allwinner	Not listed	Allwinner is a China fabless-design company that is focused on smart AP SOCs and smart analogue ICs. The company's main solutions are applied mostly to products such as tablets, Internet TVs, smart home devices, automotive dashboard devices, smart power management, and mobile-connected devices.	A31/A31S

Source: Daiwa

Displays/touch	BBG code	Description	Product
AUO	2409 TT	AUO is the second-largest TFT-LCD panel supplier in Taiwan, and fourth-largest in the world. It accounts for an 8% market share in small-medium size panels and is ranked second-largest worldwide.	TFT-LCD Panel
Truly	0732 HK	Truly Semiconductor was founded in 1991, providing flat panel displays and both resistive and capacitive touch panels.	Touch display
JTouch	3584 TT	Founded in 2001, JTouch specialises in the design and manufacture of resistive and capacitive touch panel sensors and modules.	Touch display
Giantplus	8105 TT	Giantplus has expertise in manufacturing small-to-medium sized TFT-LCD and STN panels and touch panel modules.	Touch display
Wintek	2384 TT	Established in 1990, Wintek has become one of the major global touch-panel suppliers, mainly for mobile devices. It also manufactures related touch-module components and TFT-LCD displays and modules.	Touch display
O-Film	002456 CH	O-film is a China-based optical film manufacturer focused on touch solutions, and actively expanded into electronic components manufacturing, camera modules, from 2012.	Touch display
Focal Tech	5280 TT	Focal Tech was founded in 2005, and is China's largest smartphone touch-IC supplier with >80% market share in 2012 and about 50% in 2013 to-date.	Touch controller IC

Source: Daiwa

Mobile content/software	BBG code	Description	Product
SKYMobi	MOBI US	SKYMobi is the largest company in platform services for mobile applications in China. Based in Hangzhou, the company has branches in Beijing, Shanghai, and Shenzhen, supporting handset makers in developing mobile content.	Third-party application store
Sina	Sina US	Sina is a China online media company that operates an Internet portal, a social media platform, and develops web content. Sina Weibo, the microblog/social network, has a mass user base.	Weibo (microblog, social network)
Qihoo 360	QHIU US	Qihoo 360 is a China software company that offers Internet and mobile security services. Known for its antivirus software and Internet browser, it recently entered the smartphone market, offering customised content in partnership with local handset makers.	360 Safeguard (AntiVirus software), 360 Secure Browser (Web browser)
Tencent	0700 HK	Tencent is the largest, most-used portal in China. It is known for Internet services such as instant messaging software Tencent QQ, online gaming, and operates online ads.	Tencent QQ, WeChat (instant messenger)
Xiaomi Technology	Not listed	Xiaomi Technology, founded in 2010, is a well-known Internet company that provides a high-end smartphone, the Xiaomi phone, in China. Its core services include mobile applications and Android-based user interface customisation firmware.	MIUI (Android based UI), MITalk (instant messenger)
ThunderSoft	Not listed	ThunderSoft is a solutions provider for the Android system for smartphones, tablets, Internet TVs and STB applications; it is in partnership with handset makers and IC vendors to improve the user experience.	Android based UI (for Qualcomm, Spreadtrum IC)
Borqs	Not listed	Borqs is a third-party Android software services company that provides customisable Android software platform solutions to telecoms carriers, handset makers, and chipset vendors.	Android based UI (OPhone - UI supported by China Mobile)
Alibaba	Not listed	Alibaba is the largest Internet business platform in China, known for its online shopping platform, Taobao Marketplace, and third-party online payment service.	OS developer, mobile payment app provider

Source: Daiwa

Design house	BBG code	Description	Product
Longcheer	LHL SP	Longcheer is the one of the leading handset design solution companies in China. It was listed on the Singapore Exchange main board in 2005.	Handset design (Huawei, TCL, Lenovo)
WingTech	Not listed	WingTech provides integrated product designs, production and services in handset products covering GSM, CDMA, TD-SCDMA and EVDO.	Handset design (Spreadtrum)
Huaqin	Not listed	Established in 2005 and based in Shanghai, Huaqin supports the development, manufacture and sale of mobile terminals.	Handset design (Coolpad)
Cellon	Not listed	Cellon is a wireless design manufacturer with expertise in the development of wireless end-devices, module solutions and handset ODM business.	Handset design (Motorola)
Bellwave	Not listed	Bellwave is a Korea-based design company offering wireless communication devices, including GSM handsets.	Handset design

Source: Daiwa

AAC Technologies

2018 HK

Disappointing margin guidance

- 3Q13 earnings beat due to non-operating income but gross margin miss
- Softer margin guidance for 4Q13 echoes our concerns
- Reiterating Underperform with a target price of HKD31

Target (HKD): **31.00 → 31.00**
Downside: **1.6%**
11 Nov price (HKD): **31.50**

- 1 Buy
- 2 Outperform
- 3 Hold
- 4 Underperform (unchanged)
- 5 Sell



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■ What's new

AAC guided for a modest decline in its gross margin for 4Q13 at its 3Q13 results analyst meeting. We are cautious on AAC as we see greater margin risks and its prudent tone on its 4Q13 margin outlook reinforces our concerns.

■ What's the impact

3Q13 results: margin miss but earnings hike due to non-operating income. Despite 8% QoQ revenue growth to CNY2.1bn, AAC's gross margin contracted to 42.5% (vs. 42.8% for 2Q13), missing guidance for a mild improvement. The company attributed the margin weakness to higher production costs for new projects and rising labour costs. However, AAC's net profit rose sharply to CNY897m due mainly to a one-time disposal gain on an asset revaluation.

Weak 4Q13 margin guidance.

For 4Q13, AAC guides for double-digit QoQ revenue growth but a mild QoQ gross margin decline. We forecast its gross margin to contract further to 42% for 4Q13, due to greater pricing pressure from what we consider an unfavourable product mix.

Margin downtrend should continue; new products take time to bear fruit.

We believe AAC's shift in focus to non-acoustic products and integrated solutions could be extra long-term growth drivers but envisage a limited contribution in 2014. We forecast AAC's gross margin to fall to 42% in 2014, due to pricing pressure from its major customer and unfavourable industry trends – we believe the high-end smartphone segment is becoming saturated, with limited room for acoustic products upgrades.

■ What we recommend

We reiterate our Underperform (4) rating, with a six-month target price of HKD31, based on a 13x PER (at a discount to AAC's past-three-year average of 14x) applied to our one-year forward EPS forecast. The main risk to our call would be a better-than-expected gross margin delivery.

■ How we differ

We are more concerned than the market about margin pressure from

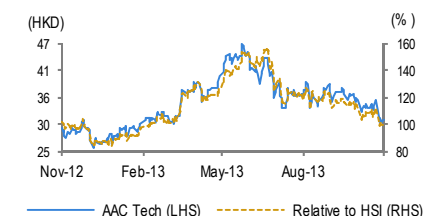
AAC's increasingly unfavourable product mix.

Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	25.85-46.40
Market cap (USDbn)	4.99
3m avg daily turnover (USDm)	24.78
Shares outstanding (m)	1,228
Major shareholder	Chun Yuan Wu Ingrid (21.4%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	8,340	9,675	11,025
Operating profit (m)	2,427	2,765	3,142
Net profit (m)	2,586	2,471	2,810
Core EPS (fully-diluted)	2.106	2.012	2.289
EPS change (%)	46.7	(4.4)	13.7
Daiwa vs Cons. EPS (%)	14.4	(6.4)	(6.2)
PER (x)	11.8	12.3	10.8
Dividend yield (%)	3.4	3.3	3.7
DPS	0.842	0.805	0.915
PBR (x)	3.9	3.3	2.7
EV/EBITDA (x)	12.2	10.8	9.4
ROE (%)	37.2	28.7	27.5

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Receiver sales growth (% YoY)	28.5	(38.0)	39.9	35.8	49.0	34.5	16.1	15.3
Speaker box sales growth (% YoY)	0.0	0.0	0.0	109.0	91.4	83.2	21.4	18.3
MEMS microphone sales growth (%)	0.0	0.0	0.0	44.9	151.5	49.9	35.1	15.2

■ Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Dynamic components Revenues	1,645	1,678	2,483	3,228	5,052	6,975	8,047	9,292
Microphone Revenues	158	146	366	459	774	1,000	1,294	1,477
Other Revenue	453	379	500	372	457	365	335	257
Total Revenue	2,256	2,203	3,349	4,060	6,283	8,340	9,675	11,025
Other income	0	0	0	0	0	0	0	0
COGS	(1,316)	(1,214)	(1,839)	(2,275)	(3,509)	(4,796)	(5,612)	(6,406)
SG&A	(223)	(184)	(237)	(290)	(464)	(726)	(844)	(960)
Other op. expenses	(123)	(159)	(214)	(358)	(462)	(391)	(455)	(517)
Operating profit	594	646	1,060	1,136	1,849	2,427	2,765	3,142
Net-interest inc./(exp.)	20	12	20	22	4	2	7	7
Assoc/forex/extraord./others	3	19	20	(17)	163	463	(2)	2
Pre-tax profit	616	676	1,099	1,142	2,016	2,892	2,769	3,151
Tax	(26)	(67)	(112)	(109)	(259)	(312)	(305)	(347)
Min. int./pref. div./others	(0)	5	(1)	3	6	6	6	6
Net profit (reported)	590	615	987	1,036	1,763	2,586	2,471	2,810
Net profit (adjusted)	590	615	987	1,036	1,763	2,586	2,471	2,810
EPS (reported)(CNY)	0.481	0.501	0.804	0.844	1.435	2.106	2.012	2.289
EPS (adjusted)(CNY)	0.481	0.501	0.804	0.844	1.435	2.106	2.012	2.289
EPS (adjusted fully-diluted)(CNY)	0.481	0.501	0.804	0.844	1.435	2.106	2.012	2.289
DPS (CNY)	0.096	0.199	0.359	0.360	0.574	0.842	0.805	0.915
EBIT	594	646	1,060	1,136	1,849	2,427	2,765	3,142
EBITDA	727	816	1,257	1,395	1,849	2,427	2,765	3,142

■ Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	616	676	1,099	1,142	2,016	2,892	2,769	3,151
Depreciation and amortisation	133	170	197	259	0	0	0	0
Tax paid	(26)	(67)	(112)	(109)	(259)	(312)	(305)	(347)
Change in working capital	(43)	133	(155)	(369)	(469)	(574)	(610)	(561)
Other operational CF items	(0)	5	(1)	(0)	6	19	15	12
Cash flow from operations	680	918	1,029	923	1,294	2,025	1,870	2,255
Capex	(588)	(245)	(576)	(1,189)	(927)	(900)	(855)	(898)
Net (acquisitions)/disposals	0	0	(104)	(75)	(60)	0	0	0
Other investing CF items	120	4	(177)	(100)	(43)	(14)	(14)	(14)
Cash flow from investing	(469)	(241)	(857)	(1,363)	(1,030)	(914)	(869)	(912)
Change in debt	18	(13)	283	421	144	31	32	33
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	0	(118)	(245)	(441)	(442)	(705)	(1,034)	(988)
Other financing CF items	12	(77)	(211)	100	(26)	0	0	0
Cash flow from financing	30	(208)	(172)	80	(324)	(674)	(1,002)	(955)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	241	469	(1)	(361)	(60)	437	(1)	387
Free cash flow	212	677	172	(441)	264	1,111	1,001	1,343

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (CNYm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	1,266	1,735	1,735	1,374	1,314	1,751	1,750	2,137
Inventory	296	230	343	559	958	1,332	1,603	2,002
Accounts receivable	563	729	1,293	1,488	2,329	3,092	3,587	4,087
Other current assets	129	38	32	5	6	9	10	11
Total current assets	2,254	2,733	3,402	3,425	4,607	6,184	6,950	8,238
Fixed assets	1,289	1,364	1,752	2,697	3,624	4,524	5,379	6,277
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	161	157	430	592	694	695	699	708
Total assets	3,704	4,254	5,584	6,714	8,926	11,403	13,029	15,223
Short-term debt	200	187	470	891	1,035	1,066	1,098	1,131
Accounts payable	366	482	857	897	1,575	2,153	2,306	2,632
Other current liabilities	75	101	241	216	310	298	302	315
Total current liabilities	641	770	1,569	2,004	2,921	3,517	3,706	4,078
Long-term debt	0	0	0	0	0	0	0	0
Other non-current liabilities	0	0	0	0	0	0	0	0
Total liabilities	641	770	1,569	2,004	2,921	3,517	3,706	4,078
Share capital	100	100	100	100	100	100	100	100
Reserves/R.E./others	2,964	3,384	3,915	4,611	5,905	7,786	9,223	11,045
Shareholders' equity	3,064	3,484	4,015	4,710	6,005	7,886	9,322	11,144
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	3,704	4,254	5,584	6,714	8,926	11,403	13,029	15,223
EV	29,324	28,841	29,125	29,907	30,110	29,704	29,737	29,383
Net debt/(cash)	(1,066)	(1,548)	(1,264)	(483)	(279)	(685)	(652)	(1,006)
BVPS (CNY)	2.495	2.836	3.270	3.836	4.890	6.422	7.591	9.075

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	15.6	(2.3)	52.0	21.2	54.8	32.7	16.0	14.0
EBITDA (YoY)	11.1	12.3	54.1	11.0	32.5	31.3	13.9	13.7
Operating profit (YoY)	3.8	8.8	64.1	7.2	62.8	31.3	13.9	13.7
Net profit (YoY)	8.3	4.2	60.5	5.0	70.1	46.7	(4.4)	13.7
Core EPS (fully-diluted) (YoY)	9.9	4.1	60.5	5.0	70.1	46.7	(4.4)	13.7
Gross-profit margin	41.7	44.9	45.1	44.0	44.2	42.5	42.0	41.9
EBITDA margin	32.2	37.0	37.5	34.4	29.4	29.1	28.6	28.5
Operating-profit margin	26.3	29.3	31.6	28.0	29.4	29.1	28.6	28.5
Net profit margin	26.2	27.9	29.5	25.5	28.1	31.0	25.5	25.5
ROAE	21.4	18.8	26.3	23.8	32.9	37.2	28.7	27.5
ROAA	17.1	15.5	20.1	16.9	22.5	25.4	20.2	19.9
ROCE	20.1	18.6	26.0	22.5	29.3	30.4	28.5	27.7
ROIC	31.5	29.6	40.6	29.5	32.4	33.5	31.0	29.7
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	4.2	9.9	10.2	9.5	12.8	10.8	11.0	11.0
Accounts receivable (days)	107.2	107.0	110.2	125.0	110.9	118.6	126.0	127.0
Current ratio (x)	3.5	3.5	2.2	1.7	1.6	1.8	1.9	2.0
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	20.0	39.8	44.7	42.7	40.0	40.0	40.0	40.0
Free cash flow yield	0.7	2.2	0.6	n.a.	0.9	3.7	3.3	4.4

Source: FactSet, Daiwa forecasts

■ Company profile

AAC Technologies designs and manufactures miniature acoustic components, including speakers, receivers, microphones and hands-free headsets, for use in mobile phones and other consumer handheld devices.

Lenovo Group

992 HK

Solid results

- Lenovo's 2Q FY14 results beat market expectations
- Smart devices and consumer PCs the main growth drivers
- Reiterating Buy rating with a target price of HKD9.90

Target (HKD): **9.90 → 9.90**

Upside: **12.6%**

11 Nov price (HKD): **8.79**

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell



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■ What's new

Both Lenovo's 2Q FY14 net profit (USD214m) and revenue (USD9.77bn) beat our forecasts (USD201m and USD9.6bn) and those of the Bloomberg consensus.

■ What's the impact

Solid 2Q FY14 operating margin. Revenue for Lenovo's mobile internet and digital home (MIDH) division was up by 106% YoY and accounted for 15% of total 2Q FY14 revenue (vs. 8% for 2Q FY13), thanks to strong growth of its smartphones (shipments up 78% YoY) and tablets (shipments up 421% YoY). Its PCs (79% of revenue) saw revenue growth of 4% YoY, and Lenovo remains the largest PC vendor globally with a 17.7% market share.

While the gross margin (12.9%) was below our forecast (13.6%) due to faster-than-expected revenue growth of Lenovo's consumer-PC business, the benefit of its large scale and solid cost control led to a much better operating margin of 2.9%, up from

2.4% for 2Q FY13 and beating our forecast of 2.7%.

Top-line strength should continue.

We forecast 7% QoQ revenue growth for 3Q FY14, driven by ongoing robust growth in smart devices and steady share gains in the consumer-PC market.

On smartphones, Lenovo believes its shipments have reached critical mass in China so it intends to focus more on profitability. We expect growth in markets outside China and the premium segment (including the sub-brand Vibe) to be the focus. Regarding tablets, Lenovo launched its multimode Yoga tablet at end-October and has a positive demand outlook for the holiday season.

■ What we recommend

We reiterate our Buy (1) rating with a six-month target price of HKD9.90, based on a target PER of 15x (the stock's five-year mid-cycle average) applied to our one-year forward EPS forecast. Lenovo remains our top pick in our regional PC hardware universe. The main risk to our view would be weaker-than-expected IT demand in China.

■ How we differ

Our FY14-16E EPS are 6-14% above the consensus, as we are more positive

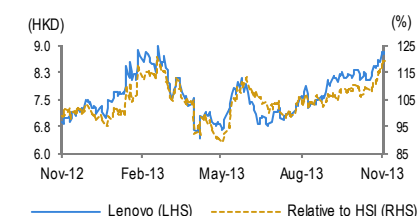
on Lenovo's revenue growth and operating margin sustainability.

Forecast revisions (%)

Year to 31 Mar	14E	15E	16E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	6.45-9.00
Market cap (USDbn)	11.81
3m avg daily turnover (USDm)	35.80
Shares outstanding (m)	10,418
Major shareholder	Legend Holdings Ltd. (31.3%)

Financial summary (USD)

Year to 31 Mar	14E	15E	16E
Revenue (m)	38,043	42,482	46,037
Operating profit (m)	1,042	1,280	1,464
Net profit (m)	814	984	1,129
Core EPS (fully-diluted)	0.078	0.094	0.108
EPS change (%)	26.9	20.8	14.8
Daiwa vs Cons. EPS (%)	6.1	11.0	13.9
PER (x)	14.5	12.0	10.5
Dividend yield (%)	1.6	2.1	0.0
DPS	0.019	0.024	0.000
PBR (x)	3.8	2.9	2.2
EV/EBITDA (x)	7.4	6.0	5.0
ROE (%)	28.3	27.7	24.0

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Mar	2009	2010	2011	2012	2013	2014E	2015E	2016E
PC Shipment (m unit)	21.5	27.5	35.3	47.6	52.4	53.0	54.1	55.0
PC shipment growth YoY (%)	2	28	28	35	10	1	2	2
Notebook shipment (m unit)	10.4	15.6	20.3	27.6	30.7	31.2	32.4	33.4
Smartphone shipment (m unit)	n.a.	n.a.	0.5	5.6	29.6	56.0	88.6	118.6

■ Profit and loss (USDm)

Year to 31 Mar	2009	2010	2011	2012	2013	2014E	2015E	2016E
Notebook Revenues	8,707	10,405	13,007	16,703	17,936	18,722	18,772	18,768
Desktop Revenues	5,897	5,868	7,266	9,873	10,525	10,077	9,732	9,403
Other Revenue	298	332	1,321	2,999	5,413	9,244	13,978	17,866
Total Revenue	14,901	16,605	21,594	29,574	33,873	38,043	42,482	46,037
Other income	1	83	0	1	20	0	0	0
COGS	(13,160)	(14,815)	(19,230)	(26,128)	(29,800)	(33,066)	(36,899)	(39,979)
SG&A	(1,566)	(1,406)	(1,758)	(2,421)	(2,735)	(3,162)	(3,518)	(3,722)
Other op.expenses	(386)	(248)	(224)	(442)	(559)	(772)	(785)	(873)
Operating profit	(210)	219	382	584	800	1,042	1,280	1,464
Net-interest inc./(exp.)	22	(43)	(24)	(1)	2	(31)	(34)	(34)
Assoc/forex/extraord./others	0	0	(0)	(1)	(1)	11	0	0
Pre-tax profit	(188)	176	358	582	801	1,021	1,246	1,430
Tax	(38)	(47)	(85)	(107)	(170)	(216)	(263)	(301)
Min. int./pref. div./others	(0)	0	(0)	(2)	4	10	0	0
Net profit (reported)	(226)	129	273	473	635	814	984	1,129
Net profit (adjusted)	(226)	129	273	473	635	814	984	1,129
EPS (reported)(USD)	(0.026)	0.014	0.028	0.047	0.062	0.078	0.094	0.108
EPS (adjusted)(USD)	(0.026)	0.014	0.028	0.047	0.062	0.078	0.094	0.108
EPS (adjusted fully-diluted)(USD)	(0.026)	0.014	0.028	0.047	0.062	0.078	0.094	0.108
DPS (USD)	0.020	0.001	0.009	0.011	0.019	0.019	0.024	0.000
EBIT	(210)	219	382	584	800	1,042	1,280	1,464
EBITDA	71	440	600	826	1,087	1,280	1,502	1,678

■ Cash flow (USDm)

Year to 31 Mar	2009	2010	2011	2012	2013	2014E	2015E	2016E
Profit before tax	(188)	176	358	582	801	1,021	1,246	1,430
Depreciation and amortisation	281	222	218	242	287	238	222	214
Tax paid	(75)	(82)	(76)	(148)	(192)	(216)	(263)	(301)
Change in working capital	(50)	696	598	1,389	(823)	(1,122)	(749)	(667)
Other operational CF items	(22)	(41)	(72)	(82)	(8)	(93)	34	34
Cash flow from operations	(54)	970	1,025	1,982	66	(172)	491	709
Capex	(194)	(108)	(148)	(329)	(441)	(513)	(564)	(616)
Net (acquisitions)/disposals	20	4	30	(179)	(139)	0	0	0
Other investing CF items	519	(222)	84	(557)	5	(46)	30	29
Cash flow from investing	345	(327)	(34)	(1,065)	(575)	(559)	(535)	(587)
Change in debt	124	(219)	(223)	(212)	229	229	229	229
Net share issues/(repurchases)	(44)	14	(61)	11	(38)	0	0	0
Dividends paid	(179)	(12)	(88)	(115)	(195)	(195)	(250)	(301)
Other financing CF items	(17)	0	0	0	(91)	64	0	0
Cash flow from financing	(116)	(217)	(373)	(316)	(94)	99	(20)	(72)
Forex effect/others	(7)	12	58	16	(10)	0	0	0
Change in cash	169	438	677	618	(613)	(632)	(65)	50
Free cash flow	(248)	862	877	1,653	(375)	(685)	(74)	93

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (USDm)

As at 31 Mar	2009	2010	2011	2012	2013	2014E	2015E	2016E
Cash & short-term investment	1,863	2,238	2,954	3,758	3,454	2,823	3,260	3,864
Inventory	450	879	804	1,218	1,965	2,248	2,703	3,100
Accounts receivable	704	1,408	1,761	2,994	3,458	4,569	5,344	5,941
Other current assets	1,083	1,711	2,418	3,850	3,513	3,834	3,834	3,834
Total current assets	4,101	6,236	7,936	11,820	12,390	13,474	15,141	16,739
Fixed assets	367	277	251	510	700	686	588	816
Goodwill & intangibles	1,853	2,066	2,134	3,091	3,326	3,239	3,115	2,996
Other non-current assets	301	377	384	439	465	544	544	544
Total assets	6,622	8,956	10,706	15,861	16,882	17,943	19,387	21,094
Short-term debt	20	65	72	63	176	123	149	149
Accounts payable	1,669	3,236	2,279	4,178	3,724	4,144	4,625	4,952
Other current liabilities	2,777	3,119	5,682	7,569	8,192	8,412	8,412	8,412
Total current liabilities	4,467	6,419	8,033	11,810	12,091	12,678	13,185	13,512
Long-term debt	230	200	0	0	303	355	355	355
Other non-current liabilities	614	731	838	1,603	1,807	1,819	1,819	1,819
Total liabilities	5,311	7,350	8,871	13,413	14,202	14,853	15,360	15,687
Share capital	30	31	32	33	33	33	33	33
Reserves/R.E./others	1,281	1,574	1,803	2,328	2,633	3,047	3,984	5,364
Shareholders' equity	1,311	1,606	1,835	2,361	2,667	3,081	4,018	5,397
Minority interests	0	0	0	87	14	9	9	9
Total equity & liabilities	6,622	8,956	10,706	15,861	16,882	17,943	19,387	21,094
EV	10,195	9,836	8,927	8,199	8,846	9,456	9,046	8,442
Net debt/(cash)	(1,613)	(1,973)	(2,883)	(3,695)	(2,975)	(2,345)	(2,756)	(3,359)
BVPS (USD)	0.148	0.176	0.190	0.233	0.259	0.296	0.386	0.518

■ Key ratios (%)

Year to 31 Mar	2009	2010	2011	2012	2013	2014E	2015E	2016E
Sales (YoY)	(8.9)	11.4	30.0	37.0	14.5	12.3	11.7	8.4
EBITDA (YoY)	(90.1)	520.3	36.2	37.7	31.7	17.8	17.3	11.7
Operating profit (YoY)	n.a.	n.a.	74.8	52.8	37.0	30.3	22.8	14.4
Net profit (YoY)	n.a.	n.a.	111.2	73.1	34.3	28.2	20.8	14.8
Core EPS (fully-diluted) (YoY)	n.a.	n.a.	99.8	64.6	32.0	26.9	20.8	14.8
Gross-profit margin	11.7	10.8	10.9	11.7	12.0	13.1	13.1	13.2
EBITDA margin	0.5	2.7	2.8	2.8	3.2	3.4	3.5	3.6
Operating-profit margin	n.a.	1.3	1.8	2.0	2.4	2.7	3.0	3.2
Net profit margin	(1.5)	0.8	1.3	1.6	1.9	2.1	2.3	2.5
ROAE	n.a.	8.9	15.9	22.5	25.3	28.3	27.7	24.0
ROAA	n.a.	1.7	2.8	3.6	3.9	4.7	5.3	5.6
ROCE	n.a.	12.7	20.2	26.4	28.2	31.0	31.6	28.0
ROIC	(226.2)	(47.9)	(41.2)	(41.6)	(81.8)	364.9	100.2	69.6
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	n.a.	26.6	23.6	18.4	21.2	21.2	21.1	21.1
Accounts receivable (days)	22.5	23.2	26.8	29.3	34.8	38.5	42.6	44.7
Current ratio (x)	0.9	1.0	1.0	1.0	1.0	1.1	1.1	1.2
Net interest cover (x)	n.a.	5.1	15.8	738.4	n.a.	33.3	38.2	43.6
Net dividend payout	n.a.	9.2	32.2	24.2	30.7	23.9	25.4	0.0
Free cash flow yield	n.a.	7.3	7.4	14.0	n.a.	n.a.	n.a.	0.8

Source: FactSet, Daiwa forecasts

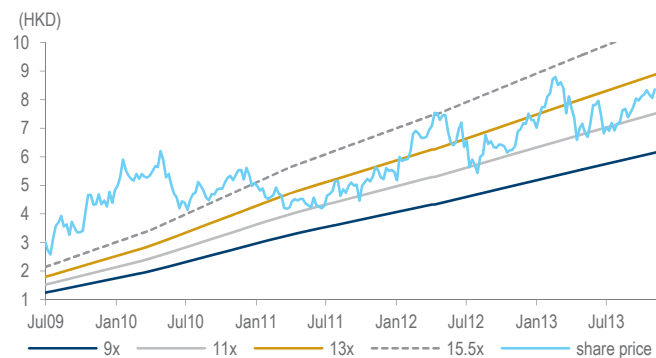
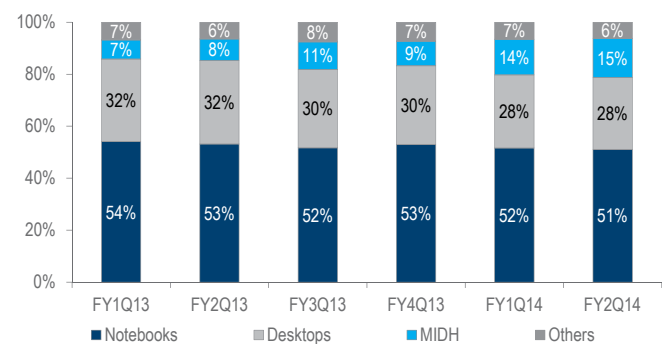
■ Company profile

Lenovo is currently the largest PC vendor in China and globally, in terms of shipments. In addition to PCs, Lenovo has launched its own-branded handsets and smartphones in China in recent years. The company is currently the second-largest smartphone vendor in China and the fourth-largest globally.

■ Lenovo: quarterly P&L statement

(USDm)	FY2014E				FY2015E				2013A	2014E	2015E
	1Q	2Q	3QE	4QE	1QE	2QE	3QE	4QE			
Net sales	8,787	9,774	10,419	9,063	9,934	10,698	11,690	10,160	33,873	38,043	42,482
Gross profit	1,191	1,265	1,349	1,172	1,293	1,399	1,539	1,352	4,074	4,976	5,583
Operating profit	202	284	317	239	254	340	405	280	800	1,042	1,280
Non-operating profit	14	-19	-8	-8	-8	-9	-8	-8	1	-21	-34
Pre-tax profit	215	265	309	231	247	331	397	272	801	1,021	1,246
Net profit	170	214	247	174	197	265	317	204	635	814	984
Pre-tax EPS (USDcent)	2.07	2.55	2.97	2.22	2.37	3.18	3.81	2.61	7.77	9.80	11.96
Net EPS (USDcent)	1.63	2.05	2.38	1.67	1.89	2.54	3.05	1.96	6.16	7.82	9.44
Operating Ratios											
Gross margins	13.6%	12.9%	12.9%	12.9%	13.0%	13.1%	13.2%	13.3%	12.0%	13.1%	13.1%
Operating margin	2.3%	2.9%	3.0%	2.6%	2.6%	3.2%	3.5%	2.8%	2.4%	2.7%	3.0%
Pre-tax margin	2.5%	2.7%	3.0%	2.6%	2.5%	3.1%	3.4%	2.7%	2.4%	2.7%	2.9%
Net margin	1.9%	2.2%	2.4%	1.9%	2.0%	2.5%	2.7%	2.0%	1.9%	2.1%	2.3%
YoY%											
Net revenues	10%	13%	11%	16%	13%	9%	12%	12%	15%	12%	12%
Gross profit	24%	20%	22%	22%	8%	11%	14%	15%	18%	22%	12%
Operating income	11%	38%	30%	41%	26%	20%	28%	17%	37%	30%	23%
Pre-tax income	16%	30%	26%	40%	15%	25%	28%	18%	38%	27%	22%
Net income	18%	31%	24%	40%	16%	24%	28%	18%	34%	28%	21%
QoQ%											
Net revenues	12%	11%	7%	-13%	10%	8%	9%	-13%			
Gross profit	24%	6%	7%	-13%	10%	8%	10%	-12%			
Operating income	19%	41%	12%	-25%	6%	34%	19%	-31%			
Pre-tax income	30%	23%	17%	-25%	7%	34%	20%	-31%			
Net income	37%	26%	16%	-30%	14%	34%	20%	-36%			

Source: Company Data, Daiwa forecasts

■ Lenovo: one-year forward PER

■ Lenovo: revenue breakdown by product


MediaTek

2454 TT

New products should raise 2014 market share in China

- We forecast its share of the China market to rise to 50% for 2014, from 48% for 2013
- The octa-core MT6592 may be a mainstream IC in 2014
- MT6582/MT6588 ICs should support market-share gains

Target (TWD): **480.00 → 480.00**

Upside: **12.7%**

11 Nov price (TWD): **426.00**

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell



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What's new

We expect MediaTek's new products to result in the company's market share rising in China in 2014.

What's the impact

We forecast its share of the China smartphone-IC market to be 50% for 2014 (2013: 48%), as we believe MediaTek's octa-core smartphone IC has been well received there. Given this, octa-core ICs could become mainstream in China by 2014.

We understand that the octa-core Cortex A7 MT6592 IC has impressive clock speeds of 1.7-2GHz, and has low power consumption (its competitor's existing octa-core application processor with a big LITTLE architecture has four Cortex A7 cores and four A15 cores) as it can shift between running single and multiple cores simultaneously. The MT6592 should help China

smartphone makers gain access to the mid-range and high-end large-screen (4.8-6") smartphone segments, as well as help MediaTek receive more orders globally. We believe China smartphone makers will be able to narrow the technology gap with the global brands in terms of performance by using the MT6592.

We also believe MediaTek's 2014 smartphone-IC market share will be supported by its new cost-efficient, quad-core smartphone ICs, the MT6582 and MT6588, due to be available from the end of this year. The new quad-core ICs will see the company expanding its portfolio of quad-core smartphone ICs in a nine-month period to a wide range of segments. We continue to expect the company to have a dominant share in the quad-core smartphone-IC market in China in 2014.

What we recommend

We reaffirm our Buy (1) rating. Our six-month target price is TWD480, based on a 20x PER (its past-two-year average) applied to the average of our 2013-14E EPS. The main risk to our view would be lower-than-expected 2013-15 smartphone-IC shipments.

How we differ

We remain more positive than the market on the 2014-15 gross-margin

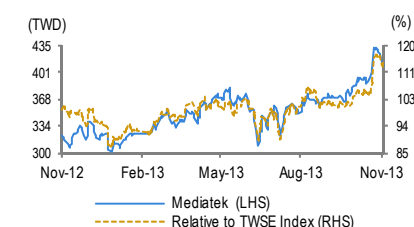
outlook for MediaTek's smartphone-IC business.

Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	301.50-432.50
Market cap (USDbn)	19.48
3m avg daily turnover (USDm)	83.16
Shares outstanding (m)	1,349
Major shareholder	Li Tsui-Hsin (3.6%)

Financial summary (TWD)

Year to 31 Dec	13E	14E	15E
Revenue (m)	135,097	196,318	215,950
Operating profit (m)	24,666	40,147	49,471
Net profit (m)	26,937	39,439	48,175
Core EPS (fully-diluted)	19.962	25.464	31.104
EPS change (%)	55.7	27.6	22.2
Daiwa vs Cons. EPS (%)	6.7	10.8	20.4
PER (x)	21.3	16.7	13.7
Dividend yield (%)	1.8	3.1	4.0
DPS	7.5	13.3	16.9
PBR (x)	2.8	2.6	2.4
EV/EBITDA (x)	15.7	10.0	7.9
ROE (%)	14.2	18.5	20.6

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Average selling price (USD)	6.6	6.5	5.0	4.0	4.5	5.4	5.5	5.7
Change in ASP (%)	(4)	(2)	(22)	(21)	13	20	2	2
WCDMA smartphone IC market	n.a.	n.a.	n.a.	18.8	43.6	62.2	61.1	64.1
Rev percentage from smartphone +3G handsets (%)	n.a.	n.a.	n.a.	7.3	39.8	55.0	70.3	71.3

■ Profit and loss (TWDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Handset IC Revenues	60,351	82,134	80,389	57,662	69,189	97,644	141,893	156,083
TV & DVD IC Revenues	19,499	18,655	17,534	17,954	17,013	33,588	48,809	53,690
Other Revenue	10,552	14,723	15,599	11,242	13,060	3,865	5,616	6,177
Total Revenue	90,402	115,512	113,522	86,857	99,263	135,097	196,318	215,950
Other income	0	0	0	0	0	0	0	0
COGS	(41,819)	(47,695)	(52,614)	(47,513)	(58,201)	(75,925)	(109,097)	(115,965)
SG&A	(5,000)	(7,245)	(6,519)	(5,816)	(6,174)	(7,394)	(10,844)	(11,386)
Other op. expenses	(21,275)	(24,185)	(23,311)	(21,184)	(22,384)	(27,113)	(36,230)	(39,128)
Operating profit	22,308	36,387	31,079	12,345	12,505	24,666	40,147	49,471
Net-interest inc./(exp.)	1,290	494	586	1,007	1,621	900	842	842
Assoc/forex/extraord./others	(2,500)	550	623	852	2,494	3,030	1,102	1,102
Pre-tax profit	21,098	37,431	32,288	14,203	16,620	28,596	42,091	51,415
Tax	(1,924)	(725)	(1,351)	(587)	(971)	(1,659)	(2,652)	(3,239)
Min. int./pref. div./others	16	0	25	7	39	0	0	0
Net profit (reported)	19,190	36,706	30,961	13,623	15,688	26,937	39,439	48,175
Net profit (adjusted)	19,190	36,706	30,961	13,623	15,688	26,937	39,439	48,175
EPS (reported)(TWD)	17.886	33.624	28.293	12.246	12.818	19.962	25.464	31.104
EPS (adjusted)(TWD)	17.886	33.624	28.293	12.246	12.818	19.962	25.464	31.104
EPS (adjusted fully-diluted)(TWD)	17.886	33.624	28.293	12.246	12.818	19.962	25.464	31.104
DPS (TWD)	14.637	11.010	20.720	16.414	7.004	7.470	13.255	16.908
EBIT	22,308	36,387	31,079	12,345	12,505	24,666	40,147	49,471
EBITDA	25,603	39,632	34,056	15,074	16,202	30,181	45,938	55,551

■ Cash flow (TWDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	21,098	37,431	32,288	14,203	16,620	28,596	42,091	51,415
Depreciation and amortisation	3,295	3,245	2,978	2,729	3,696	5,515	5,791	6,080
Tax paid	(1,924)	(725)	(1,351)	(587)	(971)	(1,659)	(2,652)	(3,239)
Change in working capital	4,016	2,423	(4,487)	379	(3,650)	(7,965)	(8,672)	(2,457)
Other operational CF items	9,113	12,876	(20)	(16)	(4,252)	7,061	6,223	745
Cash flow from operations	35,599	55,250	29,408	16,707	11,442	31,548	42,781	52,544
Capex	(1,705)	(1,574)	(2,122)	(2,585)	(2,268)	(2,495)	(2,745)	(2,882)
Net (acquisitions)/disposals	(1,394)	4,620	(3,035)	1,886	1,414	0	0	0
Other investing CF items	(7,385)	(1,277)	(1,117)	1,714	(3,322)	26	0	0
Cash flow from investing	(10,483)	1,769	(6,274)	1,016	(4,177)	(2,469)	(2,745)	(2,882)
Change in debt	(40)	0	0	4,255	4,768	0	0	0
Net share issues/(repurchases)	0	0	0	0	0	4,203	0	0
Dividends paid	(19,630)	(15,024)	(28,343)	(21,999)	(10,328)	(12,145)	(24,734)	(31,551)
Other financing CF items	(3,213)	125	270	(2,172)	139	(529)	0	0
Cash flow from financing	(22,883)	(14,899)	(28,073)	(19,917)	(5,421)	(8,471)	(24,734)	(31,551)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	2,233	42,120	(4,940)	(2,194)	1,844	20,608	15,302	18,111
Free cash flow	33,894	53,676	27,285	14,123	9,174	29,053	40,036	49,662

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (TWDm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	57,594	96,847	92,073	91,032	90,276	110,908	126,210	144,321
Inventory	5,547	8,173	9,388	9,392	13,867	21,118	30,344	32,255
Accounts receivable	5,429	7,267	7,164	7,384	6,585	12,847	18,668	20,535
Other current assets	2,656	1,751	3,970	4,234	7,343	10,541	15,318	16,850
Total current assets	71,226	114,038	112,595	112,042	118,071	155,414	190,541	213,961
Fixed assets	6,504	6,889	7,808	9,810	10,708	12,706	13,797	14,727
Goodwill & intangibles	12,375	11,005	9,897	16,472	16,344	18,713	19,308	19,498
Other non-current assets	8,970	6,662	7,734	9,417	65,120	67,877	68,177	68,477
Total assets	99,074	138,594	138,035	147,741	210,243	254,710	291,822	316,663
Short-term debt	1	0	0	4,107	8,910	9,040	9,040	9,040
Accounts payable	4,907	11,794	8,419	9,022	9,047	14,595	20,972	22,292
Other current liabilities	12,324	17,660	17,367	17,299	14,916	25,175	36,175	38,452
Total current liabilities	17,232	29,454	25,786	30,428	32,873	48,810	66,186	69,783
Long-term debt	0	0	0	148	114	765	765	765
Other non-current liabilities	83	248	535	837	1,482	1,508	1,508	1,508
Total liabilities	17,316	29,702	26,321	31,413	34,469	51,082	68,459	72,056
Share capital	10,732	10,901	10,999	11,475	13,494	13,494	13,494	13,494
Reserves/R.E./others	70,879	97,970	100,714	104,803	162,246	190,133	209,869	231,113
Shareholders' equity	81,611	108,871	111,713	116,278	175,740	203,627	223,364	244,607
Minority interests	148	21	0	50	34	0	0	0
Total equity & liabilities	99,074	138,594	138,035	147,741	210,243	254,710	291,822	316,663
EV	517,401	478,020	482,773	488,118	493,627	473,742	458,440	440,329
Net debt/(cash)	(57,593)	(96,847)	(92,073)	(86,777)	(81,253)	(101,104)	(116,406)	(134,517)
BVPS (TWD)	75.229	98.993	101.560	101.330	130.237	150.902	165.528	181.270

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	12.1	27.8	(1.7)	(23.5)	14.3	36.1	45.3	10.0
EBITDA (YoY)	(24.7)	54.8	(14.1)	(55.7)	7.5	86.3	52.2	20.9
Operating profit (YoY)	(30.0)	63.1	(14.6)	(60.3)	1.3	97.2	62.8	23.2
Net profit (YoY)	(42.9)	91.3	(15.7)	(56.0)	15.2	71.7	46.4	22.2
Core EPS (fully-diluted) (YoY)	(44.2)	88.0	(15.9)	(56.7)	4.7	55.7	27.6	22.2
Gross-profit margin	53.7	58.7	53.7	45.3	41.4	43.8	44.4	46.3
EBITDA margin	28.3	34.3	30.0	17.4	16.3	22.3	23.4	25.7
Operating-profit margin	24.7	31.5	27.4	14.2	12.6	18.3	20.5	22.9
Net profit margin	21.2	31.8	27.3	15.7	15.8	19.9	20.1	22.3
ROAE	22.9	38.5	28.1	12.0	10.7	14.2	18.5	20.6
ROAA	19.4	30.9	22.4	9.5	8.8	11.6	14.4	15.8
ROCE	26.6	38.2	28.2	10.6	8.2	12.4	18.0	20.3
ROIC	81.5	197.1	188.0	48.1	19.0	23.6	35.9	42.7
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	9.1	1.9	4.2	4.1	5.8	5.8	6.3	6.3
Accounts receivable (days)	25.3	20.1	23.2	30.6	25.7	26.2	29.3	33.1
Current ratio (x)	4.1	3.9	4.4	3.7	3.6	3.2	2.9	3.1
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	81.8	32.7	73.2	134.0	54.6	37.4	52.1	54.4
Free cash flow yield	5.9	9.3	4.7	2.5	1.6	5.1	7.0	8.6

Source: FactSet, Daiwa forecasts

■ Company profile

MediaTek is the fourth-largest IC-design house globally and Asia's largest. The company is a leader in PC optical-disk-driver (ODD) ICs, DVD-player ICs, and DVD-recorder ICs. It is also one of the major providers of handset ICs and LCD-TV ICs globally.

SK Hynix

000660 KS

Memory-chip fundamentals remain intact for 2014

- Due to production loss, we expect 4Q13 earnings to dip QoQ
- Potential inventory build-ups by key industry participants are likely to limit the decline in chip prices for 1Q14
- Outlook for memory-chip market remains bright for 2014, with limited supply growth given complexity in process technologies

Target (KRW): 40,000 → 40,000

Upside: 27.0%

11 Nov price (KRW): 31,500

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell


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■ What's new

Although we forecast SK Hynix's (Hynix) operating profit to decline QoQ for 4Q13, we project further earnings expansion in 2014 on healthy supply and demand dynamics for memory chips.

■ What's the impact

For 4Q13, Hynix expects its DRAM bit-growth rate to decline by a low-teen percentage QoQ, due mainly to some loss of production at its DRAM fab in Wuxi in China owing to a fire on 4 September. In addition, the company guides for its NAND-flash shipments to decline by a mid-teen percentage QoQ as it has converted some of its NAND-flash production capacity to produce more profitable DRAM.

Regarding its Wuxi fab, operations commenced in October and Hynix plans to run the facility at full capacity (on an input basis) from mid-November. However, as it believes there could be delivery delays for

some equipment, the fab's full ramp-up may be postponed by about one month. Thus, we believe the production disruption issue is likely to be resolved fully during 1Q14 on an output basis.

As for DRAM pricing, Hynix expects contract prices for commodity chips to increase further in 4Q13 but does not foresee a sharp decline in chip prices even when its Wuxi fab reaches normalised operations. Given that inventory levels in the industry (chip makers, distribution channels, and set makers) are very low at present, any price decline would result in inventory build-ups by key industry participants, in our view.

■ What we recommend

Hynix share price has risen by 22% YTD on robust memory-chip prices and strong earnings momentum. We reaffirm our Buy (1) rating as we are confident of further earnings expansion for 2014. We maintain our six-month target price of KRW40,000, based on the stock's mid-cycle PBR of 1.8x applied to our 2014E BVPS. Risks to our view would include weak demand for core IT products and increasing competition.

■ How we differ

Our 2013E EPS is 13.6% lower than the Bloomberg consensus estimate as our forecasts incorporate restoration

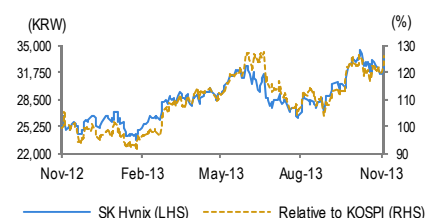
costs. Our 2014-15E EPS are 7.1-8.3% lower than the consensus estimates as we factor in Hynix's guidance for a higher effective tax rate.

Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	23,700-34,600
Market cap (USDbn)	20.41
3m avg daily turnover (USDm)	155.50
Shares outstanding (m)	695
Major shareholder	SK Telecom (21.1%)

Financial summary (KRW)

Year to 31 Dec	13E	14E	15E
Revenue (bn)	14,165	15,635	16,254
Operating profit (bn)	3,355	4,152	3,927
Net profit (bn)	2,547	3,263	3,113
Core EPS (fully-diluted)	3,491	4,472	4,268
EPS change (%)	n.a.	28.1	(4.6)
Daiwa vs Cons. EPS (%)	(13.6)	(7.1)	(8.3)
PER (x)	9.0	7.0	7.4
Dividend yield (%)	0.0	0.6	0.6
DPS	0	200	200
PBR (x)	1.8	1.4	1.2
EV/EBITDA (x)	3.8	3.0	2.7
ROE (%)	23.1	23.5	18.4

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
DRAM shipment (m 1Gb equiv.)	1,862.5	2,399.0	3,308.0	5,005.0	7,535.0	10,135.0	12,720.0	16,020.0
NAND shipment (m 8Gb equiv.)	533.8	426.9	910.0	2,264.0	3,540.0	5,120.0	7,750.0	12,080.0
Global semiconductor capex (US\$bn)	33.3	19.9	43.3	56.4	55.9	53.2	54.5	56.9

■ Profit and loss (KRWbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
DRAM	4,984	6,002	9,555	7,408	7,242	10,311	11,485	11,865
NAND & Other	1,834	1,905	2,551	2,988	2,920	3,854	4,149	4,389
Other Revenue	0	0	0	0	0	0	(0)	(0)
Total Revenue	6,818	7,906	12,106	10,396	10,162	14,165	15,635	16,254
Other income	0	0	0	0	0	0	0	0
COGS	(7,363)	(6,280)	(7,644)	(8,705)	(8,551)	(9,008)	(9,550)	(10,350)
SG&A	(1,375)	(1,435)	(1,461)	(1,322)	(1,839)	(1,802)	(1,933)	(1,977)
Other op. expenses	(1,277)	(441)	(26)	0	0	0	0	0
Operating profit	(3,197)	(249)	2,975	369	(227)	3,355	4,152	3,927
Net-interest inc./(exp.)	(329)	(404)	(279)	(254)	(238)	(232)	(179)	(125)
Assoc/forex/extraord./others	(1,249)	282	(30)	(70)	266	(370)	(17)	(28)
Pre-tax profit	(4,775)	(371)	2,666	45	(199)	2,753	3,955	3,774
Tax	30	38	(69)	(101)	41	(206)	(692)	(660)
Min. int./pref. div./others	0	0	0	0	0	0	0	0
Net profit (reported)	(4,745)	(333)	2,598	(56)	(159)	2,547	3,263	3,113
Net profit (adjusted)	(4,745)	(333)	2,598	(56)	(159)	2,547	3,263	3,113
EPS (reported)(KRW)	(10,328)	(593)	4,401	(95)	(229)	3,666	4,697	4,481
EPS (adjusted)(KRW)	(10,328)	(593)	4,401	(95)	(229)	3,666	4,697	4,481
EPS (adjusted fully-diluted)(KRW)	(9,901)	(573)	4,258	(89)	(218)	3,491	4,472	4,268
DPS (KRW)	0	0	200	0	0	0	200	200
EBIT	(3,197)	(249)	2,975	369	(227)	3,355	4,152	3,927
EBITDA	(366)	2,458	6,124	3,836	2,976	6,410	7,348	7,212

■ Cash flow (KRWbn)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	(4,775)	(371)	2,666	45	(199)	2,753	3,955	3,774
Depreciation and amortisation	2,831	2,707	3,149	3,467	3,204	3,055	3,196	3,285
Tax paid	30	38	(69)	(101)	41	(206)	(692)	(660)
Change in working capital	(1,256)	(894)	(68)	(813)	(762)	195	(420)	(352)
Other operational CF items	2,794	(141)	205	258	(71)	129	127	127
Cash flow from operations	(376)	1,340	5,884	2,856	2,212	5,926	6,166	6,172
Capex	(2,173)	(756)	(3,264)	(3,554)	(3,737)	(3,500)	(3,400)	(3,500)
Net (acquisitions)/disposals	(36)	(55)	(731)	330	(490)	(696)	(1,207)	(1,009)
Other investing CF items	172	(194)	(689)	(165)	(472)	(215)	(55)	(29)
Cash flow from investing	(2,038)	(1,004)	(4,683)	(3,389)	(4,698)	(4,411)	(4,662)	(4,537)
Change in debt	1,117	(735)	(1,140)	608	(411)	(995)	(773)	(1,138)
Net share issues/(repurchases)	0	1,031	0	0	2,329	0	0	0
Dividends paid	0	0	0	(89)	0	0	0	(139)
Other financing CF items	54	58	0	(0)	(0)	30	(122)	16
Cash flow from financing	1,171	355	(1,140)	519	1,917	(964)	(895)	(1,260)
Forex effect/others	67	(8)	(16)	5	(16)	0	0	0
Change in cash	(1,175)	682	44	(9)	(585)	551	609	375
Free cash flow	(2,549)	585	2,619	(698)	(1,525)	2,426	2,766	2,672

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (KRWbn)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	719	1,518	2,202	1,876	1,785	3,010	4,819	6,198
Inventory	1,092	1,057	1,282	1,184	1,509	1,261	1,451	1,531
Accounts receivable	750	1,730	1,605	1,541	1,720	2,006	2,137	2,255
Other current assets	198	612	328	336	300	387	438	475
Total current assets	2,759	4,917	5,416	4,937	5,314	6,664	8,844	10,459
Fixed assets	12,363	10,143	10,591	10,899	11,586	12,031	12,235	12,450
Goodwill & intangibles	496	462	604	708	984	1,126	1,162	1,190
Other non-current assets	958	781	802	694	765	935	1,020	1,070
Total assets	16,576	16,304	17,412	17,238	18,649	20,756	23,260	25,168
Short-term debt	2,612	2,971	2,578	2,830	2,719	1,601	1,584	1,572
Accounts payable	2,625	2,798	875	678	593	698	744	761
Other current liabilities	0	0	1,897	1,308	1,129	1,396	1,429	1,448
Total current liabilities	5,238	5,769	5,350	4,817	4,441	3,695	3,756	3,782
Long-term debt	5,136	3,984	3,477	3,946	3,753	3,876	3,120	1,994
Other non-current liabilities	676	631	678	600	715	868	926	944
Total liabilities	11,050	10,384	9,505	9,363	8,909	8,440	7,802	6,720
Share capital	2,316	2,966	2,969	2,978	3,488	3,488	3,488	3,488
Reserves/R.E./others	2,775	2,487	4,937	4,897	6,252	8,829	11,970	14,961
Shareholders' equity	5,090	5,452	7,906	7,876	9,740	12,317	15,458	18,449
Minority interests	436	467	2	(0)	(1)	(1)	(1)	(1)
Total equity & liabilities	16,576	16,304	17,412	17,238	18,649	20,756	23,260	25,168
EV	29,785	28,254	25,740	26,783	26,570	24,350	21,768	19,250
Net debt/(cash)	7,029	5,437	3,853	4,901	4,687	2,467	(115)	(2,632)
BVPS (KRW)	11,075	9,247	13,394	13,300	14,032	17,730	22,251	26,556

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	(21.1)	16.0	53.1	(14.1)	(2.2)	39.4	10.4	4.0
EBITDA (YoY)	n.a.	n.a.	149.1	(37.4)	(22.4)	115.4	14.6	(1.9)
Operating profit (YoY)	n.a.	n.a.	n.a.	(87.6)	n.a.	n.a.	23.7	(5.4)
Net profit (YoY)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	28.1	(4.6)
Core EPS (fully-diluted) (YoY)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	28.1	(4.6)
Gross-profit margin	n.a.	20.6	36.9	16.3	15.9	36.4	38.9	36.3
EBITDA margin	n.a.	31.1	50.6	36.9	29.3	45.3	47.0	44.4
Operating-profit margin	n.a.	n.a.	24.6	3.6	n.a.	23.7	26.6	24.2
Net profit margin	(69.6)	(4.2)	21.5	(0.5)	(1.6)	18.0	20.9	19.2
ROAE	n.a.	n.a.	38.9	n.a.	n.a.	23.1	23.5	18.4
ROAA	n.a.	n.a.	15.4	n.a.	n.a.	12.9	14.8	12.9
ROCE	n.a.	n.a.	22.2	2.6	n.a.	19.7	21.9	18.6
ROIC	(25.6)	(2.1)	25.1	(3.7)	(1.7)	21.2	22.7	20.8
Net debt to equity	138.1	99.7	48.7	62.2	48.1	20.0	net cash	net cash
Effective tax rate	n.a.	n.a.	2.6	224.0	n.a.	7.5	17.5	17.5
Accounts receivable (days)	45.4	57.2	50.3	55.2	58.6	48.0	48.4	49.3
Current ratio (x)	0.5	0.9	1.0	1.0	1.2	1.8	2.4	2.8
Net interest cover (x)	n.a.	n.a.	10.7	1.5	n.a.	14.5	23.1	31.4
Net dividend payout	n.a.	n.a.	4.5	n.a.	n.a.	0.0	4.3	4.5
Free cash flow yield	n.a.	2.7	12.0	n.a.	n.a.	11.1	12.6	12.2

Source: FactSet, Daiwa forecasts

■ Company profile

SK Hynix is the second-largest DRAM manufacturer globally, with a 24.7% market share (based on revenue) for 2012. The company's core products are DRAM and NAND-flash memory chip, but it also has small exposure to CMOS image sensors. SK Hynix has production facilities in Korea and in Wuxi, China.

Semiconductor Manufacturing Int'l Corp

981 HK

Price appears to factor in business improvement

- Revenue contribution from 40/45nm process should rise moderately in 2014
- Plans 8-inch capacity expansion for its specialty-IC business
- Improving fundamentals look priced in; maintaining Hold

Target (HKD): **0.550 → 0.550**
Upside: **0.0%**
11 Nov price (HKD): **0.550**

- 1 Buy
- 2 Outperform
- 3 Hold (unchanged)
- 4 Underperform
- 5 Sell



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■ What's new

We project a significant earnings improvement for SMIC for 2013 and solid earnings growth for 2014-15, driven by strong ongoing growth in business from its China clients, but believe its share-price strength YTD factors in its improving fundamentals.

■ What's the impact

We forecast revenue from SMIC's 40/45nm process to account for 22% of its total 2014 revenue, up from 13% for 2013E, driven by demand from China-based IC-design houses for consumer electronics. Further, our industry research indicates demand for SMIC's 40nm process remains strong. We forecast 40nm process shipments for China IC makers (used for smartphones, set-top-boxes, Internet Protocol TV and tablets) to rise by 12% YoY for 2014 but expect most major China smartphone/tablet IC makers to allocate 50% of their

products to use the 28nm process next year (15% for 2013E).

SMIC aims to expand its 8-inch capacity for its specialty-IC business to meet rising demand for products like SIM cards, smart cards and ID cards in 2014. We forecast revenue from its specialty-IC business to amount to 32% of total revenue for 2014 (vs. 24% for 2013E), on the back of its planned roll-out of differentiated technology offerings next year.

We expect SMIC to benefit from government support and limited capex. It has generated a net profit for the past six quarters, on low rises in depreciation expenses and high revenue growth. Management expects capex to rise slightly YoY for 2014 with moderate depreciation expense growth.

■ What we recommend

Our six-month target price is HKD0.55, based on a 0.8x PBR (in line with SMIC's past-one-year average multiple) applied to our 2014E BVPS. We believe SMIC's 43% YTD share-price rise factors in the improving fundamentals we see and hence maintain our Hold (3) rating. Upside and downside risks to our call are faster-than-expected gross margin expansion and a faster- or slower-than-expected ramp-up of its 28nm process.

■ How we differ

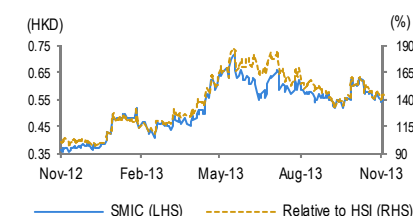
We are more positive on the future revenue contribution from advanced process nodes.

Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	0.355-0.720
Market cap (USDbn)	2.27
3m avg daily turnover (USDm)	10.98
Shares outstanding (m)	32,040
Major shareholder	Shanghai Ind. Holding (5.8%)

Financial summary (USD)

Year to 31 Dec	13E	14E	15E
Revenue (m)	2,076	2,325	2,488
Operating profit (m)	195	231	280
Net profit (m)	181	195	233
Core EPS (fully-diluted)	0.006	0.006	0.007
EPS change (%)	588.8	7.5	19.3
Daiwa vs Cons. EPS (%)	13.2	14.9	5.5
PER (x)	12.5	11.6	9.8
Dividend yield (%)	0.0	0.0	0.0
DPS	0.000	0.000	0.000
PBR (x)	0.9	0.8	0.7
EV/EBITDA (x)	3.8	3.4	3.0
ROE (%)	7.6	7.4	8.0

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Wafer shipment ('000)	1,611.2	1,376.6	1,986.0	1,703.6	2,217.3	2,505.5	2,706.0	2,787.2
Average selling price (USD)	749	723	720	716	725	779	808	839
Utilisation rate(%)	86	73	96	69	88	90	91	92

■ Profit and loss (USDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Computer Revenues	107	54	61	45	33	41	46	49
Communication Revenues	695	533	749	553	780	951	1,065	1,140
Other Revenue	552	483	745	721	888	1,084	1,214	1,299
Total Revenue	1,354	1,070	1,555	1,319	1,702	2,076	2,325	2,488
Other income	0	0	0	0	0	0	0	0
COGS	(1,413)	(1,185)	(1,245)	(1,218)	(1,336)	(1,629)	(1,759)	(1,853)
SG&A	(80)	(242)	(72)	(90)	(139)	(161)	(172)	(183)
Other op.expenses	(238)	(608)	(195)	(203)	(210)	(91)	(163)	(172)
Operating profit	(377)	(964)	43	(191)	16	195	231	280
Net-interest inc./(exp.)	(39)	(52)	(25)	(25)	(44)	(37)	(33)	(32)
Assoc/forex/extraord./others	11	9	(10)	52	42	33	17	12
Pre-tax profit	(406)	(1,007)	9	(163)	14	191	215	259
Tax	(26)	47	5	(83)	9	(10)	(19)	(26)
Min. int./pref. div./others	5	(2)	0	n.a.	1	0	0	0
Net profit (reported)	(427)	(962)	14	(246)	24	181	195	233
Net profit (adjusted)	(427)	(962)	14	(246)	24	181	195	233
EPS (reported)(USD)	(0.023)	(0.043)	0.001	(0.009)	0.001	0.006	0.006	0.007
EPS (adjusted)(USD)	(0.023)	(0.043)	0.001	(0.009)	0.001	0.006	0.006	0.007
EPS (adjusted fully-diluted)(USD)	(0.023)	(0.043)	0.001	(0.009)	0.001	0.006	0.006	0.007
DPS (USD)	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
EBIT	(377)	(964)	43	(191)	16	195	231	280
EBITDA	286	(361)	607	360	528	734	824	908

■ Cash flow (USDm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	(406)	(1,007)	9	(163)	14	191	215	259
Depreciation and amortisation	806	793	620	550	566	593	652	691
Tax paid	(26)	47	5	(83)	9	(10)	(19)	(26)
Change in working capital	69	(19)	7	115	0	(34)	(33)	(22)
Other operational CF items	130	472	53	(25)	(2)	0	0	0
Cash flow from operations	573	285	694	395	587	741	814	903
Capex	(669)	(217)	(492)	(950)	(413)	(675)	(743)	(780)
Net (acquisitions)/disposals	(16)	60	(77)	52	(83)	0	0	0
Other investing CF items	(72)	(55)	(15)	(21)	(39)	(77)	(51)	(33)
Cash flow from investing	(757)	(211)	(584)	(919)	(535)	(752)	(793)	(813)
Change in debt	4	(70)	(239)	(43)	201	(50)	0	(50)
Net share issues/(repurchases)	168	0	199	308	0	0	0	0
Dividends paid	0	0	0	0	0	0	0	0
Other financing CF items	1	(9)	2	4	(9)	0	0	0
Cash flow from financing	173	(79)	(38)	269	192	(50)	0	(50)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(10)	(5)	73	(255)	244	(61)	21	40
Free cash flow	(96)	68	203	(555)	174	66	72	123

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (USDm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	456	464	677	399	576	523	544	584
Inventory	172	194	213	207	296	391	418	439
Accounts receivable	199	204	207	165	328	400	448	480
Other current assets	99	45	82	94	66	80	90	96
Total current assets	927	907	1,179	865	1,266	1,395	1,501	1,599
Fixed assets	3,038	2,330	2,431	2,594	2,459	2,595	2,745	2,896
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	306	287	293	269	348	425	476	509
Total assets	4,271	3,524	3,903	3,728	4,073	4,415	4,721	5,004
Short-term debt	562	493	706	796	568	568	568	568
Accounts payable	186	229	516	281	424	560	600	630
Other current liabilities	152	310	178	172	116	128	141	148
Total current liabilities	900	1,032	1,399	1,248	1,108	1,256	1,308	1,345
Long-term debt	537	551	179	75	529	479	479	429
Other non-current liabilities	42	111	116	155	160	160	160	160
Total liabilities	1,478	1,693	1,694	1,479	1,797	1,895	1,947	1,934
Share capital	3,498	3,508	3,868	4,256	4,143	4,143	4,143	4,143
Reserves/R.E./others	(749)	(1,712)	(1,699)	(2,011)	(1,867)	(1,623)	(1,368)	(1,072)
Shareholders' equity	2,749	1,796	2,170	2,245	2,276	2,520	2,775	3,071
Minority interests	43	35	39	4	1	0	0	0
Total equity & liabilities	4,271	3,524	3,903	3,728	4,073	4,415	4,721	5,004
EV	2,958	2,887	2,519	2,750	2,794	2,796	2,775	2,685
Net debt/(cash)	642	579	207	473	520	523	502	412
BVPS (USD)	0.147	0.080	0.089	0.083	0.077	0.079	0.086	0.096

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	(12.7)	(20.9)	45.3	(15.1)	29.0	22.0	12.0	7.0
EBITDA (YoY)	(64.0)	n.a.	n.a.	(40.8)	46.8	39.0	12.3	10.2
Operating profit (YoY)	n.a.	n.a.	n.a.	n.a.	n.a.	1,128.0	18.6	21.1
Net profit (YoY)	n.a.	n.a.	n.a.	n.a.	n.a.	642.0	7.7	19.3
Core EPS (fully-diluted) (YoY)	n.a.	n.a.	n.a.	n.a.	n.a.	588.7	7.5	19.3
Gross-profit margin	n.a.	n.a.	19.9	7.7	21.5	21.5	24.3	25.5
EBITDA margin	21.1	n.a.	39.1	27.3	31.0	35.3	35.4	36.5
Operating-profit margin	n.a.	n.a.	2.8	n.a.	0.9	9.4	9.9	11.2
Net profit margin	(31.5)	(89.9)	0.9	(18.6)	1.4	8.7	8.4	9.4
ROAE	n.a.	n.a.	0.7	n.a.	1.1	7.6	7.4	8.0
ROAA	n.a.	n.a.	0.4	n.a.	0.6	4.3	4.3	4.8
ROCE	n.a.	n.a.	1.5	n.a.	0.5	5.6	6.3	7.1
ROIC	(10.7)	(33.0)	1.8	(7.4)	0.6	6.3	6.7	7.4
Net debt to equity	23.3	32.3	9.5	21.1	22.9	20.8	18.1	13.4
Effective tax rate	n.a.	n.a.	n.a.	n.a.	n.a.	5.0	9.0	10.0
Accounts receivable (days)	67.1	68.8	48.2	51.4	52.9	64.1	66.6	68.1
Current ratio (x)	1.0	0.9	0.8	0.7	1.1	1.1	1.1	1.2
Net interest cover (x)	n.a.	n.a.	1.8	n.a.	0.4	5.3	7.0	8.6
Net dividend payout	n.a.	n.a.	0.0	n.a.	0.0	0.0	0.0	0.0
Free cash flow yield	n.a.	3.0	8.9	n.a.	7.7	2.9	3.2	5.4

Source: FactSet, Daiwa forecasts

■ Company profile

Incorporated in China in 2000, Semiconductor Manufacturing Int'l Corp (SMIC) is the fourth-largest semiconductor foundry by revenue in the world. It is engaged in wafer-fabrication, mask-making, and the packaging and testing of semiconductors. It has six fabs: three in Shanghai, two in Beijing and one in Tianjin. The company also manages government-owned fabs in Chengdu and Wuhan. In 2012, SMIC had fabricating capacity for 2.42m eight-inch equivalent wafers, of which 17% was for 12-inch wafers.

Sunny Optical Technology

2382 HK

Eyeing China's smartphone market

- Good proxy for strong shipment growth and spec upgrades in China's smartphone market over 2013-15E
- Increasing demand for high-pixel cameras for smartphones should underpin Sunny Optical's revenue growth and margins
- Reiterating Buy call

 Target (HKD): **11.60 → 11.60**

 Upside: **73.4%**

 11 Nov price (HKD): **6.69**

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell


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■ What's new

We believe the fast-growing China smartphone market, as well as smartphone spec upgrades in China, will be the main business drivers for Sunny Optical, making the stock a good proxy for the development of China's smartphone market.

■ What's the impact

Strong handset component growth. We forecast Sunny Optical's 2013 and 2014 total revenue to increase by 51% YoY and 42% YoY, respectively, mainly driven by handset applications (around 71% of 2013E revenue). We forecast revenue for the compact camera module (CCM) business to rise by 79%/50% YoY in 2013/14, and handset lens set revenue growth of 53%/49% YoY.

Pixel migration a key driver.

Despite increasing competition from China handset camera-module suppliers in 1H13, Sunny Optical looks likely to post a 22% YoY rise in its CCM blended ASP on the back of demand for better camera features, even in the mass-market smartphone segment. We forecast 5MP+ CCM shipments to rise from 49% of shipments in 1H13 to 53% in 2013 and 67% in 2014.

Competence for the long term.

In our view, Sunny Optical's expertise in manufacturing optical components (lenses) for camera modules and other components should lead to it being recognised by the China brand names, as well as global brand names, as a producer of quality products.

■ What we recommend

We have a Buy (1) rating on Sunny Optical and believe the stock's valuations are relatively attractive. We forecast a 41% earnings CAGR for 2012-15 on strong top-line growth and a stable margin outlook, as well as ROEs of 23-27% for 2013-14. Our six-month target price of HKD11.6 is based on a PER of 15x applied to the average of our 2013-14E EPS. Risks to our call would include price pressure in the CCM business.

■ How we differ

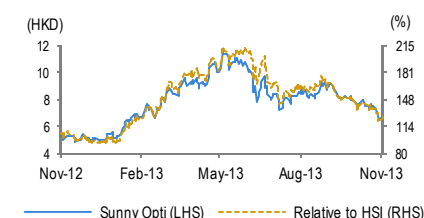
We are more upbeat than the Bloomberg consensus on margin expansion in 2014-15.

Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	4.95-11.56
Market cap (USDbn)	0.86
3m avg daily turnover (USDm)	10.38
Shares outstanding (m)	1,000
Major shareholder	Fidelity International (5.1%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	6,028	8,565	11,048
Operating profit (m)	599	875	1,189
Net profit (m)	476	705	969
Core EPS (fully-diluted)	0.482	0.714	0.981
EPS change (%)	36.2	48.1	37.5
Daiwa vs Cons. EPS (%)	(2.4)	6.1	13.1
PER (x)	10.9	7.4	5.4
Dividend yield (%)	2.8	4.1	5.6
DPS	0.145	0.214	0.294
PBR (x)	2.2	1.8	1.4
EV/EBITDA (x)	8.5	5.8	4.2
ROE (%)	22.6	27.4	30.0

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
CCM ASP (USD)	n.a.	2.8	2.4	2.6	3.9	4.8	5.5	5.8
CCM shipment (m units)	n.a.	27.8	43.7	69.6	96.6	137.2	178.4	223.0
Handset lens sets ASP (USD)	n.a.	0.58	0.64	0.58	0.54	0.59	0.65	0.70
Handset lens sets shipment (m units)	n.a.	30.9	26.2	31.9	36.0	50.1	67.8	87.8

■ Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Optical components	580	637	903	1,128	1,309	1,505	1,844	2,128
Optoelectronic products	557	546	720	1,193	2,491	4,317	6,505	8,683
Other Revenue	130	127	195	178	185	205	216	238
Total Revenue	1,267	1,310	1,818	2,499	3,984	6,028	8,565	11,048
Other income	0	0	0	0	0	0	0	0
COGS	(1,016)	(1,036)	(1,426)	(1,976)	(3,243)	(4,977)	(7,055)	(9,058)
SG&A	(139)	(121)	(151)	(182)	(214)	(259)	(340)	(424)
Other op.expenses	(15)	(46)	(59)	(68)	(118)	(194)	(295)	(377)
Operating profit	97	107	182	273	409	599	875	1,189
Net-interest inc./(exp.)	8	18	17	46	22	7	7	11
Assoc/forex/extraord./others	(17)	(25)	(35)	(79)	(34)	(34)	(34)	(34)
Pre-tax profit	89	100	165	240	397	572	848	1,165
Tax	(12)	(13)	(27)	(38)	(58)	(98)	(143)	(196)
Min. int./pref. div./others	2	5	6	14	7	2	0	0
Net profit (reported)	78	92	144	215	346	476	705	969
Net profit (adjusted)	78	92	144	215	346	476	705	969
EPS (reported)(CNY)	0.078	0.092	0.147	0.223	0.360	0.493	0.730	1.004
EPS (adjusted)(CNY)	0.078	0.092	0.147	0.223	0.360	0.493	0.730	1.004
EPS (adjusted fully-diluted)(CNY)	0.078	0.092	0.146	0.221	0.354	0.482	0.714	0.981
DPS (CNY)	0.020	0.020	0.044	0.071	0.105	0.145	0.214	0.294
EBIT	97	107	182	273	409	599	875	1,189
EBITDA	153	164	235	282	483	599	875	1,189

■ Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	89	100	165	240	397	572	848	1,165
Depreciation and amortisation	73	83	87	88	109	147	183	211
Tax paid	(12)	(13)	(27)	(38)	(58)	(98)	(143)	(196)
Change in working capital	54	(36)	(47)	(224)	(209)	(244)	(480)	(568)
Other operational CF items	8	6	13	31	9	9	9	9
Cash flow from operations	212	139	191	97	247	386	417	621
Capex	(150)	(76)	(67)	(203)	(308)	(500)	(300)	(300)
Net (acquisitions)/disposals	3	8	(34)	10	43	(9)	(9)	(9)
Other investing CF items	(207)	296	(621)	281	85	0	0	0
Cash flow from investing	(355)	228	(721)	87	(180)	(509)	(309)	(309)
Change in debt	36	20	57	(33)	23	260	(10)	(100)
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(21)	(20)	(20)	(44)	(71)	(105)	(145)	(214)
Other financing CF items	(19)	(7)	(53)	(20)	(38)	(2)	0	0
Cash flow from financing	(4)	(6)	(16)	(97)	(86)	153	(155)	(314)
Forex effect/others	0	1	(0)	0	0	0	0	0
Change in cash	(147)	361	(546)	88	(18)	30	(46)	(2)
Free cash flow	62	63	125	(106)	(61)	(114)	117	321

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (CNYm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	683	760	264	386	524	556	510	508
Inventory	126	148	221	472	748	1,091	1,546	1,985
Accounts receivable	258	376	454	627	901	1,363	1,937	2,498
Other current assets	3	1	588	337	94	94	94	94
Total current assets	1,069	1,284	1,527	1,822	2,267	3,104	4,087	5,085
Fixed assets	497	486	465	489	646	999	1,116	1,205
Goodwill & intangibles	21	27	23	0	0	0	0	0
Other non-current assets	25	24	42	64	89	89	89	89
Total assets	1,612	1,822	2,058	2,375	3,002	4,193	5,292	6,380
Short-term debt	18	29	88	62	103	353	353	253
Accounts payable	190	294	398	599	939	1,500	2,049	2,482
Other current liabilities	11	11	11	9	11	11	11	11
Total current liabilities	219	334	496	671	1,052	1,864	2,413	2,745
Long-term debt	17	27	25	17	0	10	0	0
Other non-current liabilities	9	11	8	7	18	18	18	18
Total liabilities	246	372	530	694	1,070	1,892	2,431	2,763
Share capital	98	98	98	98	98	98	98	98
Reserves/R.E./others	1,245	1,319	1,398	1,564	1,824	2,193	2,754	3,509
Shareholders' equity	1,343	1,416	1,496	1,661	1,922	2,291	2,851	3,606
Minority interests	24	33	32	20	10	10	10	10
Total equity & liabilities	1,612	1,822	2,058	2,375	3,002	4,193	5,292	6,380
EV	4,632	4,585	5,136	4,969	4,844	5,072	5,109	5,011
Net debt/(cash)	(647)	(704)	(151)	(306)	(422)	(194)	(157)	(256)
BVPS (CNY)	1.343	1.416	1.529	1.721	1.996	2.373	2.953	3.735

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	(8.3)	3.4	38.8	37.4	59.5	51.3	42.1	29.0
EBITDA (YoY)	(41.1)	7.3	42.9	20.2	71.2	23.8	46.2	35.8
Operating profit (YoY)	(59.6)	10.7	69.8	50.0	49.7	46.3	46.2	35.8
Net profit (YoY)	(65.2)	17.3	56.4	49.7	60.8	37.5	48.1	37.5
Core EPS (fully-diluted) (YoY)	(68.2)	17.3	59.2	51.0	60.1	36.2	48.1	37.5
Gross-profit margin	19.8	20.9	21.6	20.9	18.6	17.4	17.6	18.0
EBITDA margin	12.1	12.6	12.9	11.3	12.1	9.9	10.2	10.8
Operating-profit margin	7.6	8.2	10.0	10.9	10.3	9.9	10.2	10.8
Net profit margin	6.2	7.0	7.9	8.6	8.7	7.9	8.2	8.8
ROAE	6.0	6.7	9.9	13.6	19.3	22.6	27.4	30.0
ROAA	4.9	5.4	7.4	9.7	12.9	13.2	14.9	16.6
ROCE	7.2	7.4	11.6	16.1	21.6	25.5	29.8	33.6
ROIC	11.9	12.8	14.4	16.7	24.2	27.4	30.3	32.6
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	13.6	12.8	16.2	15.8	14.7	17.1	16.8	16.8
Accounts receivable (days)	91.6	88.2	83.3	79.0	70.0	68.5	70.3	73.3
Current ratio (x)	4.9	3.8	3.1	2.7	2.2	1.7	1.7	1.9
Net interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	25.5	21.8	29.6	31.8	29.2	29.3	29.3	29.3
Free cash flow yield	1.2	1.2	2.4	n.a.	n.a.	n.a.	2.2	6.1

Source: FactSet, Daiwa forecasts

■ Company profile

Founded in 1984, Sunny Optical is the leading optical component manufacturer in the China technology supply chain. The company develops and provides optical related products with various applications, including instruments, components and opto-electronic modules, with leading China smartphone brand name makers Huawei, Lenovo and Coolpad as its major customers.

Tencent Holdings

700 HK

Creating a new eco-system for mobile Internet

- As a leading global mobile social platform, Tencent's WeChat app is expected to generate strong revenue growth
- New services offered on WeChat could create a new ecosystem connecting online to offline
- Reiterate Buy (1) rating and six-month target price of HKD500

Target (HKD): 500.00 → 500.00

Upside: 21.6%

11 Nov price (HKD): 411.20

- 1 Buy (unchanged)
- 2 Outperform
- 3 Hold
- 4 Underperform
- 5 Sell



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What's new

Tencent is moving faster than we expected in monetising its WeChat (known as Weixin in China) mobile instant-messaging (MIM) app via mobile games and new services. We expect WeChat to become one of the leading global mobile social platforms (GMSP) over the next few years, and forecast its overall revenue to reach CNY4.9bn in 2014.

What's the impact

With the rising number of smartphone users in China and Tencent's strong pipeline of mobile games for its WeChat app, we forecast the company's mobile game revenue to reach CNY3.9bn for 2014. On top of Tencent's resilient online game business, we expect mobile games to

be the new growth engine of the future. Tencent is gradually expanding its online to offline (O2O) services via WeChat, and we believe it is in the early stage of creating a new ecosystem to connect online to offline. In our view, this is an interesting business model with huge potential. We also see the possibility of Tencent leveraging Sogou's search product into mobile, and most likely adding it to its WeChat platform.

What we recommend

While the stock has been one of the top performers YTD (up 66%), we think it will continue to outperform in 2014 due to its scarcity value as the only listed large-cap Chinese Internet stock in Hong Kong, with a strong earnings growth outlook and new business model focused on the mobile ecosystem.

We have a six-month target price of HKD500, based on a target 2014E PER of 35x, to reflect the earlier-than-expected monetisation of WeChat's mobile games. Downside risks would include a sharp decline in revenue from core games and the slower-than-expected monetisation of WeChat.

How we differ

We have one of the highest target prices among all the brokers, as we are more optimistic on revenue generation from WeChat, and are also

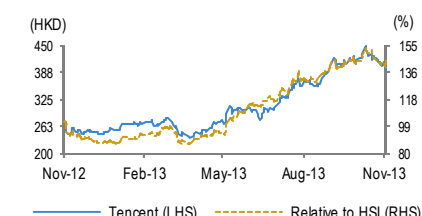
positive on Tencent's games business, both online and mobile.

Forecast revisions (%)

Year to 31 Dec	13E	14E	15E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	237.20-447.80
Market cap (USDbn)	98.29
3m avg daily turnover (USDm)	186.80
Shares outstanding (m)	1,853
Major shareholder	Naspers Limited (34.1%)

Financial summary (CNY)

Year to 31 Dec	13E	14E	15E
Revenue (m)	60,795	84,611	110,355
Operating profit (m)	19,953	25,935	33,686
Net profit (m)	17,327	22,378	28,913
Core EPS (fully-diluted)	9.116	11.765	15.188
EPS change (%)	18.9	29.1	29.1
Daiwa vs Cons. EPS (%)	4.0	5.3	6.0
PER (x)	35.4	27.5	21.3
Dividend yield (%)	0.4	0.5	0.7
DPS	1.310	1.718	2.247
PBR (x)	11.3	8.4	6.2
EV/EBITDA (x)	23.1	17.4	13.1
ROE (%)	36.8	35.9	34.4

Source: FactSet, Daiwa forecasts

Financial summary

■ Key assumptions

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Active Instant Messaging user account (m)	376.6	522.9	647.6	721.0	798.2	848.5	888.5	908.5
Peak simultaneous online IM user account (m)	49.7	93.0	127.5	152.7	176.4	178.2	195.5	209.0
Fee-based IVAS/VAS registered subscriptions (m)	31.4	51.6	65.7	77.2	70.9	100.7	104.7	97.3
ACU of mini casual games (m)	2.1	2.9	3.2	4.1	4.2	4.4	4.9	5.2
ACU of advanced casual games (m)	0.0	1.1	1.7	2.7	4.3	6.2	7.2	7.5
ACU of MMOG (m)	0.0	1.5	1.2	1.6	1.9	2.7	4.0	4.5

■ Profit and loss (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Value-added services (VAS)	6,314	11,436	18,198	26,314	35,718	46,111	61,605	77,621
Online advertising	826	962	1,373	1,992	3,382	5,041	7,556	10,863
Other Revenue	15	41	75	190	4,793	9,644	15,451	21,870
Total Revenue	7,155	12,440	19,646	28,496	43,894	60,795	84,611	110,355
Other income	112	78	294	890	552	1,606	1,636	1,921
COGS	(2,170)	(3,889)	(6,320)	(9,928)	(18,207)	(27,439)	(39,203)	(51,869)
SG&A	(1,491)	(2,070)	(3,004)	(5,265)	(8,139)	(11,605)	(16,332)	(20,651)
Other op.expenses	(359)	(538)	(778)	(1,939)	(2,612)	(3,405)	(4,777)	(6,070)
Operating profit	3,246	6,021	9,838	12,254	15,487	19,953	25,935	33,686
Net-interest inc./(exp.)	(36)	134	255	504	836	1,181	1,428	1,628
Assoc/forex/extraord./others	(106)	(114)	(180)	(659)	(1,272)	(1,088)	(1,530)	(1,733)
Pre-tax profit	3,105	6,041	9,913	12,099	15,051	20,045	25,833	33,580
Tax	(289)	(819)	(1,798)	(1,874)	(2,266)	(3,809)	(4,521)	(5,709)
Min. int./pref. div./others	(31)	(66)	(62)	(22)	(53)	(56)	(80)	(105)
Net profit (reported)	2,785	5,156	8,054	10,203	12,732	16,181	21,232	27,767
Net profit (adjusted)	2,945	5,477	8,574	10,940	14,286	17,327	22,378	28,913
EPS (reported)(CNY)	1.553	2.852	4.407	5.552	6.895	8.731	11.456	15.600
EPS (adjusted)(CNY)	1.643	3.030	4.692	5.953	7.737	9.349	12.074	15.600
EPS (adjusted fully-diluted)(CNY)	1.602	2.965	4.607	5.886	7.667	9.116	11.765	15.188
DPS (CNY)	0.350	0.400	0.550	0.750	1.000	1.310	1.718	2.247
EBIT	3,406	6,342	10,359	12,991	17,042	21,098	27,081	34,832
EBITDA	3,766	6,880	11,137	14,930	19,654	24,503	31,859	40,901

■ Cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Profit before tax	3,105	6,041	9,913	12,099	15,051	20,045	25,833	33,580
Depreciation and amortisation	359	538	778	1,939	2,612	3,519	4,855	6,387
Tax paid	(322)	(456)	(1,542)	(1,836)	(2,225)	(3,724)	(4,420)	(5,581)
Change in working capital	202	2,106	3,501	15,194	21,654	2,947	3,707	1,964
Other operational CF items	236	170	(366)	(14,038)	(17,663)	(5,397)	(6,822)	(7,465)
Cash flow from operations	3,580	8,398	12,285	13,358	19,429	17,390	23,154	28,886
Capex	(1,404)	(821)	(2,024)	(4,848)	(4,839)	(6,080)	(8,461)	(8,461)
Net (acquisitions)/disposals	0	68	0	(6,875)	(4,659)	0	0	0
Other investing CF items	(1,110)	(4,272)	(9,991)	(3,632)	(6,772)	76	76	76
Cash flow from investing	(2,515)	(5,025)	(12,015)	(15,355)	(16,270)	(6,004)	(8,385)	(8,385)
Change in debt	0	202	0	2,917	(7,041)	0	0	0
Net share issues/(repurchases)	(301)	91	(144)	(887)	218	0	0	0
Dividends paid	(258)	(555)	(624)	(895)	(1,225)	(1,853)	(2,427)	(3,185)
Other financing CF items	(311)	(136)	4,880	3,238	5,662	0	0	0
Cash flow from financing	(870)	(397)	4,112	4,373	(2,386)	(1,853)	(2,427)	(3,185)
Forex effect/others	(76)	(1)	(52)	(172)	(2)	0	0	0
Change in cash	119	2,976	4,331	2,204	771	9,533	12,342	17,316
Free cash flow	2,175	7,578	10,261	8,510	14,591	11,311	14,693	20,425

Source: FactSet, Daiwa forecasts

Financial summary continued ...

■ Balance sheet (CNYm)

As at 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Cash & short-term investment	5,129	11,354	22,134	26,328	27,189	36,689	48,989	66,289
Inventory	5	0	0	0	568	787	1,095	1,428
Accounts receivable	983	1,229	1,715	2,021	2,354	3,260	4,538	5,918
Other current assets	378	574	1,524	7,155	6,398	7,975	9,990	13,029
Total current assets	6,496	13,157	25,374	35,503	36,509	48,712	64,612	86,665
Fixed assets	1,165	2,517	3,293	5,885	7,403	10,659	14,921	17,652
Goodwill & intangibles	370	269	573	3,780	4,719	3,986	3,254	2,521
Other non-current assets	1,824	1,563	6,591	11,636	26,625	29,249	36,070	43,535
Total assets	9,856	17,506	35,830	56,804	75,256	92,606	118,857	150,373
Short-term debt	0	202	5,299	8,020	1,077	1,077	1,077	1,077
Accounts payable	245	697	1,380	2,244	4,212	6,174	8,772	11,430
Other current liabilities	1,847	3,664	6,343	10,919	15,376	19,064	23,773	27,832
Total current liabilities	2,092	4,563	13,022	21,183	20,665	26,314	33,621	40,339
Long-term debt	0	0	0	3,733	7,517	7,439	7,439	7,439
Other non-current liabilities	645	644	967	2,799	4,926	5,011	5,112	5,239
Total liabilities	2,736	5,207	13,989	27,716	33,108	38,765	46,172	53,018
Share capital	0	0	0	0	0	0	0	0
Reserves/R.E./others	7,021	12,178	21,757	28,464	41,297	52,934	71,698	96,264
Shareholders' equity	7,021	12,179	21,757	28,464	41,298	52,934	71,698	96,264
Minority interests	98	120	84	625	851	907	987	1,091
Total equity & liabilities	9,856	17,506	35,830	56,804	75,256	92,606	118,857	150,373
EV	593,384	587,208	580,820	580,367	576,323	566,826	554,636	537,474
Net debt/(cash)	(5,129)	(11,151)	(16,835)	(14,574)	(18,595)	(28,173)	(40,473)	(57,773)
BVPS (CNY)	3.908	6.696	11.852	15.471	22.283	28.562	38.686	51.941

■ Key ratios (%)

Year to 31 Dec	2008	2009	2010	2011	2012	2013E	2014E	2015E
Sales (YoY)	87.2	73.9	57.9	45.0	54.0	38.5	39.2	30.4
EBITDA (YoY)	95.3	82.7	61.9	34.1	31.6	24.7	30.0	28.4
Operating profit (YoY)	96.2	86.2	63.3	25.4	31.2	23.8	28.4	28.6
Net profit (YoY)	84.0	86.0	56.6	27.6	30.6	21.3	29.2	29.2
Core EPS (fully-diluted) (YoY)	83.8	85.1	55.4	27.8	30.3	18.9	29.1	29.1
Gross-profit margin	69.7	68.7	67.8	65.2	58.5	54.9	53.7	53.0
EBITDA margin	52.6	55.3	56.7	52.4	44.8	40.3	37.7	37.1
Operating-profit margin	47.6	51.0	52.7	45.6	38.8	34.7	32.0	31.6
Net profit margin	41.2	44.0	43.6	38.4	32.5	28.5	26.4	26.2
ROAE	48.3	57.1	50.5	43.6	41.0	36.8	35.9	34.4
ROAA	35.0	40.0	32.2	23.6	21.6	20.6	21.2	21.5
ROCE	53.7	64.6	52.3	38.2	37.2	37.3	37.7	37.2
ROIC	159.5	331.7	261.8	106.1	69.1	65.7	73.9	77.9
Net debt to equity	net cash	net cash	net cash	net cash	net cash	net cash	net cash	net cash
Effective tax rate	9.3	13.6	18.1	15.5	15.1	19.0	17.5	17.0
Accounts receivable (days)	38.7	32.5	27.4	23.9	18.2	16.9	16.8	17.3
Current ratio (x)	3.1	2.9	1.9	1.7	1.8	1.9	1.9	2.1
Net interest cover (x)	95.9	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net dividend payout	22.5	14.0	12.5	13.5	14.5	15.0	15.0	15.0
Free cash flow yield	0.4	1.3	1.7	1.4	2.4	1.9	2.5	3.4

Source: FactSet, Daiwa forecasts

■ Company profile

Tencent is the largest and most used Internet service portal in China. Over the past decade, the company has been able to maintain steady earnings growth under its user-oriented strategy. On 16 June 2004, it was listed on the main board of the Hong Kong Stock Exchange.

China Wireless Technologies

2369 HK

Target (HKD): **n.a.**

Up/downside: -

11 Nov price (HKD): **2.87**

A leading China smartphone brand

■ Not Rated

- Ranked fourth in China's smartphone market by shipments for 2012
- Has good access to the telecoms operators' networks
- Focuses on the lower-end smartphone segment



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China Tech Team

■ Background

For 2013, China Wireless Technologies (China Wireless) guides for revenue of HKD20bn and shipments of 30-35m on the back of: 1) the company's good access to telecoms carriers' networks, 2) its focus on the low-end smartphone segment, and 3) enhanced branding.

■ Highlights

China Wireless provides 3G smartphones (with TD-SCDMA/ WCDMA/ CDMA-EVDO) for the China market, and FDD-LTE smartphones for markets overseas (Europe and the US). Management believes the company's mature TD-LTE smartphone, developed in 2012, gives it a technology edge over other China smartphone makers.

The company had revenue of HKD9.6bn for 1H13, up 54.9% YoY. For 2013, it guides for: 1) smartphone shipments of 30m (up 43% YoY), 2) revenue of HKD22-24bn, and 3) 10% of its shipments to go overseas (2012: 5%).

According to China Wireless, its Coolpad smartphone brand had a 11.2% share of China smartphone shipments for 2012 (compared with Samsung Electronics at 17%, Lenovo at 12%, and Huawei at 10%), up from 9.7% for 2011. The Coolpad has become one of the four biggest domestic smartphone brands in China (along with ZTE, Huawei, and Lenovo). Our industry research suggests the company shipped about 16m smartphones for 1H13.

Pricing competition among the major players in China's smartphone market is intensifying. China Wireless saw its gross margin fall to 13% for 1H13, from 11.9% for 2012. The company has indicated it has been working on reducing its operating costs/revenue ratio through tighter control of SG&A expenses in order to drive earnings growth.

Its blended ASP for smartphones is currently about CNY650-680 (the same level as for 2012), and the company targets the mainstream low-end of the smartphone market.

(We estimate smartphones priced CNY600-800 to account for over 40% of China's total smartphone shipments for 2013). China Wireless believes its price strategy is likely to help it gain market share sequentially.

The company has good access to China telecoms carriers' networks. In 1H13, the company distributed its handsets to China Mobile (55%), China Unicom (30%), and China Telecom (25%). For the full year, it aims for these proportions to be: China Mobile (40%), China Unicom (30%), and China Telecom (30%).

■ Valuation

The stock is trading currently at a 2014 PER of 10x, based on the Bloomberg-consensus EPS forecast.

Share price performance



12-month range	1.91-3.83
Market cap (USDbn)	0.78
3m avg daily turnover (USDm)	8.22

Source: FactSet, Daiwa

FocalTech

5280 TT

Focusing on its specialist technology and applications

- A leading player in China's touch-controller IC business
- Focaltech aims to maintain its 50% share of China's market for smartphone touch-controller ICs this year
- It listed on the TWSE main board on 8 November 2013 at a price of TWD250

Target (TWD): **n.a.**

Up/downside: -

11 Nov price (TWD): **291.00**

■ Not Rated



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■ Background

Founded in the US in 2005, Focaltech is a fabless company specialising in the design and development of touch-controller ICs (since 2009) and display-driver ICs (since 2007). The company is a leading player in China's smartphone and tablet-PC touch-IC markets, with about a 50% share of the China smartphone market for touch-controller ICs at present.

Focaltech's 2012 revenue increased by 2.9x YoY, driven by its touch-controller ICs (99% of total revenue). In terms of product applications, smartphones and tablets accounted for about 88% and 12%, respectively, of its 1H13 revenue.

■ Highlights

Its 2013 shipment target is above 200m units, up 60-70% YoY from 137m units in 2012. Focaltech offers capacitive touch-

controller ICs for touch displays with sizes from below 4 inches to 15.6 inches. Its customer base includes China's major smartphone makers, namely: Lenovo, Huawei, ZTE, Coolpad, Gionee, K Touch, TCL, Xiaomi (its Hongmi model only), and Hisense.

Focaltech developed a low-cost in-cell touch controller IC for China smartphone maker VSUN, which was launched in August 2013. FocalTech claims to have specialist controller-IC technology. Also, it believes it has a good yield rate, which allows it to provide attractive pricing to China smartphone makers that use in-cell solutions.

It aims to have approximate shares of 50% of China's smartphone market and 30% of the tablet market for 2013. This compares with about an 80% share that the company says it had in 2012 of China's smartphone touch-IC market, driven by strong smartphone demand in China.

Management is positive that it will be able to maintain its market share in smartphone touch ICs and raise its share slightly in tablet PC touch-IC in 2H13 and beyond.

Competition for Focaltech comes mainly from Greater China touch-IC

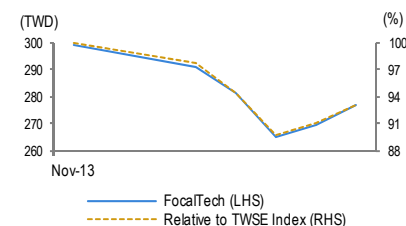
players (ie, Goodix and Mstar). Focaltech expects its ASP to be down YoY for 2013, but is implementing cost controls and measures to boost its income in order to mitigate the impact.

For 1H3, Focaltech generated revenue of TWD2.26bn (TWD4.74bn for 2012) and a gross margin of 47.9% (vs. 53.6% for 2012), with the latter reflecting a lower ASP. The company aims to increase its driver-IC sales in 4Q13 and 2014.

■ Valuation

Focaltech was listed on the main board of the TWSE on 8 November, at an IPO price of TWD250. Its current market cap is USD500m.

Share price performance



12-month range	291.00-299.50
Market cap (USDbn)	0
3m avg daily turnover (USDm)	38.50

Source: FactSet, Daiwa

ILI Technology

3598 TT

The main supplier of handset driver ICs for China

- Has a high share of China's handset driver-IC market
- Lags behind its competitors in the touch-IC business
- Consensus forecasts revenue to be flat YoY for 2013 and rise by 5-10% YoY for 2014

Target (TWD): **n.a.**

Up/downside: -

11 Nov price (TWD): **51.70**

■ Not Rated



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■ Background

ILI Technology (Ilitek) is a Taiwan-based fabless company that develops and manufactures display-driver ICs, and is the main provider of handset driver ICs for the China market.

■ Highlights

For 2012, the company generated revenue of TWD10,542m and a net profit of TWD595m. Its revenue breakdown for 1H13 was as follows: handset driver ICs 80%, mid-sized to large LCD driver ICs 15-18%, and touch-controller ICs about 2-5%.

For 2014, Ilitek expects its main business-growth driver to be handset driver ICs, on the back of resolution upgrades of smartphone displays. China handset makers are the main customers in Ilitek's handset-driver business, and the

company expects them to remain so in 2014.

Ilitek derives 40% of its revenue from global and China handset brand names. This implies to us that 60% of its revenue is from China second-tier handset makers.

The company has market shares in China in terms of shipments of more than 50% in QVGA driver ICs, about 50% in HVGA driver ICs, and about 10% in WVGA driver ICs. This makes it the main supplier of driver ICs to China in the low-end market segment.

Ilitek is one of few players placing foundry orders at Powerchip's 12-inch fab with 0.11µm process manufacturing, and as a result its wafer cost is 10% lower than those of its competitors. The company's main competitors are Sitronix and Galaxycore in the QVGA and lower-resolution display driver-IC segment, and Himax in the HVGA/WVGA display driver-IC segment.

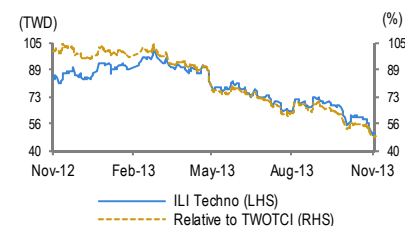
In 2014, the company expects its main competitors to be Novatek, Orise, and Himax in the higher-resolution QHD/HD driver-IC segment.

Ilitek sees a less exciting outlook for its touch-controller ICs in 2014, given that: 1) the company is not one of the top-three players in China in this segment, and 2) as a touch-IC supplier, it could face more competition from application-processor (AP) makers and could lose business if touch-controller ICs are integrated into APs. The top touch-controller IC players in the China market currently are Focaltech, Goodix, and Mstar Semiconductor.

■ Valuation

The stock is trading currently at PERs of 9x for 2013 and 8x for 2014, based on Bloomberg consensus EPS forecasts, compared with a forward PER trading range of 7-16x over the past three years.

Share price performance



12-month range	51.70-100.48
Market cap (USDbn)	0.13
3m avg daily turnover (USDm)	0

Source: FactSet, Daiwa

RDA Microelectronics

RDA US

Expanding into the China smartphone-IC market

- Expects its product roadmap for EDGE/WCDMA smartphone ICs to be a long-term business-growth driver
- Guides for a continuous gross-margin improvement in 2H13
- Has agreed be acquired by Tsinghua Unigroup for USD18.5/American depositary share

Target (USD): **n.a.**

Up/downside: -

11 Nov price (USD): **18.14**

■ Not Rated



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■ Background

Founded in 2004, RDA Microelectronics (RDA) is the second-largest feature phone-IC provider in China by shipments (behind Mediatek), with about a 25% market share, and is now expanding into China's smartphone-IC market. RDA acquired Coolsand (Not listed), a private China company providing baseband solutions, on 26 March 2012.

On 11 November 2013, the company announced that it had entered into an agreement to be acquired by Tsinghua Unigroup for USD18.5/American depositary share (ADS) (which had been proposed on 7 November, after the company received a non-binding acquisition proposal from Shanghai Pudong Science and Technology Investment Co at USD15.5/ADS in September).

■ Highlights

RDA started expanding into China's smartphone-IC market this year. The company began trials of its 40nm single-chip RDA8810 EDGE smartphone baseband IC in 4Q13 and aims to start commercial shipments of this chip by year-end. Management has said it believes RDA's cost structure for single-chip EDGE smartphone ICs are the lowest in the China market. Meanwhile, the company plans to launch a sample WCDMA smartphone IC in 2014. In addition, it aims to start shipping its RDA8811 EDGE chip for the tablet-PC market next year, and targets a 10% market share of the China tablet IC market one year after its launch of this chip (ie, by 2H14).

Regarding its presence in China's feature-phone IC market, RDA has said that it is gaining market share there as it has the lowest-cost 2G handset ICs in the China market, such as the RDA8851 chip, which management expects to generate a higher gross-profit margin than the company's average gross-profit margin. It is also working on integrating power amplifiers into baseband solutions for its upcoming products.

Management aims for RDA to have a 40% share of China's feature phone-

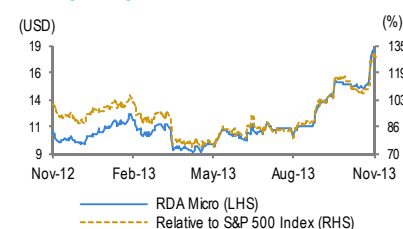
IC market at the end of this year. We forecast RDA's feature-phone IC shipments for China to range from 120-150m units for 2013. This would imply about a 23-29% share of China's handset-IC market, based on our forecast for total China feature-phone IC shipments of about 520m units.

■ Valuation

For 2014, the Bloomberg consensus forecasts revenue growth of 14% YoY and growth in basic earnings per ADS of 22% YoY to USD1.31, following a 20% YoY decline in earnings per ADS for 2013.

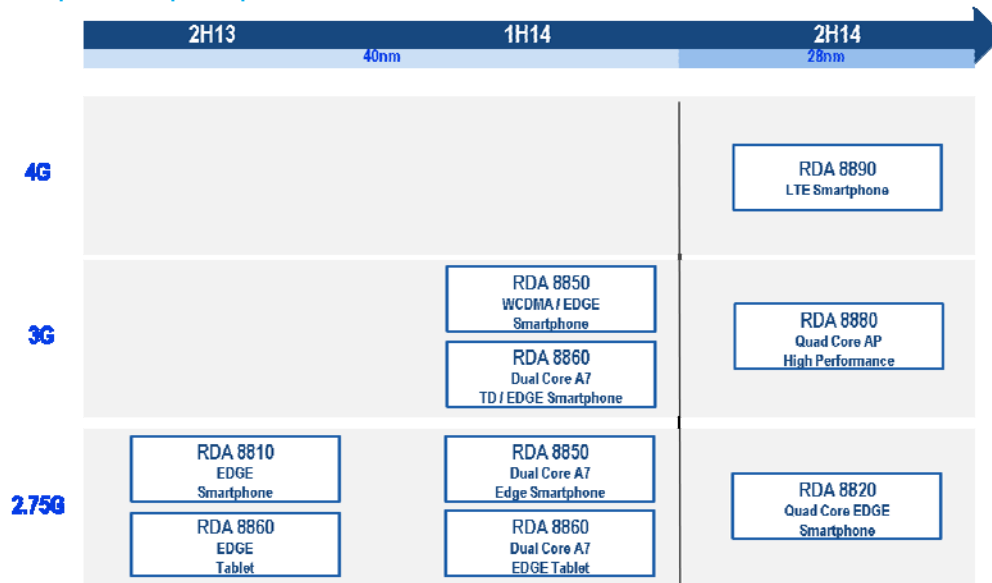
The stock is trading currently at PERs of 17x for 2013 and 14x for 2014, based on consensus EPS forecasts.

Share price performance



12-month range	9.09-17.53
Market cap (USDbn)	0.85
3m avg daily turnover (USDm)	1.27

Source: FactSet, Daiwa

■ RDA: product roadmap for smartphone platform


Source: Company

■ RDA: financial summary

(USDm)	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	2009	2010	2011	2012
Revenue	72.0	94.4	109.3	115.6	97.1	110.3	118.4	191.2	288.9	391.3
Gross profit	25.9	29.3	34.0	36.7	31.2	35.7	31.0	56.9	99.7	125.8
Operating profit	14.4	12.9	14.0	13.0	11.0	13.5	11.8	21.2	52.9	54.2
Pre-tax profit	15.2	13.4	14.8	14.2	11.8	15.1	11.7	21.6	56.3	57.6
Net profit	13.9	12.2	13.5	13.4	10.7	13.7	11.3	19.1	51.6	52.9
Basic earnings per ADS (USD)	0.32	0.27	0.30	0.29	0.23	0.30	0.05	0.06	1.18	1.17
Diluted earnings per ADS (USD)	0.30	0.25	0.28	0.28	0.22	0.29	0.03	0.05	1.11	1.12

YoY %

Revenue	(12.6)	31.1	15.8	5.8	(16.0)	13.5	21.9	61.5	51.1	35.5
Gross profit	(11.1)	13.2	16.1	7.8	(14.8)	14.3	(0.8)	83.8	75.3	26.1
Operating profit	(12.6)	(10.7)	8.8	(7.3)	(15.3)	23.1	7.7	78.7	150.2	2.5
Pre-tax profit	(14.2)	(11.6)	10.3	(4.3)	(16.8)	28.3	(0.8)	85.2	160.2	2.2
Net profit	(16.4)	(11.8)	10.3	(0.8)	(19.9)	28.0	5.6	69.2	169.9	2.5

Margins (%)

Gross-profit margin	35.9	31.0	31.1	31.7	32.1	32.3	26.2	29.8	34.5	32.2
Operating-profit margin	20.0	13.6	12.8	11.2	11.3	12.3	10.0	11.1	18.3	13.9
Net-profit margin	19.2	12.9	12.3	11.6	11.0	12.4	9.6	10.0	17.9	13.5

Source: Company

■ RDA: 12-month forward PER


Source: Bloomberg

Shenzhen O-film Tech

002456 CH

Target (CNY): **n.a.**
Up/downside: -
11 Nov price (CNY): **42.15**

Company sees metal mesh and camera modules as drivers

■ Not Rated

- O-film's guidance and market consensus expectations point to its strong business growth potential for 2013-14
- Claims 40-50% shares of the China smartphone and tablet PC touch-panel markets
- Focusing on metal mesh and camera modules for 2014



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■ Background

Shenzhen O-film Tech (O-film) makes touch panels, LCD modules (LCM), camera modules and related components. The company is one of China's fastest-growing component makers by revenue.

■ Highlights

According to the company, LCM should contribute more than 90% of revenue in 2013, and its revenue growth in 2014 should come from metal mesh and camera modules.

O-film expects strong growth in touch penetration in 2014. It believes the penetration of touch screens in the notebook (NB) segment will increase sharply in 2014, backed by: 1) more mature OS support, and 2) an improving cost structure. O-film

expects the cost gap between touch NBs and non-touch NBs to narrow to less than CNY1,000 in 2014, from CNY1,500-2,000 currently.

It believes metal mesh will become the mainstream solution for touch NBs, backed by its cost efficiency and short time to market. O-film, Young Fast, Fujifilm and Mitsubishi are the major proponents of metal mesh, though there are questions in the market over production yields.

Shift in focus for its camera-module business. O-film said its camera-module business has focused on the high end in 2013 but should expand to the lower end in 2014. According to O-film, it can provide 13-megapixel (MP) camera-module solutions thanks to advances by its Tokyo and Taipei design centres. Its 28MP camera module is used in Xiaomi's Red Rice (Hongmi) smartphone.

Management said O-film would focus on 8MP modules in 2H13 and 13MP modules in 2014, and that it would expand production capacity aggressively. Major clients include Lenovo, Huawei, Xiaomi, Tienyu, Gionee, Coolpad and Hisense, and management believes it could approach Sony and Samsung for business in the coming year.

O-film claims about half of China's smartphone and tablet PC touch-panel markets.

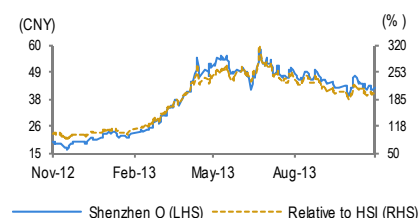
Management has said O-film offers the most competitive price (USD5 cheaper than an in-cell solution) in the smartphone segment. O-film claims it is the primary touch-panel provider for Lenovo and Huawei.

Growing tablet PC touch-panel business. O-film is a leading provider of GFF touch-panels in China's tablet-PC market; its clients include Samsung, Google, Acer, Lenovo, and Asustek. It said it can provide 0.6mm super-slim touch panels that are not greatly different from panels using in-cell solutions.

■ Valuation

O-film is trading at PERs of 33x for 2013E and 24x for 2014E, based on the Bloomberg consensus EPS.

Share price performance



12-month range	16.95-58.30
Market cap (USDbn)	3.22
3m avg daily turnover (USDm)	0

Source: FactSet, Daiwa

■ Touch solutions offered by various companies

	GG	GFF	G1F	OGS	TOL	Metal mesh
O-film		V				V
TPK	V	V	V	V	V	
Wintek	V			V		
Young Fast		V	V			V
J-Touch		V	V			V

Source: Daiwa

Note: GG = glass glass, GFF = glass film film, G1F = glass on film, OGS = one-glass solution, TOL = touch on lens

■ O-film: financial summary

(CNYm)	2009	2010	2011	2012	1H13
Revenue	372.5	617.7	1,240.6	3,917.4	3,294.1
Gross profit	98.4	139.5	163.3	763.5	571.0
Operating profit	65.6	67.8	51.7	436.4	308.2
Pre-tax profit	56.7	61.2	25.5	378.1	263.5
Net profit	51.0	52.1	20.7	321.1	220.8
Basic EPS (CNY)	0.18	0.16	0.06	0.84	0.49
Diluted EPS (CNY)	0.18	0.16	0.06	0.84	0.49
YoY %					
Revenue	61.6	65.8	100.9	215.8	156.8
Gross profit	52.3	41.8	17.1	367.5	117.6
Operating profit	56.8	3.3	(23.8)	744.6	86.9
Pre-tax profit	41.4	7.9	(58.3)	1,381.1	134.8
Net profit	36.8	2.2	(60.2)	1,450.4	156.9
Margins (%)					
Gross margin	26.4	22.6	13.2	19.5	17.3
Operating margin	17.6	11.0	4.2	11.1	9.4
Net margin	13.7	8.4	1.7	8.2	6.7

Source: Company

Spreadtrum Communications

SPRD US

Upside from potential China listing in 2014

- Market share in China TD-SCDMA smartphone ICs could fall on the back of competition from Mediatek
- Company announced in July that it would be privatised
- Market seems to believe a possible listing of the stock in China would support investment in future products

Target (USD): **n.a.**

Up/downside: -

11 Nov price (USD): **30.48**

■ Not Rated



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■ Background

Spreadtrum Communications (Spreadtrum) is a fabless semiconductor company, and is engaged in the design, development, and marketing of baseband, RF processor solutions and turnkey solutions for the wireless-communications and mobile-television markets.

It announced in July that Tsinghua Unigroup would acquire all of its outstanding ordinary shares for USD31.00/American Depositary Share (ADS) with an equity value of about USD1.78bn.

■ Highlights

Spreadtrum plans to produce more dual-core solutions in 2H13 (more than 65% of its solutions were single-core for 1H13), as the cost gap between dual-core and single-core smartphones has narrowed.

Our market research indicates that Mediatek's (2454 TT, TWD426, Buy [1]) MT6572 chipset is currently winning more orders from the big China smartphone brands than Spreadtrum's SC8825, and the MT6572 chip accounted for most of Mediatek's 3Q13 smartphone IC shipments. That implies that Spreadtrum's overall share of the China TD-SCDMA smartphone IC market could decline in 2H13, from 70% for 1H13.

In terms of WCDMA smartphone ICs, Spreadtrum launched its SC7710 WCDMA smartphone IC in 3Q13, and plans to launch its dual-core WCDMA smartphone ICs early next year. We expect to see only limited demand for its single-core WCDMA smartphone ICs in China in 3Q13. Hence, we believe these ICs will not have a meaningful impact on revenue until its quad-core smartphone IC is launched in 2H14. The market believes its product roadmap will accelerate after it relists in Shanghai to generate sufficient funds for future product development.

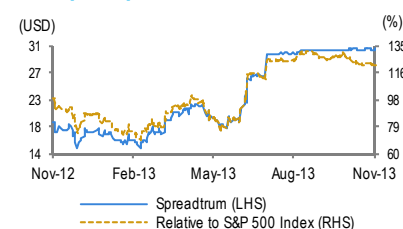
For 2014, we note that investors seem interested in: 1) the company's listing schedule for A-shares (that is the reason for the Tsinghua Unigroup acquisition in offering USD31/ADS), and 2) its available

quad-core smartphone-IC schedule using the 28nm process. Assuming its A-share PER in 2014 is similar to those of other leading China tech companies (such as O-Film), we may be surprised by the growth of its market cap after it lists on the A-share market. Besides, once Spreadtrum is able to provide quad-core smartphone ICs in 2H14, we may see price competition intensify between it and Mediatek.

■ Valuation

The Bloomberg consensus forecasts Spreadtrum's 2014 revenue to rise by 11.4% YoY, and its basic EPS to be USD2.85, an 8% YoY increase. The stock is trading currently at an 11.5x 2013E PER and 10.2x 2014E PER, based on the consensus forecasts.

Share price performance



12-month range	14.96-30.60
Market cap (USDbn)	1.48
3m avg daily turnover (USDm)	14.76

Source: FactSet, Daiwa

TCL Communication Technology

2618 HK

Fast time-to-market strategy for smartphones

- A major China handset maker that returned to net profit in 2Q13
- Produces Alcatel-branded and fast time-to-market smartphones
- A major customer of Mediatek's multi-core IC solution; should be favourable for Mediatek

Target (HKD): **n.a.**

Up/downside: -

11 Nov price (HKD): **6.83**

■ Not Rated



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■ Background

TCL Communication (TCL) is a 50%-owned listed subsidiary of TCL Corporation (a China-based manufacturer of branded consumer-electronics goods) and specialises in developing and producing handsets (feature phones and smartphones).

■ Highlights

Has been making a net profit since 2Q13. TCL saw a QoQ turnaround in its bottom line to a net profit of HKD39m for 2Q13 and HKD226m for 3Q13 (from a net loss of HKD246m for 1Q13). This was driven mainly by a solid rise in smartphone shipments, which the company attributed to: 1) its earlier adoption than other China brands of new components and materials, and 2) its leveraging on the Alcatel brand that it manufactures, and rapid provision to the market of advanced and price-competitive smartphones.

TCL's also posted an improvement in its gross-profit margin to 19.6% for 3Q13 (from 16.4% for 1Q13). The company expects its advanced smartphone shipments (mainly quad-core and priced at USD150-200) to rise to 30% of its total smartphone shipments for 4Q13, from over 20% for 2Q13.

TCL now expects revenue growth of 40% YoY for 2013.

This should be driven mainly by steady shipments of its handsets and high growth in smartphone shipments. Management has said it expects the company's shipments of total handsets to reach 50m units for 2013 (36m units for 1-3Q13), up from 42.6m units (of which 6.5m are smartphones) for 2012. It aims to ship 15-18m smartphones in 2013 and has indicated the revenue contribution from smartphones should rise from 43% for 2012 to 60-70% for 2013.

A major China smartphone maker for export markets with the Alcatel brand. The company expects overseas markets and China to respectively account for 85-90% and 10-15% of its 2013 smartphone shipments. Also, with its success in developing Alcatel-branded smartphones, TCL expects high smartphone shipment growth over 2013-14 in France, Germany, Russia,

North America, South America, Mexico, and Southeast Asia.

Fast time-to-market strategy using Mediatek's (2454 TT, TWD426, Buy [1]) solution and new materials/technology.

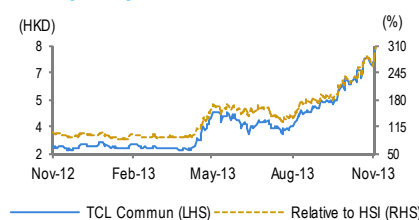
TCL's smartphone shipments for 1H13 were mainly WCDMA ones (over 80%). This reflects its strategy of focusing on export markets, where WCDMA smartphones are more common than in China.

Further, TCL now provides fast time-to-market smartphones as it used Mediatek's multi-core smartphone-IC solution for about 60% of its smartphone shipments for 1H13.

■ Valuation

TCL is trading at a 2014 PER of 11x, based on the Bloomberg-consensus EPS forecast.

Share price performance



12-month range	2.18-7.38
Market cap (USDbn)	1.01
3m avg daily turnover (USDm)	4.45

Source: FactSet, Daiwa

■TCL: financial summary

(HKDm)	1Q12	2Q12	3Q12	4Q12	1Q13	2Q13	3Q13	2011	2012	1-3Q13
Revenue	2,105	2,988	3,053	3,885	2,449	3,958	5,454	10,653	12,031	11,861
Gross profit	419	564	510	604	402	727	1,071	2,328	2,097	2,199
Operating profit	71	125	(35)	(182)	(205)	39	241	925	(21)	78
Pre-tax profit	30	82	(81)	(220)	(241)	14	220	783	(188)	(8)
Net profit	26	79	(87)	(226)	(246)	39	226	800	(208)	19
Basic EPS (HK cents)	2.3	7.1	(7.7)	(20.0)	(21.8)	3.47	19.75	72.83	(18.49)	1.66
Diluted EPS (HK cents)	2.3	6.9	(7.5)	(19.6)	(21.7)	3.38	19.04	70.40	(18.07)	1.62

YoY %

Revenue	(0.9)	20.7	6.7	21.7	16.3	32.5	78.6	22.4	12.9	45.6
Gross profit	(11.5)	4.2	(14.6)	(15.8)	(3.9)	28.9	109.9	19.5	(9.9)	47.4
Operating profit	(67.0)	(49.1)	n.a.	n.a.	n.a.	(69.1)	n.a.	14.4	n.a.	(51.7)
Pre-tax profit	(83.5)	(62.4)	n.a.	n.a.	n.a.	(83.0)	n.a.	5.2	n.a.	n.a.
Net profit	(85.7)	(62.5)	n.a.	n.a.	n.a.	(50.4)	n.a.	14.0	n.a.	5.3

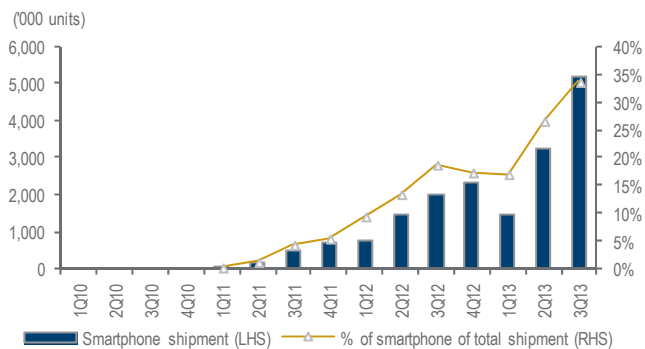
QoQ %

Revenue	(34.0)	41.9	2.2	27.3	(37.0)	61.6	37.8			
Gross profit	(41.6)	34.6	(9.5)	18.5	(33.4)	80.6	47.4			
Operating profit	(64.9)	77.6	n.a.	n.a.	n.a.	n.a.	521.1			
Pre-tax profit	(81.0)	171.0	n.a.	n.a.	n.a.	n.a.	1,477.0			
Net profit	(86.7)	208.4	n.a.	n.a.	n.a.	n.a.	473.7			

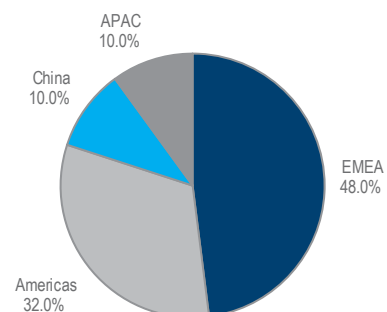
Margins (%)

Gross margin	19.9	18.9	16.7	15.6	16.4	18.4	19.6	21.9	17.4	18.5
Operating margin	3.4	4.2	(1.2)	(4.7)	(8.4)	1.0	4.4	8.7	(0.2)	0.7
Net margin	1.2	2.7	(2.9)	(5.8)	(10.1)	1.0	4.1	7.5	(1.7)	0.2

Source: Company

■TCL: smartphone shipments


Source: Company

■ TCL: smartphone revenue by region (1-3Q13)


Source: Company

Truly International 732 HK

Target (HKD): **n.a.**
Up/downside: -
11 Nov price (HKD): **4.77**

Riding on rising smartphone components business in China

■ Not Rated

- One of China's leading LCD-panel makers
- Revenue up 124% YoY for camera modules, 29% YoY for mobile LCD panels and 37-fold YoY for touch-panel lamination in 1H13
- Institutional investors' shareholdings are increasing



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■ Background

Truly International (Truly) is one of China's leading LCD-panel, touch-panel and camera-module providers for the country's smartphone and tablet industries. Since early 2012, its revenue growth has been catching up aggressively with that of China's smartphone-component industry. Combined revenue for camera-module and touch-panel/modules more than doubled YoY for 1H13.

■ Highlights

For 1H13, Truly's revenue by product was as follows: mobile 38% from LCD displays, 24% from full-laminated touch displays, 6% from capacitive touch panels, 12% from compact camera modules, 10% from panels for automobile applications, and 11% from others. Currently, Truly's clients include ZTE, Huawei, BBK, Lenovo, K-touch, Oppo, Coolpad and Gionee.

The revenue generated by Truly's mobile LCD-panel module business in 1H13 came from both its colour super-twist nematic (CSTN) and thin-film-transistor (TFT) businesses. Over the past 18 months, Truly has been expanding its TFT-LCD-panel module capacity aggressively to catch up with the high shipment growth for China's smartphone-panel business. In 1H13, the company's TFT-LCD-panel module business posted solid revenue growth of 29% YoY.

In addition, Truly is among the top-5 handset LCD-panel providers globally, and is the main supplier for Samsung Electronics (SEC) (for the Samsung Anycall) and the China handset makers. SEC is Truly's largest CSTN LCD-panel customer.

Truly's camera-module business recorded revenue growth of 124% YoY for 1H13. The company is actively expanding its camera-module business by providing a wider range of 5-13MP camera modules. Its CMOS sensors come from SEC and OmniVision, while Largan Precision is the main supplier of its lenses.

Truly provides total touch-panel laminated solutions for companies that require touch-display modules. Management stated that its monthly

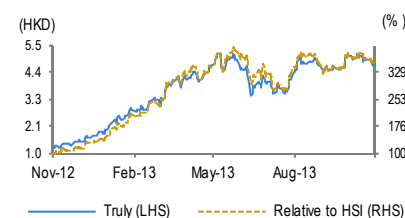
capacity should reach about 9-10M units by 4Q13, most of which will be the film-to-film type. It commented that it aims to start producing glass-film type touch panels as well.

In the longer term, the company targets to expand its business of providing LCD displays for automobile applications and to win orders from global brands. Its automotive-display business posted revenue growth of 20% YoY (with TFT-LCD display revenue up 116% YoY) for 1H13.

■ Valuation

Over the past 18 months, the Truly stock has been trading within a one-year forward PER range of 3-11x. The stock is trading currently at a 2014E PER of 9x, based on the Bloomberg consensus EPS forecast.

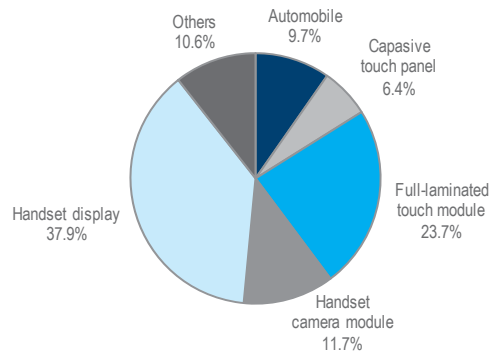
Share price performance



12-month range	1.25-5.20
Market cap (USDbn)	1.78
3m avg daily turnover (USDm)	8.71

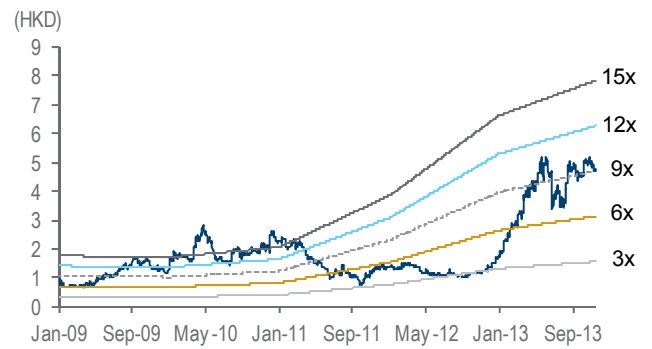
Source: FactSet, Daiwa

■ Truly: revenue breakdown by product (1H13)



Source: Company

■ Truly: 1-year forward PER bands



Source: Bloomberg

Huawei Technologies

Huawei: opportunities and challenges

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- 10% revenue CAGR for 2012-17, according to the company
- Enterprise IT solutions business is the fastest-expanding business in terms of revenue growth
- Smartphone business is expanding as well, as management focuses on increasing brand awareness

■ Background

Huawei Technologies (Not listed) is one of China's leading information and communications technology (ICT) solutions providers, as well as one of the biggest telecommunications equipment makers in the world. The company says it is aggressively moving into the consumer and enterprise IT markets, where it intends to provide IT solutions.

■ Highlights

Huawei targets a 10% revenue CAGR for 2012-17. During a recent company visit, Huawei told us that, for the next 10 years, it is targeting revenue growth for its enterprise and consumer businesses, having spent the past 10 years building up its business in the telecoms-equipment market (mostly dealing with telecoms operators).

We believe it would be a big challenge for any company to switch to a different field, with a different client base (from operators to enterprises and end-consumers).

Company expects revenue from the consumer and enterprise sectors combined to account for 40% of total revenue for 2017, up from 27% for 2012.

Huawei said it expects revenue for the consumer business to grow to 25% of total revenue for 2017 (up from 22% for 2012) and to 15% for the enterprise segment (up from 5% for 2012).

Meanwhile, revenue from its carrier-network business should fall to 60% for 2017 (from 73% for 2012) due to the shift in focus, according to the company. Huawei's current operating profit is mainly derived from its telecoms-operator business (currently, its consumer business makes a slight net profit, while its enterprise business makes a net loss).

Enterprise business expanding the fastest in terms of revenue growth. The enterprise business aims to help businesses (excluding the telecoms operators) build up their business systems, IT infrastructure, etc. The ICT business, including network and data-centre solutions, has become the main focus for the company's enterprise business.

Smartphone business is expanding. The company's smartphone business accounts for 50% of the company's consumer business revenue. Huawei said it recorded 32m smartphone shipments in 2012 (more than 40% YoY growth), making it China's largest smartphone supplier,

according to the company. Huawei has been working on building up its brand name, mostly in China and the emerging markets.

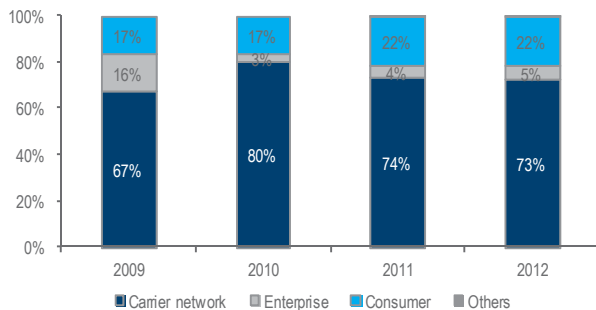
The company plans to improve the profitability of its consumer business by creating more value for customers, as well as increasing its operating efficiency. Meanwhile, Huawei believes its strength in product development will make it as a long-term winner in the consumer device market.

R&D strength. Huawei said it has 70,000 R&D staff, spread across 16 R&D centres in 30 cities. Its accumulated R&D investment over the past decade was CNY130bn.

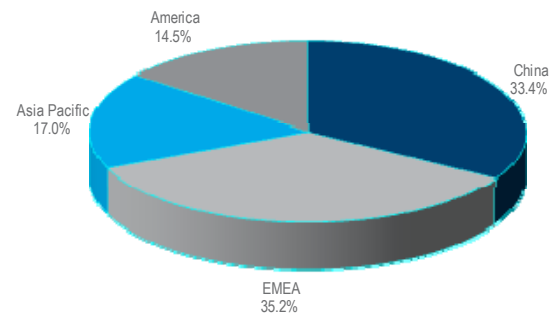
The company said it will keep investing in R&D – its R&D/revenue ratio was 13.7% in 2012, up from 11.6% in 2011. Its 2012 revenue was CNY220bn (or USD35.3bn), up 8% YoY. Its 2012 net income was CNY15.4bn.

Huawei's business can be broken down into: 1) the enterprise division (5% of total revenue), 2) the consumer division (22% of total revenue), and 3) the telecoms-carrier network division (73% of total revenue).

Huawei's revenue breakdown by market is: China at 33%, Asia Pacific at 17%, North/South America at 15%, and Europe, Middle East and Africa (EMEA) at about 35%.

■ Huawei: revenue breakdown by business segment


Source: Company

■ Huawei: 2012 revenue breakdown by geographic region


Source: Company

■ Huawei: profit and loss summary (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012
Revenue	125,217	149,059	182,548	203,929	220,198
Gross profit	49,758	58,969	80,353	76,448	87,577
Operating profit	16,197	21,052	30,676	18,582	19,957
Pretax profit	9,381	22,144	28,548	12,457	18,091
Net profit	7,848	18,274	24,716	11,647	15,380
Margin analysis					
Gross margin	39.7	39.6	44.0	37.5	39.8
Operating margin	12.9	14.1	16.8	9.1	9.1
Net margin	6.3	12.2	13.5	5.7	7.0
YoY %					
Revenue		19.0	22.5	11.7	8.0
Gross profit		18.5	36.3	(4.9)	14.6
Operating profit		30.0	45.7	(39.4)	7.4
Pretax profit		136.1	28.9	(56.4)	45.2
Net profit		132.4	35.4	(52.9)	32.1

Source: Company

■ Huawei: balance sheet (CNYm)

As at 31 Dec	2008	2009	2010	2011	2012
Cash and cash equivalent	21,017	29,232	41,501	57,192	67,180
Short-term investments	-	-	13,957	5,150	4,469
Account & notes receivable	52,854	63,282	68,734	55,330	59,829
Inventories	23,044	24,947	27,568	26,436	22,237
Other current assets	8,813	7,145	248	16,070	15,753
Total current assets	105,728	124,606	152,008	160,178	169,468
Fixed assets, net	7,285	8,317	16,008	18,631	20,366
Other non-current assets	5,227	6,730	10,968	15,040	20,172
Total assets	118,240	139,653	178,984	193,849	210,006
Accounts payable	60,528	70,013	82,656	38,049	40,273
Short-term borrowing	12,983	7,887	2,695	7,057	4,677
Other short-term liabilities	2,629	4,871	5,759	58,344	61,267
Long-term borrowing	1,026	8,490	10,264	13,270	16,077
Other non-current liabilities	3,620	5,076	8,210	10,901	12,688
Total liabilities	80,786	96,337	109,584	127,621	134,982
Common stock	37,421	43,253	69,381	66,274	75,048
Total shareholder's equity	37,454	43,316	69,400	66,228	75,024
Total liabilities & equity	118,240	139,653	178,984	193,849	210,006

Source: Company

■ Huawei: cash flow (CNYm)

Year to 31 Dec	2008	2009	2010	2011	2012
Cash flow from operations	6,455	21,741	31,555	17,826	24,969
Cash flow from investing	(12,477)	(5,219)	(14,708)	3,421	(5,426)
Cash flow from financing	13,992	(8,384)	(10,152)	(4,774)	(9,180)
Net change in cash	7,970	8,138	6,695	16,473	10,363

Source: Company

Xiaomi: China's answer to Apple

- Xiaomi seems to be fashioning an Apple-like image, backed by its Android-based MIUI platform
- The company, by some measures the fourth-largest smartphone maker globally, is targeting shipments of 20m-plus units in 2013
- As well as using Apple's component suppliers, it is increasingly leveraging the domestic supply chain and Mediatek's solutions



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■ Background

Top-3 hardware player in China. Xiaomi (Not listed) is a privately owned company that designs, develops and sells its own brand of consumer-electronics items via the Internet. In its recent fundraising, Xiaomi's implied enterprise value (EV) was USD10bn, putting it among the top-three largest hardware makers in China on this measure (together with Lenovo with a market cap of USD12bn, and Huawei [Not listed]).

On the same basis, Xiaomi is the fourth-largest smartphone maker globally with an enterprise value of USD10bn (Nokia [USD30bn market cap], Lenovo [USD12bn], Huawei [market cap not available, but widely thought to be a top-3 player], Blackberry [USD3.4bn], and HTC [USD4.4bn]).

■ Highlights

New products. With its recent launch of the Mi3 smartphone and Red Rice (Hongmi) low-cost smartphone, Xiaomi has signalled its intention to become a leading smartphone maker in China.

Ambitions to become a global player. Xiaomi recently hired ex-Google top management/product director Hugo Barra to lead its global division, with a view to expanding its global business and strengthening its ties with the US company. Xiaomi expects Barra to be instrumental in helping to expand its presence overseas, and join the ranks of the big multinational players.

Business model includes hardware, software/content, and social networking, backed by MIUI operating system.

Xiaomi aims to provide a refined user interface (UI) for Android smartphone users through its MIUI platform (launched in 2010), which provides a weekly stream of updates that encourage close interaction between the company and the sizable base of users of its products. Xiaomi thinks MIUI has set a precedent for the potential success of its app, content, service, community service businesses.

Xiaomi is seen as China's answer to Apple. Xiaomi is widely viewed in China as attempting to

build up its brand as the country's answer to Apple, with its unique operating system (MIUI), positive buzz among the young generation, and marketing acumen. The company often sees a "shortage" of its smartphones, selling out its new models online within five minutes of launch. Internet sell-through also brings cost efficiencies, given the lack of retail marketing costs. Indeed, a shortage of its Hongmi smartphone pushed up the second-hand price on-line to CNY1,000, from an original price of CNY799.

Xiaomi is competitive on price/performance.

1) Xiaomi tries to provide similar specs to those of Apple smartphones (even using Apple's component suppliers) but at a much lower price for online sales, with profits expected to come through later in the product's life cycle. Its Mi1/Mi2/Mi3 models have similar specs to Apple's iPhones but are priced at CNY1,999 (compared with over CNY3,300 for the equivalent Apple product). 2) This year, Xiaomi has been tapping the local supply chain as well as Apple's component suppliers. Its Hongmi smartphone, priced at CNY799, leverages Mediatek's solutions as well as components sourced from China-based players.

China's answer to Apple

Targeting 20m-plus unit shipments this year

Aiming for 200%-plus YoY shipment growth.

The company expects its smartphone shipments to reach 20m units in 2013 (7m shipped in 1H13), up from 7m in 2012. Such a level would imply around 200% YoY shipment growth for 2013, vs. our expectations in the market for 80-100% YoY growth for the industry. In 1H13, the company posted revenue of CNY13.3bn, higher than its full-year 2012 revenue of CNY12.6bn.

■ Shipment trends for China's top-10 players

(m units)	2011	2012	2013E	2014E
Huawei	15	33	45	60
ZTE	14	27	40	52
Lenovo	5	28	40	60
Coolpad	9	15	25	35
TCL Communication	3	12	20	35
Xiaomi	1	7	20	40
Gionee	2	12	18	26
OPPO	2	7	13	23
BBK	1	5	12	20
Tianyu	1	5	10	16
Top-10 players' shipments	53	151	243	367
Total China smartphone shipments	64	240	430	615
Top-10 players' shipment share (%)	83	63	57	60

Source: Companies for historical numbers and 2013 forecasts, Daiwa forecasts

The company's strong smartphone sales-volume growth in 2013 comes as the profile of its brand in China continues to rise and is supported by the launch of its low-cost smartphone (the Red Rice [Hongmi]).

Xiaomi tries to provide specs similar to those of Apple smartphones (even using Apple's component suppliers) but at a much lower price.

■ Bill of materials: Xiaomi vs. iPhone

	iPhone 5	Xiaomi Red Rice (Hongmi)	Xiaomi Mi1
Global launch	4Q12	Aug-13	4Q11
1. Application Processor	17.5 (A6)	16.8 (MT6589T quad-core 1.5GHz)	10 (Qcom 8260 dual-core 1.5GHz)
2. Display (Module+Touch)	44 (4", Retina Display, In-cell)	27 (4.7")	35 (4")
3. Memory	20.85 (Flash: NAND, 16GB, RAM: 1GB)	11.2 (1GB RAM, 4GB storage)	22 (1GB RAM, 4GB storage)
4. Mechanical/E-Mechanical (Glass & Metals, PCB...etc)	33	3.3	20
5. Battery (3.7V)	4.5 (3.8V)	3.8	5
6. Bluetooth/ WLAN	5 (Murata Dual-Band Wireless Module)	1.2	8
7. Camera	18 (8MP/1.2MP)	8.8 (8MP/1.3MP)	12 (8MP)
8. Baseband / RF / PA	34 (QCOM MDM9615M / RTR8600)	9.3	20
9. User interface (Sensors)	6.5		4
10. Power management IC	8.5		2
11. Box content	7	1.3	8
Total materials	199.85	82.7	151
Estimated manufacturing cost	8	2	9
BOM cost	207.85	84.7	160
Shipment price for operator	650	130	180

Source: Daiwa estimates

The Hongmi model is all about China

Having initially favoured Apple's component suppliers, Xiaomi is now building up its local supply chain. For OEM work it uses Wingtech for its TD-SCDMA offerings and Longcheer for WCDMA offerings.

Its recently launched low-cost Hongmi sports Mediatek's quad-core MT6589T processor (1.5GHz), together with a 4.7" display, and is priced at CNY799. The higher-end Mi3 model is powered by a Qualcomm 800 series (MSM 8974 AB) quad-core processor, and has a 5" display and 16GB RAM. It is priced at CNY1,999.

■ Specs for new China smartphones vs. global smartphones

	Xiaomi Mi3	Xiaomi Red Rice (Hongmi)	Sony Xperia Z1	Apple iPhone5S	Apple iPhone5C	SEC Galaxy Note 3
Model	Mi3	Red Rice (Hongmi)	Xperia Z1	iPhone5S	iPhone5C	Galaxy Note 3
Global launch	13-Sep	13-Aug	13-Sep	13-Sep	13-Sep	13-Sep
Network	WCDMA/TD-SCDMA/CDMA	TD-SCDMA (Planned WCDMA)	LTE/WCDMA	WCDMA/CDMA/FDD-LTE/TD-LTE	WCDMA/CDMA/FDD-LTE/TD-LTE	LTE/WCDMA
OS	MIUI V5/Android 4.2.1	MIUI V5/Android 4.2.1	Android 4.2.2	iOS7	iOS7	Android 4.3
Display	5.0"	4.7"	5.0"	4.0"	4.0"	5.7"
Resolution	1920*1080 (HD 441ppi)	1280*720 (HD720 312ppi)	1920*1080 (HD 441ppi)	1136*640 (Retina 326 ppi)	1136*640 (Retina 326 ppi)	1920*1080 (HD 386ppi)
Processor	TD/WCDMA: Nvidia Tegra4 CA-15 quad-core 1.8GHz WCDMA: Qualcomm800 MSM8974AB quad-core 2.3GHz	MT6589T CA7 quad-core 1.5GHz	Qualcomm800 MSM8974 quad-core 2.2GHz	Apple A7 Dual-core 1.6GHz	Apple A6 Dual-core 1.3GHz	LTE: 2.3GHz Qualcomm quad-core 3G: 1.9GHz Exynos 5 quad-core*2 (CA15 1.9GHz+CA7 1.3GHz)
Memory-storage	16/64GB	4GB	16GB	16/32/64GB	16/32GB	32/64GB
Memory-RAM	2GB	1GB	2GB	2GB	1GB	3GB
Weight	145g	158g	170g	112g	132g	168g
Thickness	8.1mm	9.9mm	8.5mm	7.6mm	8.97mm	8.3mm
Camera	Rear: 13MP Front: 2MP	Rear: 8MP Front: 1.3MP	Rear: 20.7MP Front: 2MP	Rear: 8MP Front: 1.2MP	Rear: 8MP Front: 1.2MP	Rear: 13MP Front: 2MP
Pricing	CNY1,999(16GB)/ CNY2499 (64GB)	CNY799	USD935	USD649/USD749/USD849	USD549/USD649	USD700 (32GB)

Source: Companies, Daiwa

Thinking differently

According to the company, the growth in its business in recent years has largely flowed from its progress in the smartphone space, most notably from its moves to broaden its ecosystem.

There are several ways Xiaomi seeks to stand out from other handset makers:

- It emphasises mobile content — its MIUI OS is updated every week and has several functions specifically tailored to China-based consumers, including its own app store.
- It has an Internet-centric business — Xiaomi has built up customer recognition of its products through Internet-based promotion, which keeps down costs while encouraging direct interaction with users. It also keeps costs in check through a shipment-by-order model (B2C).
- It aims to deliver high-spec products at low prices — the idea is that the specs of the model sustain consumer interest until the bill of materials falls, paving the way for profitability in the later stages of the product's life cycle to offset losses incurred in the initial stages.
- With margins on hardware manufacturing declining, Xiaomi seeks to add value through its focus on content service/usage — its customised UI and self-developed or co-developed mobile apps/platforms have boosted consumer awareness of the company and its products, allowing it to develop its own distinct user community, rather than one considered part of the larger Android/Google platform.





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Share price and Daiwa recommendation trend

■ SK Hynix: share price and Daiwa recommendation trend

Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
26/04/11	40,000	Outperform	27/10/11	28,000	Outperform	04/01/13	32,000	Buy
07/06/11	38,000	Outperform	02/02/12	32,000	Outperform	22/03/13	35,000	Buy
13/07/11	32,000	Outperform	21/03/12	38,000	Buy	24/04/13	37,000	Buy
21/07/11	30,000	Outperform	01/06/12	34,000	Buy	28/05/13	40,000	Buy
27/09/11	26,000	Outperform	26/07/12	28,000	Buy			



Source: Daiwa

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