

# TK Group (2283 HK)

## NDR takeaways: 2H19 recovery on track

We hosted NDR with TK mgmt. last week, and investors are interested about 1) smart home/healthcare segments, 2) auto business progress, 3) trade war impact, and 4) capacity expansion in Vietnam. Overall, we expect revenue/net profit to recover with 20%/8% YoY in 2H19E, driven by improving orders and better margins. We fine-tuned our FY19E EPS and maintain TP of HK\$4.09 based on 8.2x FY20E P/E. Trading at 7.2x FY20E P/E and 33% FY20E ROE, we think the stock is attractive and reiterate BUY.

- **Smart home/healthcare as major growth drivers for FY19-20E.** We expect FY19E growth to come from : 1) smart home (+20% YoY) for Google Home/Nest/Amazon and Xiaomi's supply chain, 2) healthcare (+15% YoY) from Philips and client win for domestic e-cigarette supplier, 3) mobile and wearables (+10% YoY) driven by solid demand from Otterbox/Jabra, new in-box items for Apple and potential order win for Beats/Bose's TWS in FY20E. In addition, mgmt. stated that TK stepped up efforts to expand into domestic clients and expect sales to reach HK\$100mn/200mn in FY19/20E (vs 3% or HK\$70mn in FY18).
- **Automobile molding remains on fast track.** We are positive on fast-growing revenue from auto display panel molding, as Faurecia, a French tier-1 supplier, now became TK's No. 6 client in 1H19. Meanwhile, mgmt. plans to enhance its competitiveness by accelerating M&A in Europe. We estimate auto revenue to grow 13% CAGR in FY19-21E.
- **CAPEX for capacity expansion in Vietnam/Huizhou/Shenzhen.** TK guided CAPEX of HK\$ 170mn in FY19E (vs HK\$260mn in FY18), mainly for 1) transferring 10% of plastic capacity to Vietnam, 2) further expansion in Huizhou to double its capacity by FY21E, and 3) upgrade spraying production lines in Shenzhen with advanced automation.
- **Stock is attractive at 7.2x P/E and 33% ROE; Maintain Buy.** We fine-tuned FY19 EPS mainly to reflect lower GPM. We reiterate Buy with TP of HK\$4.09 based on 8.2x FY20E P/E, in-line with its 5-year historical forward P/E. Upcoming catalysts include Google/Amazon smart home product rollouts and margin recovery with better utilization. Major risks include weaker demand in smart home and wearables, prolonged trade war and weaker macro environment.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (HK\$ mn)	1,861	2,299	2,528	2,893	3,366
YoY growth (%)	14.4	23.5	10.0	14.4	16.3
Net income (HK\$ mn)	302	350	340	417	509
EPS (HK\$)	0.36	0.42	0.41	0.50	0.61
YoY growth (%)	46.1	15.6	(3.0)	22.8	21.9
P/E (x)	9.7	8.4	8.7	7.1	5.8
P/B (x)	3.2	2.7	2.3	2.3	2.3
Yield (%)	4.8	5.6	5.2	6.4	7.8
ROE (%)	33.1	32.6	26.9	33.0	40.3

Source: Company data, CMBIS estimates

### BUY (Maintain)

Target Price	HK\$4.09
(Previous TP	HK\$4.09)
Up/Downside	+15.5%
Current Price	HK\$3.54

### China Technology Sector

#### Alex Ng

Tel: (852) 3900 0881

Email: alexng@cmbi.com.hk

#### Iris Zhang

Tel: (852) 3761 8780

Email: iriszhang@cmbi.com.hk

#### Stock Data

Mkt Cap (HK\$ mn)	2,950
Avg 3 mths t/o (HK\$ mn)	1.72
52w High/Low (HK\$)	6.17/2.74
Total Issued Shares (mn)	833.3
Source: Bloomberg	

#### Shareholding Structure

Eastern Mix Co Ltd	39.92%
Pui Leung Li	10.73%
Value Partners	7.84%
Source: HKEx	

#### Share Performance

	Absolute	Relative
1-mth	9.3%	14.3%
3-mth	-11.3%	-7.2%
6-mth	-18.4%	-8.6%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

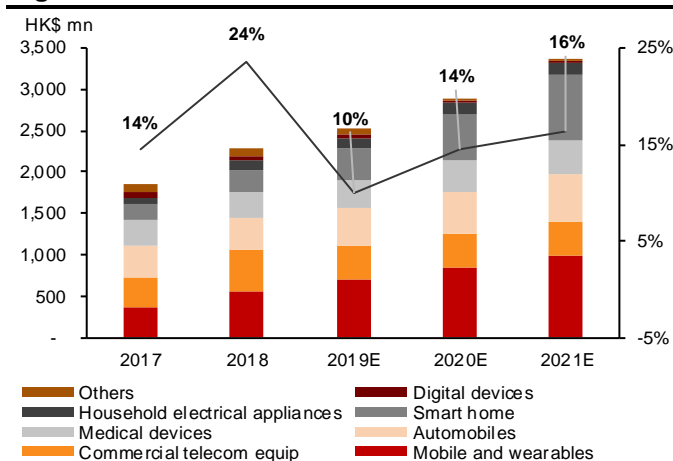
#### Auditor: Pricewaterhouse Coopers

#### Related Reports:

TK Group (2282 HK, Buy) – Backend loaded in 2H19; Maintain Buy – 26 Aug 2019

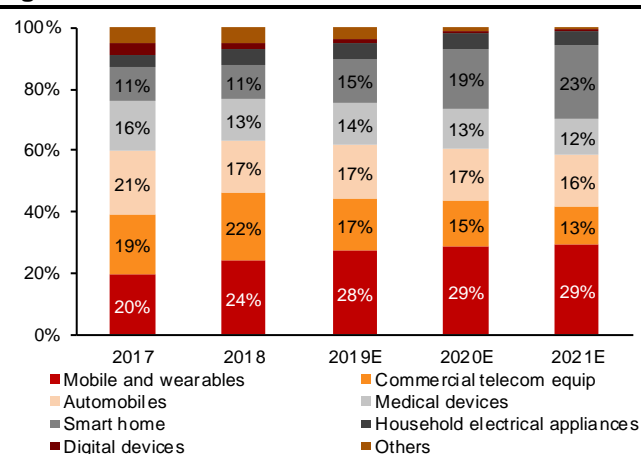
## Focus Charts

Figure 1: TK revenue trend



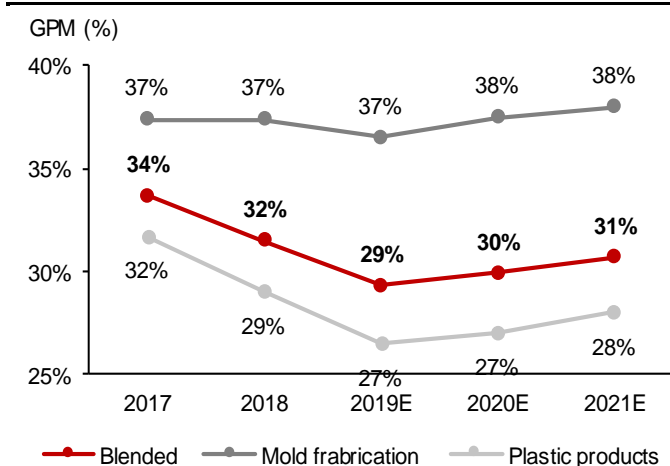
Source: Company data, CMBIS estimates

Figure 2: TK revenue mix



Source: Company data, CMBIS estimates

Figure 3: TK margin trend



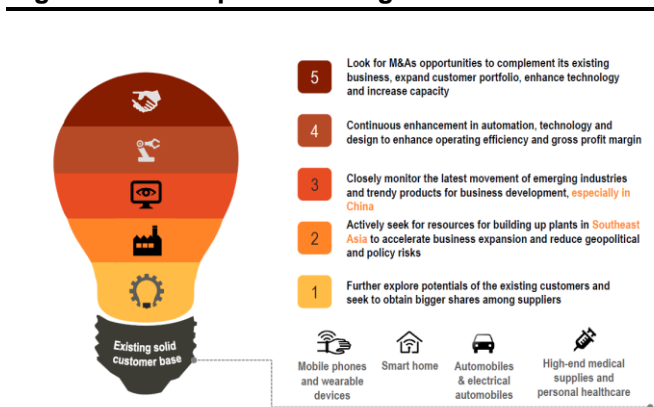
Source: Company data, CMBIS estimates

Figure 4: 1H19 top six customers

#	Company name	Industry	Product category
1	Polycom	Commercial telecommunications equipment	Mold and plastic products
2	A leading healthcare product brand	Medical and health care	Mold and plastic products
3	A leading smartphone brand	Mobile phones and wearable devices	Mold and plastic products
4	A leading smart phone accessory brand	Mobile phones and wearable devices	Mold and plastic products
5	A leading audio equipment brand	Mobile phones and wearable devices	Mold and plastic products
6	A 1st tier manufacturer of automobile	Automobile	Mold

Source: Company data, CMBIS estimates

Figure 5: Development strategies



Source: Company data, CMBIS estimates

Figure 6: Fast-growing business segments



Source: Company data, CMBIS estimates

## Earnings Revision

Figure 7: Earnings revision

HK\$ mn	New			Old			Change (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	2,528	2,893	3,366	2,528	2,893	3,366	0%	0%	0%
Gross profit	736	864	1,031	741	866	1,033	-1%	0%	0%
Operating profit	357	439	536	371	440	538	-4%	0%	0%
Net profit	340	417	509	354	419	510	-4%	0%	0%
EPS (HK\$)	0.41	0.50	0.61	0.42	0.50	0.61	-4%	0%	0%
Gross margin	29.1%	29.9%	30.6%	29.3%	29.9%	30.7%	-0.2 ppt	-0.1 ppt	-0.1 ppt
Operating margin	14.1%	15.2%	15.9%	14.7%	15.2%	16.0%	-0.6 ppt	-0.1 ppt	-0.1 ppt
Net Margin	13.4%	14.4%	15.1%	14.0%	14.5%	15.2%	-0.6 ppt	-0.1 ppt	0 ppt

Sources: Company data, CMBIS

Figure 8: CMBI estimates vs consensus

HK\$ mn	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	2,528	2,893	3,366	2,510	2,795	3,132	1%	4%	7%
Gross Profit	736	864	1,031	738	849	972	0%	2%	6%
Operating Profit	357	439	536	357	424	498	0%	4%	8%
Net profit	340	417	509	341	407	474	0%	2%	7%
EPS (HK\$)	0.41	0.50	0.61	0.40	0.48	0.55	2%	5%	10%
Gross Margin	29.1%	29.9%	30.6%	29.4%	30.4%	31.0%	-0.3 ppt	-0.5 ppt	-0.4 ppt
Operating Margin	14.1%	15.2%	15.9%	14.2%	15.2%	15.9%	-0.1 ppt	0 ppt	0 ppt
Net Margin	13.4%	14.4%	15.1%	13.6%	14.6%	15.1%	-0.2 ppt	-0.1 ppt	0 ppt

Source: Bloomberg, CMBIS

Figure 9: Revenue breakdown

HK\$ mn	FY17	FY18	1H19	2H19E	FY19E	FY20E	FY21E
Mobile phones and wearable	369	562	241	402	643	772	910
...YoY	25%	52%	5%	21%	14%	20%	18%
Household electrical appliances	74	116	48	83	131	144	158
...YoY	-17%	57%	4%	19%	13%	10%	10%
Medical devices	297	306	136	216	352	405	445
...YoY	36%	3%	0%	27%	15%	15%	10%
Commercial telecom equipment	359	497	205	217	422	422	422
...YoY	-4%	38%	-3%	-24%	-15%	0%	0%
Automobiles	388	398	205	237	442	508	569
...YoY	0%	3%	3%	19%	11%	15%	12%
Smart home	210	256	106	205	311	373	522
...YoY	132%	22%	-3%	40%	21%	20%	40%
Digital devices	70	46	20	22	42	38	30
...YoY	-12%	-34%	-2%	-16%	-10%	-10%	-20%
Others	94	117	43	142	185	232	307
...YoY	1%	25%	-39%	207%	58%	25%	33%
<b>Total</b>	<b>1,861</b>	<b>2,299</b>	<b>1,005</b>	<b>1,523</b>	<b>2,528</b>	<b>2,893</b>	<b>3,366</b>
<b>...YoY</b>	<b>14%</b>	<b>24%</b>	<b>-2%</b>	<b>20%</b>	<b>10%</b>	<b>14%</b>	<b>16%</b>

Source: Company data, CMBIS

**Figure 10: P&L forecast**

HK\$ mn	FY17	FY18	1H19	2H19E	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>1,861</b>	<b>2,299</b>	<b>1,005</b>	<b>1,523</b>	<b>2,528</b>	<b>2,893</b>	<b>3,366</b>
...YoY	14.4%	23.5%	-2.0%	19.7%	10.0%	14.4%	16.3%
Cost of sales	-1,234	-1,574	-729	-1,063	-1,792	-2,029	-2,335
<b>Gross profit</b>	<b>627</b>	<b>724</b>	<b>276</b>	<b>460</b>	<b>736</b>	<b>864</b>	<b>1,031</b>
GPM (%)	33.7%	31.5%	27.5%	30.2%	29.1%	29.9%	30.6%
...YoY	37.4%	15.5%	-14.5%	14.7%	1.6%	17.4%	19.3%
SG&A	-300	-346	-153	-226	-379	-425	-495
...% of rev	16.1%	15.1%	15.3%	14.8%	15.0%	14.7%	14.7%
<b>Operating profit</b>	<b>327</b>	<b>378</b>	<b>123</b>	<b>234</b>	<b>357</b>	<b>439</b>	<b>536</b>
OPM (%)	17.6%	16.5%	12.2%	15.4%	14.1%	15.2%	15.9%
...YoY	73.5%	15.6%	-24.6%	8.7%	-5.6%	22.9%	22.2%
<b>Net profit</b>	<b>302</b>	<b>350</b>	<b>114</b>	<b>226</b>	<b>340</b>	<b>417</b>	<b>509</b>
NPM (%)	16.2%	15.2%	11.4%	14.8%	13.4%	14.4%	15.1%
...YoY	46.7%	16.0%	-18.7%	7.6%	-3.0%	22.8%	21.9%

Source: Company data, CMBIS

## Valuation

### Maintain BUY with TP HK\$4.09

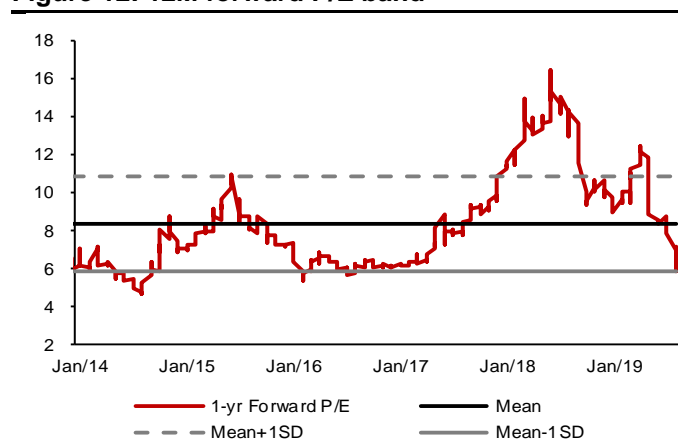
Our TP of HK\$4.09 is based on 8.2x FY20E P/E, in-line with its 5-yr historical forward P/E, which we view as appropriate given our positive view on long-term outlook and improving profitability/ROE.

Upcoming catalysts include Google/Amazon smart home product rollouts and margin recovery with better utilization. Major risks include weaker demand in smart home and wearables, prolonged trade war and weaker macro environment.

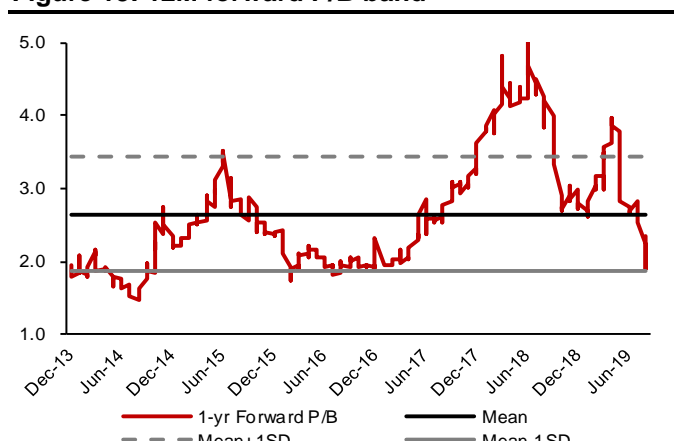
**Figure 11: Peers' valuation**

Company	Ticker	Rating	Market Cap (US\$ mn)	Price (LC)	TP (LC)	Up/Down -side	P/E (x)		P/B (x)		ROE (%)	
							FY19E	FY20E	FY19E	FY20E	FY19E	FY20E
TK Group	2283 HK	Buy	376	3.54	4.09	15%	7.7	6.4	2.3	2.3	29.7	35.7
Tongda	698 HK	Buy	446	0.54	0.91	69%	4.2	3.5	0.5	0.5	11.7	12.8
BYDE	285 HK	Hold	2,709	9.43	10.36	10%	13.0	9.1	1.1	1.0	8.6	11.2
FIH	2038 HK	NR	932	0.89	NA	NA	-	-	-	-	-	-
HI-P Intl	HIP SP	NR	643	1.11	NA	NA	10.1	10.1	1.4	1.3	15.1	13.8
<b>Average</b>							<b>8.7</b>	<b>7.3</b>	<b>1.3</b>	<b>1.3</b>	<b>16.3</b>	<b>18.4</b>

Source: Bloomberg, CMBIS

**Figure 12: 12M forward P/E band**

Source: Bloomberg, CMBIS

**Figure 13: 12M forward P/B band**

Source: Bloomberg, CMBIS

## Financial Summary

### Income statement

YE 31 Dec (HK\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>1,861</b>	<b>2,299</b>	<b>2,528</b>	<b>2,893</b>	<b>3,366</b>
COGS	(1,234)	(1,574)	(1,792)	(2,029)	(2,335)
<b>Gross profit</b>	<b>627</b>	<b>724</b>	<b>736</b>	<b>864</b>	<b>1,031</b>
Selling and marketing	(85)	(88)	(96)	(107)	(125)
Other admin exp.	(215)	(258)	(283)	(318)	(370)
<b>Operating profit</b>	<b>327</b>	<b>378</b>	<b>357</b>	<b>439</b>	<b>536</b>
Financial cost	(2)	(3)	(3)	(3)	(3)
Other income/(losses)	24	32	44	49	58
<b>Pre-tax profit</b>	<b>350</b>	<b>407</b>	<b>397</b>	<b>485</b>	<b>591</b>
Tax	(48)	(57)	(58)	(68)	(83)
Minority interest					
<b>Net profit</b>	<b>302</b>	<b>350</b>	<b>340</b>	<b>417</b>	<b>509</b>

### Cash flow summary

YE 31 Dec (HK\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Profit before taxation</b>	<b>350</b>	<b>407</b>	<b>397</b>	<b>485</b>	<b>591</b>
Depreciation/amortization	77	88	97	112	127
Change in working capital	(4)	14	(164)	45	(198)
Others	(23)	(18)	(32)	(44)	(53)
<b>Net cash from operating</b>	<b>400</b>	<b>491</b>	<b>299</b>	<b>599</b>	<b>467</b>
Capex	(114)	(261)	(152)	(188)	(219)
Other	(1)	(23)			
<b>Net cash from investing</b>	<b>(115)</b>	<b>(284)</b>	<b>(152)</b>	<b>(188)</b>	<b>(219)</b>
Net borrowings	(101)	244	37	0	0
Dividend paid	(124)	(150)	(153)	(188)	(229)
Share issuance/(repurchase)					
Other	99	(88)	(3)	(3)	(3)
<b>Net cash from financing</b>	<b>(126)</b>	<b>6</b>	<b>(119)</b>	<b>(190)</b>	<b>(231)</b>
<b>Net change in cash</b>	<b>159</b>	<b>214</b>	<b>28</b>	<b>220</b>	<b>17</b>
Cash at beginning of the year	381	541	754	782	1,002
Exchange difference	1	(1)			
<b>Cash at the end of the year</b>	<b>541</b>	<b>754</b>	<b>782</b>	<b>1,002</b>	<b>1,019</b>

### Balance sheet

YE 31 Dec (HK\$ mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Current assets</b>	<b>1,203</b>	<b>1,574</b>	<b>1,719</b>	<b>2,016</b>	<b>2,207</b>
Cash & equivalents	541	754	782	1,002	1,019
Account receivables	292	302	321	392	437
Inventories	305	343	442	447	576
Pledged bank deposits	0	85	85	85	85
Other current assets	9	10	11	11	12
<b>Non-current assets</b>	<b>436</b>	<b>590</b>	<b>593</b>	<b>654</b>	<b>729</b>
PPE	416	516	543	604	679
Other non-current assets	20	73	50	50	50
<b>Total assets</b>	<b>1,639</b>	<b>2,163</b>	<b>2,312</b>	<b>2,670</b>	<b>2,936</b>
<b>Current liabilities</b>	<b>643</b>	<b>807</b>	<b>653</b>	<b>782</b>	<b>768</b>
ST borrowings	33	107	189	189	189
Account payables	264	308	262	383	359
Other current liabilities	346	392	202	209	219
<b>Non-current liabilities</b>	<b>84</b>	<b>281</b>	<b>109</b>	<b>109</b>	<b>109</b>
LT borrowings	65	235	63	63	63
Other non-current liabilities	19	46	46	46	46
<b>Total liabilities</b>	<b>727</b>	<b>1,088</b>	<b>762</b>	<b>891</b>	<b>876</b>
Share capital	83	83	83	83	83
Reserves	828	992	1,179	1,179	1,179
Minority interest					
<b>Shareholders' equity</b>	<b>912</b>	<b>1,075</b>	<b>1,262</b>	<b>1,262</b>	<b>1,262</b>
<b>Total equity and liabilities</b>	<b>1,639</b>	<b>2,163</b>	<b>2,024</b>	<b>2,153</b>	<b>2,139</b>

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Mobile and wearables	20	24	25	27	27
Telecom. equipment	19	22	17	15	13
Automobiles	21	17	17	18	17
Medical devices	16	13	14	14	13
Smart home	11	11	12	13	16
Household elec. appliance	4	5	5	5	5
Digital devices	4	2	2	1	1
Others	5	5	7	8	9
<b>Growth (%)</b>					
Revenue	14.4	23.5	10.0	14.4	16.3
Gross profit	37.4	15.5	1.6	17.4	19.3
Operating profit	73.5	15.6	(5.6)	22.9	22.2
Net profit	46.7	16.0	(3.0)	22.8	21.9
<b>Profit &amp; loss ratio (%)</b>					
Gross margin	33.7	31.5	29.1	29.9	30.6
Operating margin	17.6	16.5	14.1	15.2	15.9
Net profit margin	16.2	15.2	13.4	14.4	15.1
<b>Balance sheet ratio</b>					
Net debt/total equity (x)	Net cash	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	1.9	1.9	2.6	2.6	2.9
Receivable turnover days	51.8	48.9	37.8	48.3	38.9
Inventory turnover days	90.4	79.6	90.1	80.4	90.1
Payable turnover days	78.1	71.4	53.3	68.9	56.1
<b>Profitability (%)</b>					
ROE	33.1	32.6	26.9	33.0	40.3
ROA	18.4	16.2	14.7	15.6	17.3

Source: Company data, CMBIS estimates



# Disclosures & Disclaimers

## Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

## CMBIS Ratings

<b>BUY</b>	: Stock with potential return of over 15% over next 12 months
<b>HOLD</b>	: Stock with potential return of +15% to -10% over next 12 months
<b>SELL</b>	: Stock with potential loss of over 10% over next 12 months
<b>NOT RATED</b>	: Stock is not rated by CMBIS
<b>OUTPERFORM</b>	: Industry expected to outperform the relevant broad market benchmark over next 12 months
<b>MARKET-PERFORM</b>	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
<b>UNDERPERFORM</b>	: Industry expected to underperform the relevant broad market benchmark over next 12 months

## CMB International Securities Limited

**Address:** 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

**CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)**

## Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US, institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.