

AAC Technologies (2018 HK)

Further strategic investments into AAC Optics; Expect ASP/margin pressure to persist

AAC announced to introduce 18 new strategic investors (led by Sequoia Capital China and State Development & Investment Corp.) to its optics subsidiary, AAC Optics, with a Rmb 1.66bn capital increase for 9.28% enlarged equity. AAC also targeted separate listing of AAC Optics within next 3 years, which is part of redemption rights for these investors. While we are positive on more investment in AAC's lens/CCM capacity, we remain cautious on its optics ASP and profitability in 2H20E, given ongoing de-spec trend, Huawei ban (AAC's No. 2 lens client), lower WLG visibility and intense competition in mid/low-end optics. Our FY21-22E EPS are 16%/7% below consensus. Maintain Hold with new TP HK\$47.5 given fair valuation at 21x FY21E P/E and optics headwinds in 2H20E.

- Introduction of 18 new strategic investors.** Following introduction of four first-round strategic investors (incl. OPPO, Xiaomi) on 22 July, AAC announced to introduce 18 new investors into AAC Optics with Rmb 1.66bn on 9 Oct. The deal implies valuation of RMB 17.9bn for AAC Optics (vs Rmb12bn in 22 Jul), and AAC's 82% stake represented 31% of AAC's mkt. cap as of 9 Oct 2020.
- Optics: ASP/margin headwinds due to Huawei ban and de-spec trend.** Although mgmt. guided "30% reported GPM" for optics in 3Q20E, we remain conservative with GPM of 22%/25% in 3Q/4Q20E (vs 13.8% in 2Q), given ongoing de-spec trend, Huawei ban (AAC's No. 2 lens client) and intense competition in mid/low-end lens from Sunny/Largan/O-Film. In addition, although we expect 1-2 WLG projects in 4Q20E, we see lack of visibility for strong demand of hybrid lens in near term, and we recommend to stay on the sidelines before AAC delivers any significant progress.
- Better iPhone volume but acoustics/haptics/casing still under pressure.** While we think AAC will benefit from iPhone 12 cycle with stabilizing share allocation, we believe its iPhone business (acoustic/haptics, 33% of FY20E sales) will face ASP pressure on lack of upgrade, and its casing biz (Huawei mainly, 16% of sales) will see shipment decline given Huawei ban in 2H20E.
- Our FY21/22E EPS are 16%/7% below consensus; Maintain HOLD.** We trimmed FY20-22E EPS by 2%/2%/2% for lower optics/casing shipment due to Huawei ban impact. Our FY21-22E EPS remains 16%/7% below consensus given our more bearish GPM estimates. Our SOTP-based TP is largely unchanged at HK\$47.5, implying 22.4x FY21E P/E. Upside risks include better optics margin and stronger iPhone shipment.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	18,131	17,884	18,329	21,051	21,670
YoY growth (%)	(14.1)	(1.4)	2.5	14.9	2.9
Net income (RMB mn)	3,796	2,222	1,675	2,296	2,564
EPS (RMB)	3.12	1.84	1.39	1.90	2.12
YoY growth (%)	(28.5)	(41.1)	(24.5)	37.1	11.7
Consensus EPS (RMB)	NA	1.84	1.39	2.27	2.75
P/E (x)	12.9	21.8	28.9	21.1	18.9
P/B (x)	2.6	2.5	2.4	2.2	2.1
Yield (%)	4.5	3.2	2.4	1.7	1.9
ROE (%)	20.0	11.3	8.3	10.6	11.0

Source: Company data, Bloomberg, CMBIS estimates

HOLD (Maintain)

Target Price **HK\$47.5**
 (Previous TP **HK\$47.3**)
 Up/Downside **6%**
 Current Price **HK\$44.65**

China Technology Sector

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Stock Data

Mkt. Cap. (HK\$m)	53,960
Avg. 3mths t/o (HK\$m)	656.54
52W High/Low (HK\$)	72.90 / 35.6
Total Issued Shares (mn)	1,209

Source: Bloomberg

Shareholding Structure

Chunyuan Wu	21.75%
Zhengmin Pan	19.24%
JPMorgan Chase	11.51%

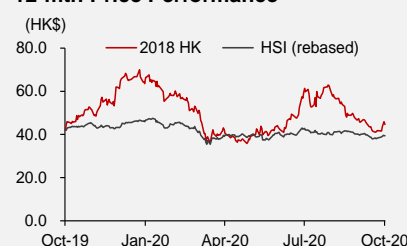
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-5.6%	-4.2%
3-mth	-27.2%	-20.9%
6-mth	10.4%	11.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte Touche Tohmatsu

Related Reports:

- AAC Tech (2018 HK) – 2Q20 another miss; Maintain Hold on slower optics in near term - 25 Aug 2020
- AAC Tech (2018 HK) – Strategic investors to boost synergy and unlock value; Upgrade to HOLD – 23 Jul 2020
- AAC tech (2018 HK) - Worst is over but GPM pressure to persist; Maintain Sell – 18 May 2020

Earnings Revision

Figure 1: CMBIS earnings revisions

RMB mn	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	18,329	21,051	21,670	18,591	21,051	21,670	-1%	0%	0%
Gross Profit	4,761	5,710	6,076	4,849	5,760	6,140	-2%	-1%	-1%
Operating Profit	1,873	2,589	2,885	1,925	2,639	2,948	-3%	-2%	-2%
Net profit	1,675	2,296	2,564	1,719	2,340	2,620	-3%	-2%	-2%
EPS (RMB)	1.39	1.90	2.12	1.42	1.93	2.17	-2%	-2%	-2%
Gross Margin	25.9%	27.1%	28.0%	26.1%	27.3%	28.3%	-0.1 ppt	-0.2 ppt	-0.3 ppt
Operating Margin	10.2%	12.3%	13.3%	10.4%	12.5%	13.6%	-0.1 ppt	-0.2 ppt	-0.3 ppt
Net Margin	9.1%	10.9%	11.8%	9.2%	11.1%	12.1%	-0.1 ppt	-0.2 ppt	-0.3 ppt

Source: Company data, CMBIS estimates

Figure 2: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	18,329	21,051	21,670	18,976	22,209	22,209	-3%	-5%	-2%
Gross Profit	4,761	5,710	6,076	5,028	6,404	6,404	-5%	-11%	-5%
Operating Profit	1,873	2,589	2,885	2,030	3,216	3,216	-8%	-20%	-10%
Net profit	1,675	2,296	2,564	1,865	2,792	2,792	-10%	-18%	-8%
EPS (RMB)	1.39	1.90	2.12	1.39	2.27	2.27	-1%	-16%	-7%
Gross Margin	25.9%	27.1%	28.0%	26.5%	28.8%	28.8%	-0.5 ppt	-1.7 ppt	-0.8 ppt
Operating Margin	10.2%	12.3%	13.3%	10.7%	14.5%	14.5%	-0.5 ppt	-2.2 ppt	-1.2 ppt
Net Margin	9.1%	10.9%	11.8%	9.8%	12.6%	12.6%	-0.7 ppt	-1.7 ppt	-0.7 ppt

Source: Bloomberg, CMBIS estimates

Figure 3: Revenue breakdown

RMB mn	FY18	FY19	1Q20	2Q20	3Q20E	4Q20E	FY20E	FY21E	FY22E
Revenue									
Dynamic components	8,675	8,167	1,421	1,908	2,139	2,193	7,661	7,811	8,074
MEMS components	814	929	199	259	318	285	1,061	1,114	1,170
Haptics & RF	8,073	7,694	1,691	1,725	1,793	2,318	7,527	7,796	7,651
Others (incl. optics)	569	1,094	249	385	695	750	2,080	4,330	4,775
Total	18,131	17,884	3,560	4,277	4,946	5,546	18,329	21,051	21,670
Revenue mix									
Dynamic components	48%	46%	40%	45%	43%	40%	42%	37%	37%
MEMS components	4%	5%	6%	6%	6%	5%	6%	5%	5%
Haptics & RF	45%	43%	47%	40%	36%	42%	41%	37%	35%
Others (incl. optics)	3%	6%	7%	9%	14%	14%	11%	21%	22%
YoY Growth (%)									
Dynamic components	-9%	-6%	-24%	8%	-6%	-2%	-6%	2%	3%
MEMS components	-4%	14%	29%	14%	10%	10%	14%	5%	5%
Haptics & RF	-22%	-5%	11%	11%	-15%	-6%	-2%	4%	-2%
Others (incl. optics)	63%	92%	32%	41%	114%	116%	90%	108%	10%
Total	-14%	-1%	-5%	12%	-1%	5%	2%	15%	3%
Gross profit margin									
Dynamic components	37.2%	31.0%	26.0%	26.4%	30.0%	29.5%	28.2%	29.0%	29.5%
MEMS components	26.6%	27.5%	16.5%	16.1%	25.0%	25.0%	21.2%	24.0%	26.0%
Haptics & RF	40.6%	29.6%	23.6%	22.8%	25.8%	30.0%	25.9%	26.2%	26.8%
Others (incl. optics)	4.0%	3.2%	9.5%	13.8%	22.0%	25.0%	20.1%	26.0%	28.0%
Total	37.2%	28.6%	23.1%	23.3%	27.0%	28.9%	25.9%	27.1%	28.0%

Source: Company data, CMBIS

Figure 4: P&L forecast

RMB mn	FY18	FY19	1Q20	2Q20	3Q20E	4Q20E	FY20E	FY21E	FY22E
Revenue	18,131	17,884	3,560	4,277	4,946	5,546	18,329	21,051	21,670
...YoY	-14.1%	-1.4%	-5.1%	12.1%	-1.3%	4.5%	2.5%	14.9%	2.9%
Cost of sales	(11,388)	(12,777)	(2,737)	(3,282)	(3,610)	(3,944)	(13,572)	(15,346)	(15,600)
Gross profit	6,743	5,107	823	995	1,336	1,602	4,756	5,704	6,070
GPM (%)	37.2%	28.6%	23.1%	23.3%	27.0%	28.9%	25.9%	27.1%	28.0%
...YoY	-22.7%	-24.3%	-27.1%	4.2%	-9.9%	4.1%	-6.9%	19.9%	6.4%
SG&A	(966)	(918)	(239)	(240)	(228)	(298)	(1,004)	(1,095)	(1,127)
...% of rev	-5.3%	-5.1%	-6.7%	-5.6%	-4.6%	-5.4%	-5.5%	-5.2%	-5.2%
R&D	(1,512)	(1,717)	(489)	(494)	(425)	(471)	(1,880)	(2,021)	(2,059)
...% of rev	-8.3%	-9.6%	-13.7%	-11.5%	-8.6%	-8.5%	-10.3%	-9.6%	-9.5%
Operating profit	4,265	2,472	95	262	683	833	1,873	2,589	2,885
OPM (%)	23.5%	13.8%	2.7%	6.1%	13.8%	15.0%	10.2%	12.3%	13.3%
...YoY	-29.9%	-42.0%	-80.5%	-25.9%	-17.6%	3.9%	-24.2%	38.2%	11.4%
Net profit	3,796	2,222	53	268	569	785	1,675	2,296	2,564
NPM (%)	20.9%	12.4%	1.5%	6.3%	11.5%	14.2%	9.1%	10.9%	11.8%
...YoY	-28.7%	-41.5%	-87.8%	-20.8%	-18.2%	3.7%	-24.6%	37.1%	11.7%

Source: Company data, CMBIS

Valuation

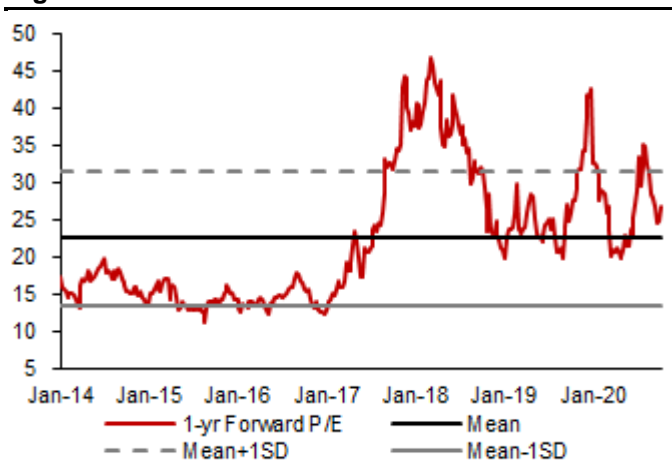
Maintain HOLD with new TP HK\$47.5

We derived our new TP of HK\$ 47.5 based on SOTP to reflect business diversification with different growth profiles and visibility. Our new TP is based on weighted-average target P/E multiple of 22.4x FY21E EPS and valuation of optics segment at RMB 17.9bn. We assign 20x P/E to AAC's core businesses, including acoustics, MEMS, haptics and mechanical RF, in-line with HK-listed peers.

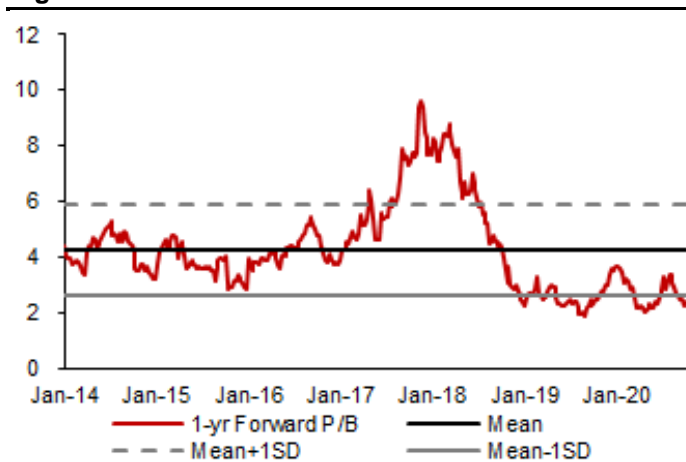
Figure 5: AAC Tech – SOTP valuation

Business segment	Value per share (RMB)	Valuation Methodology	Target P/E	% of FY21E Profit	FY21E EPS (RMB)
Acoustics	15.5	P/E target multiple	20x	40%	0.75
MEMS	1.8	P/E target multiple	20x	5%	0.09
ED & PM	13.6	P/E target multiple	20x	36%	0.68
Optics	12.1	82% of RMB 17.9bn			0.37
TP (RMB)	42.6		22.4x		1.90
TP (HK\$)	47.5				

Sources: Company data, CMBIS

Figure 6: 12M forward P/E band

Source: Company data, CMBIS

Figure 7: 12M forward P/B band

Source: Company data, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	18,131	17,884	18,329	21,051	21,670
COGS	(11,388)	(12,777)	(13,572)	(15,346)	(15,600)
Gross profit	6,743	5,107	4,756	5,704	6,070
Selling and marketing	(317)	(275)	(302)	(337)	(347)
Administrative	(650)	(643)	(701)	(758)	(780)
R&D	(1,512)	(1,717)	(1,880)	(2,021)	(2,059)
Operating profit	4,265	2,472	1,873	2,589	2,885
Financial cost	(218)	(248)	(303)	(303)	(303)
Other income/(losses)	264	329	414	323	331
Pre-tax profit	4,310	2,552	1,984	2,608	2,913
Tax	(514)	(330)	(309)	(313)	(350)
Minority interest	-	-	(1)	(1)	(1)
Net profit	3,796	2,222	1,675	2,296	2,564

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before taxation	4,310	2,552	1,984	2,608	2,913
Depreciation	1,750	1,803	2,003	2,203	2,403
Change in working capital	1,149	(627)	81	(1,319)	1,168
Others	(420)	(85)	(1)	21	(40)
Net cash from operating	6,789	3,644	4,067	3,513	6,445
Capex	(2,941)	(3,000)	(2,800)	(2,800)	(2,800)
Other	(658)	68	0	0	0
Net cash from investing	(3,599)	(2,932)	(2,800)	(2,800)	(2,800)
Net borrowings	(555)	0	0	0	0
Interest paid	(216)	(248)	(303)	(303)	(303)
Dividend paid	(2,182)	(1,531)	(1,154)	(804)	(897)
Other	(294)				
Net cash from financing	(3,247)	(1,779)	(1,457)	(1,107)	(1,200)
Net change in cash	(57)	(1,068)	(190)	(393)	2,445
Cash at beg of year	4,034	4,059	2,991	2,801	2,408
Exchange difference	81	0	0	0	0
Cash at end of year	4,059	2,991	2,801	2,408	4,853

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Current assets	11,985	11,918	11,221	13,633	13,921
Cash & equivalents	4,126	2,991	2,801	2,408	4,853
Trade and other rev.	4,474	6,930	4,708	8,500	5,253
Inventories	3,319	1,931	3,646	2,660	3,751
Other current assets	65	65	65	65	65
Non-current assets	17,884	19,080	19,877	20,474	20,870
PPE	15,440	16,637	17,433	18,030	18,426
Lease prepayments	622	622	622	622	622
Intangible assets	367	367	367	367	367
Other non-curr. assets	1,455	1,455	1,455	1,455	1,455
Total assets	29,869	30,998	31,098	34,107	34,791
Current liabilities	8,317	8,754	8,333	9,851	8,869
Short-term borrowings	3,493	3,493	3,493	3,493	3,493
Trade & other payables	4,548	4,989	4,563	6,049	5,061
Tax payables	205	202	207	238	245
Other current liabilities	71	71	71	71	71
Non-current liabilities	2,618	2,618	2,618	2,618	2,618
Government grants	118	118	118	118	118
Deferred tax liabilities	72	72	72	72	72
Other non-current liab.	2,429	2,429	2,429	2,429	2,429
Total liabilities	10,935	11,373	10,952	12,469	11,488
Share capital	99	99	99	99	99
Reserves	18,835	19,527	20,048	21,540	23,207
Minority interest					
Shareholders' equity	18,934	19,626	20,147	21,639	23,306
Total equity & liabilities	29,869	30,998	31,098	34,108	34,794

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Dynamic components	47.8	45.7	41.8	37.1	37.3
MEMS (microphone)	4.5	5.2	5.8	5.3	5.4
Electro. (haptics)	44.5	43.0	41.1	37.0	35.3
Other	3.1	6.1	11.3	20.6	22.0
Growth (%)					
Revenue	(14.1)	(1.4)	2.5	14.9	2.9
Gross profit	(22.7)	(24.3)	(6.9)	19.9	6.4
Operating Income	(29.9)	(42.0)	(24.2)	38.2	11.4
Net profit	(28.7)	(41.5)	(24.6)	37.1	11.7
Profitability (%)					
Gross Margin	37.2	28.6	25.9	27.1	28.0
Operating Margin	23.5	13.8	10.2	12.3	13.3
Net margin	20.9	12.4	9.1	10.9	11.8
Balance sheet ratios					
Net debt/total equity (x)	0.1	0.1	0.2	0.2	0.0
Current ratio (x)	1.4	1.4	1.3	1.4	1.6
Receivable turnover days	88	90.0	90.0	90.0	90.0
Inventory turnover days	89	75.0	75.0	75.0	75.0
Payable turnover days	85	70.0	70.0	70.0	70.0
Returns (%)					
ROE	20.0	11.3	8.3	10.6	11.0
ROA	12.7	7.2	5.4	6.7	7.4
Per share data (RMB)					
EPS	3.12	1.84	1.39	1.90	2.12
DPS	1.79	1.27	0.95	0.66	0.74

Source: Company data, CMBIS estimates

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