

# AAC Technologies (2018 HK)

## 2Q20 another miss; Maintain Hold on slower optics in near term

AAC's 2Q20 net profit declined 21% YoY to RMB268, 11%/34% below our/consensus estimate, while revenue (+12% YoY) is 6%/5% above our/market expectations. GPM remained weak at 23.3% (vs 25% in 2Q19), in-line with our estimate but well below 30.3% for consensus, mainly due to lower optics margin of 13.8% (vs 30% guidance). While we expect plastic lens shipment will remain on track to achieve 60kk/100kk per month by 3Q/4Q20E (vs 34kk/m avg. in 2Q), we are cautious on optics margin guidance (production GPM at 35%/40% in 3Q/4Q, vs 26% in 2Q), given slower spec upgrade, Huawei weakness (AAC's No. 2 lens client) and intense competition. Given high-end demand weakness, mgmt. also toned down WLG lens production target to 20mn (from 30mn) in 2020. Our FY20/21E EPS is 20%/22% below consensus. Maintain Hold given fair valuation at 26x FY21E P/E and optics industry headwinds in 2H20E.

- 2Q20 miss on weaker optics margin.** AAC's 2Q20 net profit of RMB268 (-21% YoY) is 11%/34% below our/consensus estimates, while revenue delivered better growth of 12% YoY, driven by iPhone strength and Android restocking post-COVID-19. 2Q GPM came in at 23.2% below 30.3% for consensus, due to weaker optics margin in our view. By segment, acoustic/ MEMS/ ED&PM grew 8%/14%/11% YoY, while optics revenue (9% of sales) grew 43% YoY, largely in-line. We think major disappointment came from weaker optics margin at 13.8%, below guidance of 30% and our street-low estimate of 15%.
- Optics: margin headwinds in 2H20E despite higher "production GPM".** AAC disclosed plastic lens shipment/ASP for the first time, and 2Q lens shipment reached 102kk with avg. 34kk per month (vs 60kk/m output in 2Q). Mgmt. explained the difference between "production output/GPM" and "sales shipment/GPM" was due to inventory level of 1-1.5 month. Although mgmt. guided higher "production GPM" of 35%/40%+ in 3Q/4Q20E (vs 26% in 2Q20), we remain conservative on AAC's optics GPM in 2H20E given weak spec upgrade, Huawei uncertainties (AAC's No. 2 lens client) and industry headwinds with intense competition from Sunny/ Largan/ O-Film. We model 22%/25% for AAC's optics GPM in 3Q/4Q20E (vs 13.8% in 2Q).
- Our FY20/21E EPS are 20%/22% below consensus; Maintain HOLD.** We raised FY20-22E EPS by 2-8% for higher iPhone shipment forecast. Our FY20-22E EPS remains 13-22 % below consensus given our more bearish GPM estimates. Our new SOTP-based TP is HK\$47.3, implying 22x 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	18,377	20,148	21,492
YoY growth (%)	(14.1)	(1.4)	2.8	9.6	6.7
Net income (RMB mn)	3,796	2,222	1,722	2,329	2,718
EPS (RMB)	3.12	1.84	1.42	1.92	2.25
YoY growth (%)	(28.5)	(41.1)	(22.5)	35.3	16.7
Consensus EPS (RMB)	NA	NA	1.74	2.48	2.90
P/E (x)	15.3	25.9	33.4	24.7	21.2
P/B (x)	3.1	2.9	2.9	2.7	2.5
Yield (%)	3.8	2.7	2.1	1.4	1.7
ROE (%)	20.0	11.3	8.5	10.7	11.6

Source: Company data, Bloomberg, CMBIS estimates

### HOLD (Maintain)

Target Price	HK\$47.3
(Previous TP)	HK\$45.3)
Up/Downside	-14%
Current Price	HK\$55.6

### China Technology Sector

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### Stock Data

Mkt. Cap. (HK\$m)	66,770
Avg. 3mths t/o (HK\$m)	771.39
52W High/Low (HK\$)	72.9/ 32.85
Total Issued Shares (mn)	1,209

Source: Bloomberg

### Shareholding Structure

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

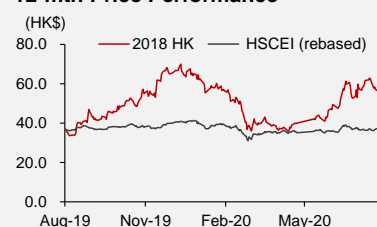
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	-9.9%	-8.9%
3-mth	35.4%	25.0%
6-mth	-4.4%	1.0%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

**Auditor: Deloitte Touche Tohmatsu**

### Related Reports:

- 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
- AAC tech (2018 HK) - Profit warning affirms our cautious view; Maintain Sell – 9 Apr 2020

## 2Q20 Results Review

Figure 1: 2Q20 results review

RMB mn	1Q19	1Q20	2Q20	QoQ	YoY	CMBIS		Consensus	
						2Q20E	Diff %	2Q20E	Diff %
Revenue	3,753	3,560	4,277	20%	12%	4,051	6%	4,097	4%
Gross Profit	1,129	823	995	21%	4%	965	3%	1,137	-12%
Operating Profit	488	95	262	176%	-26%	324	-19%	471	-44%
Net profit	432	53	268	409%	-21%	302	-11%	391	-32%
EPS (RMB)	0.36	0.04	0.22	409%	-21%	0.25	-11%	0.33	-34%
<b>Margin (%)</b>									
Gross Margin	30.1%	23.1%	23.3%			23.8%	-0.6 ppt	30.3%	-7.0 ppt
Operating Margin	13.0%	2.7%	6.1%			8.0%	-1.9 ppt	11.5%	-5.4 ppt
Net Margin	11.5%	1.5%	6.3%			7.5%	-1.2 ppt	9.5%	-3.3 ppt
<b>Growth (%)</b>									
Revenue (YoY)	-19%	-5%	12%			6%		7.4%	
Revenue (QoQ)	-22%	-33%	-76%			-77%		19.0%	
Operating profit	-59%	-81%	-26%			-8%		33.1%	
Net profit	-62%	-88%	-21%			-11%		15.7%	

Source: Company data, Bloomberg, CMBIS

Figure 2: Revenue breakdown

RMB mn	FY18	FY19	1Q20	2Q20	3Q20E	4Q20E	FY20E	FY21E	FY22E
<b>Revenue</b>									
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	2,503	7,712	7,796	7,651
Others (incl. optics)	569	1,094	249	385	695	827	2,157	4,330	4,775
<b>Total</b>	<b>18,131</b>	<b>17,884</b>	<b>3,560</b>	<b>4,277</b>	<b>4,946</b>	<b>5,808</b>	<b>18,591</b>	<b>21,051</b>	<b>21,670</b>
<b>Revenue mix</b>									
Dynamic components	48%	46%	40%	45%	43%	38%	41%	37%	37%
MEMS components	4%	5%	6%	6%	6%	5%	6%	5%	5%
Haptics & RF	45%	43%	47%	40%	36%	43%	41%	37%	35%
Others (incl. optics)	3%	6%	7%	9%	14%	14%	12%	21%	22%
<b>YoY Growth (%)</b>									
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%	2%	0%	1%	-2%
Others (incl. optics)	63%	92%	32%	41%	114%	138%	97%	101%	10%
<b>Total</b>	<b>-14%</b>	<b>-1%</b>	<b>-5%</b>	<b>12%</b>	<b>-1%</b>	<b>9%</b>	<b>4%</b>	<b>13%</b>	<b>3%</b>
<b>Gross profit margin</b>									
Dynamic components	37.2%	31.0%	26.0%	26.4%	32.0%	29.5%	28.8%	29.5%	30.0%
MEMS components	26.6%	27.5%	16.5%	16.1%	25.0%	25.0%	21.2%	25.0%	28.0%
Haptics & RF	40.6%	29.6%	23.6%	22.8%	25.8%	28.9%	25.6%	26.2%	26.8%
Others (incl. optics)	4.0%	3.2%	9.5%	13.8%	22.0%	25.0%	20.2%	26.0%	28.0%
<b>Total</b>	<b>37.2%</b>	<b>28.6%</b>	<b>23.1%</b>	<b>23.3%</b>	<b>27.9%</b>	<b>28.4%</b>	<b>26.0%</b>	<b>27.3%</b>	<b>28.3%</b>

Source: Company data, CMBIS

## Earnings Revision

Figure 3: CMBIS earnings revisions

RMB mn	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	18,591	21,051	21,670	18,134	19,453	20,350	3%	8%	6%
Gross Profit	4,849	5,760	6,140	4,693	5,280	5,702	3%	9%	8%
Operating Profit	1,925	2,639	2,948	1,911	2,434	2,766	1%	8%	7%
Net profit	1,719	2,340	2,620	1,685	2,171	2,474	2%	8%	6%
EPS (RMB)	1.42	1.93	2.17	1.39	1.79	2.04	2%	8%	6%
Gross Margin	26.1%	27.3%	28.3%	25.9%	27.1%	28.0%	0.2 ppt	0.2 ppt	0.3 ppt
Operating Margin	10.4%	12.5%	13.6%	10.5%	12.5%	13.6%	-0.2 ppt	0 ppt	0 ppt
Net Margin	9.2%	11.1%	12.1%	9.3%	11.2%	12.2%	0 ppt	0 ppt	-0.1 ppt

Source: Company data, CMBIS estimates

Figure 4: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	18,591	21,051	21,670	19,161	22,681	22,681	-3%	-7%	-4%
Gross Profit	4,849	5,760	6,140	5,308	6,693	6,693	-9%	-14%	-8%
Operating Profit	1,925	2,639	2,948	2,400	3,404	3,404	-20%	-22%	-13%
Net profit	1,719	2,340	2,620	2,120	3,001	3,001	-19%	-22%	-13%
EPS (RMB)	1.42	1.93	2.17	1.78	2.49	2.49	-20%	-22%	-13%
Gross Margin	26.1%	27.3%	28.3%	27.7%	29.5%	29.5%	-1.6 ppt	-2.2 ppt	-1.2 ppt
Operating Margin	10.4%	12.5%	13.6%	12.5%	15.0%	15.0%	-2.2 ppt	-2.5 ppt	-1.4 ppt
Net Margin	9.2%	11.1%	12.1%	11.1%	13.2%	13.2%	-1.8 ppt	-2.1 ppt	-1.1 ppt

Source: Bloomberg, CMBIS estimates

Figure 5: P&L forecast

RMB mn	FY18	FY19	1Q20	2Q20	3Q20E	4Q20E	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>18,131</b>	<b>17,884</b>	3,560	4,277	4,946	5,808	<b>18,591</b>	<b>21,051</b>	<b>21,670</b>
...YoY	-14.1%	-1.4%	-5.1%	12.1%	-1.3%	9.5%	4.0%	13.2%	2.9%
Cost of sales	(11,388)	(12,777)	(2,737)	(3,282)	(3,567)	(4,161)	(13,747)	(15,296)	(15,536)
<b>Gross profit</b>	<b>6,743</b>	<b>5,107</b>	<b>823</b>	<b>995</b>	<b>1,379</b>	<b>1,647</b>	<b>4,844</b>	<b>5,754</b>	<b>6,134</b>
GPM (%)	37.2%	28.6%	23.1%	23.3%	27.9%	28.4%	26.1%	27.3%	28.3%
...YoY	-22.7%	-24.3%	-27.1%	4.2%	-7.0%	7.0%	-5.1%	18.8%	6.6%
SG&A	(966)	(918)	(239)	(240)	(228)	(312)	(1,018)	(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)	(494)	(1,902)	(2,021)	(2,059)
...% of rev	-8.3%	-9.6%	-13.7%	-11.5%	-8.6%	-8.5%	-10.2%	-9.6%	-9.5%
<b>Operating profit</b>	<b>4,265</b>	<b>2,472</b>	<b>95</b>	<b>262</b>	<b>726</b>	<b>842</b>	<b>1,925</b>	<b>2,639</b>	<b>2,948</b>
OPM (%)	23.5%	13.8%	2.7%	6.1%	14.7%	14.5%	10.4%	12.5%	13.6%
...YoY	-29.9%	-42.0%	-80.5%	-25.9%	-12.4%	5.0%	-22.1%	37.1%	11.7%
<b>Net profit</b>	<b>3,796</b>	<b>2,222</b>	<b>53</b>	<b>268</b>	<b>605</b>	<b>793</b>	<b>1,719</b>	<b>2,340</b>	<b>2,620</b>
NPM (%)	20.9%	12.4%	1.5%	6.3%	12.2%	13.7%	9.2%	11.1%	12.1%
...YoY	-28.7%	-41.5%	-87.8%	-20.8%	-13.0%	4.8%	-22.7%	36.1%	12.0%

Source: Company data, CMBIS

## Valuation

### Maintain HOLD with new TP HK\$47.3

We derived our TP of HK\$ 47.3 based on SOTP to reflect business diversification with different growth profiles and visibility. Our TP is based on weighted-average target P/E multiple of 22.0x FY21E EPS. We assign 20x P/E to AAC's core businesses, including acoustics, MEMS, haptics and mechanical RF, in-line with HK-listed peers, while we assign 30x P/E to optics segment to reflect high growth profile and improving profitability.

**Figure 6: 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%	0.77
MEMS	1.9	P/E target multiple	20x	5%	0.09
ED & PM	13.8	P/E target multiple	20x	36%	0.69
Optics	11.4	P/E target multiple	30x	20%	0.38
<b>TP (RMB)</b>	<b>42.5</b>		<b>22.0x</b>		<b>1.93</b>
<b>TP (HK\$)</b>	<b>47.3</b>				

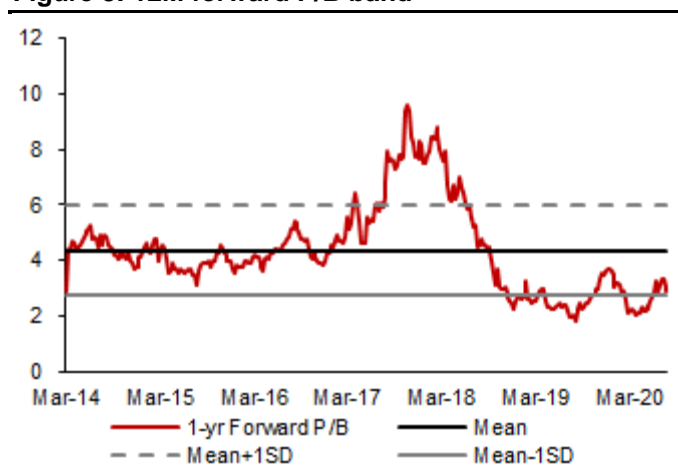
Sources: Company data, CMBIS

**Figure 7: 12M forward P/E band**



Source: Company data, CMBIS

**Figure 8: 12M forward P/B band**



Source: Company data, CMBIS

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	18,131	17,884	18,591	21,051	21,670
COGS	(11,388)	(12,777)	(13,747)	(15,296)	(15,536)
<b>Gross profit</b>	<b>6,743</b>	<b>5,107</b>	<b>4,844</b>	<b>5,754</b>	<b>6,134</b>
Selling and marketing	(317)	(275)	(307)	(337)	(347)
Administrative	(650)	(643)	(711)	(758)	(780)
R&D	(1,512)	(1,717)	(1,902)	(2,021)	(2,059)
<b>Operating profit</b>	<b>4,265</b>	<b>2,472</b>	<b>1,925</b>	<b>2,639</b>	<b>2,948</b>
Financial cost	(218)	(248)	(303)	(303)	(303)
Other income/(losses)	264	329	414	323	331
<b>Pre-tax profit</b>	<b>4,310</b>	<b>2,552</b>	<b>2,035</b>	<b>2,659</b>	<b>2,977</b>
Tax	(514)	(330)	(317)	(319)	(357)
Minority interest	-	-	(1)	(1)	(1)
<b>Net profit</b>	<b>3,796</b>	<b>2,222</b>	<b>1,719</b>	<b>2,340</b>	<b>2,620</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Profit before taxation</b>	4,310	2,552	2,035	2,659	2,977
Depreciation	1,750	1,803	2,003	2,203	2,403
Change in working capital	1,149	(627)	(40)	(1,062)	899
Others	(420)	(85)	(6)	12	(47)
<b>Net cash from operating</b>	<b>6,789</b>	<b>3,644</b>	<b>3,992</b>	<b>3,812</b>	<b>6,232</b>
Capex	(2,941)	(3,000)	(2,800)	(2,800)	(2,800)
Other	(658)	68	0	0	0
<b>Net cash from investing</b>	<b>(3,599)</b>	<b>(2,932)</b>	<b>(2,800)</b>	<b>(2,800)</b>	<b>(2,800)</b>
Net borrowings	(555)	0	0	0	0
Interest paid	(216)	(248)	(303)	(303)	(303)
Dividend paid	(2,182)	(1,531)	(1,184)	(819)	(917)
Other	(294)	0	0	0	0
<b>Net cash from financing</b>	<b>(3,247)</b>	<b>(1,779)</b>	<b>(1,487)</b>	<b>(1,122)</b>	<b>(1,220)</b>
<b>Net change in cash</b>	(57)	(1,068)	(295)	(110)	2,212
Cash at beg of year	4,034	4,059	2,991	2,697	2,586
Exchange difference	81	0	0	0	0
<b>Cash at end of year</b>	<b>4,059</b>	<b>2,991</b>	<b>2,697</b>	<b>2,586</b>	<b>4,798</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Current assets</b>	11,985	11,918	11,336	13,590	14,062
Cash & equivalents	4,126	2,991	2,697	2,586	4,798
Trade and other rev.	4,474	6,930	4,856	8,371	5,383
Inventories	3,319	1,931	3,718	2,568	3,817
Other current assets	65	65	65	65	65
<b>Non-current assets</b>	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
<b>Total assets</b>	<b>29,869</b>	<b>30,998</b>	<b>31,213</b>	<b>34,063</b>	<b>34,932</b>
<b>Current liabilities</b>	8,317	8,754	8,435	9,765	8,931
Short-term borrowings	3,493	3,493	3,493	3,493	3,493
Trade & other payables	4,548	4,989	4,661	5,963	5,123
Tax payables	205	202	210	238	245
Other current liabilities	71	71	71	71	71
<b>Non-current liabilities</b>	<b>2,618</b>	<b>2,618</b>	<b>2,618</b>	<b>2,618</b>	<b>2,618</b>
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
<b>Total liabilities</b>	<b>10,935</b>	<b>11,373</b>	<b>11,053</b>	<b>12,383</b>	<b>11,549</b>
Share capital	99	99	99	99	99
Reserves	18,835	19,527	20,061	21,583	23,286
Minority interest					
<b>Shareholders' equity</b>	<b>18,934</b>	<b>19,626</b>	<b>20,160</b>	<b>21,682</b>	<b>23,385</b>
<b>Total equity &amp; liabilities</b>	<b>29,869</b>	<b>30,998</b>	<b>31,213</b>	<b>34,064</b>	<b>34,934</b>

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Dynamic components	47.8	45.7	41.2	37.1	37.3
MEMS (microphone)	4.5	5.2	5.7	5.3	5.4
Electro. (haptics)	44.5	43.0	41.5	37.0	35.3
Other	3.1	6.1	11.6	20.6	22.0
<b>Growth (%)</b>					
Revenue	(14.1)	(1.4)	4.0	13.2	2.9
Gross profit	(22.7)	(24.3)	(5.1)	18.8	6.6
Operating Income	(29.9)	(42.0)	(22.1)	37.1	11.7
Net profit	(28.7)	(41.5)	(22.7)	36.1	12.0
<b>Profitability (%)</b>					
Gross Margin	37.2	28.6	26.1	27.3	28.3
Operating Margin	23.5	13.8	10.4	12.5	13.6
Net margin	20.9	12.4	9.2	11.1	12.1
<b>Balance sheet ratios</b>					
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
<b>Returns (%)</b>					
ROE	20.0	11.3	8.5	10.8	11.2
ROA	12.7	7.2	5.5	6.9	7.5
<b>Per share data (RMB)</b>					
EPS	3.12	1.84	1.42	1.93	2.17
DPS	1.79	1.27	0.98	0.68	0.76

Source: Company data, CMBIS estimates

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