

AAC Technologies (2018 HK)

Worst is likely over but most positives are priced in

AAC reported another NP decline of 28% YoY (vs -48%/-62% YoY in 2Q/1Q), 8% below consensus and 9% higher than our estimates. 3Q GPM came in at 29.6% (-7.5ppt YoY), below consensus of 31.5%. Given stabilising revenue (acoustic/haptics offset by optics) and narrowing earnings decline in 4Q19E/FY20E, we raise TP to HK\$45.0 based on new multiple of 18x FY20E P/E (15% below 5-yr avg.). Since most positives from Apple recovery are reflected and we are cautious on optics guidance, we recommend to take profit on recent rally and maintain Sell.

- 3Q19 miss on lower GPM.** Despite stabilized revenue of +2.9% YoY in 3Q, AAC's 3Q net profit slumped 29% YoY due to lower GPM of 29.6% (vs 37.1% in 2Q19). By segment, acoustics (46% of sales) declined 8.6% YoY, while haptics/casings (41%) and optics (6%) grew 7% YoY and 81% YoY. Mgmt. expected optics (both plastic and WLG) to become strategic key growth driver, and acoustics SLS upgrade will boost margin recovery in 4Q19E.
- Optics remains on fast track but guidance looks too aggressive.** Optics growth accelerated to 81% YoY in 3Q19 (vs 74% in 2Q) with improving yield/utilization. Mgmt. guided 60kk/m plastic lens shipment with 40% GPM in 4Q19E, and targeted 100kk/m shipment with 50% GPM in 1Q20E. AAC also plans to achieve ASP of Rmb4.5/5.0 in 1Q/4Q20E (vs. <Rmb3.5 in 3Q19). As for WLG lens, mgmt. targets to fully launch in 2020 with 10+ projects on hand now. However, we believe guidance looks too bullish on margin/ASP and visibility for WLG demand remains low at this early stage.
- Acoustics/haptics: stabilising revenue with margin pressure.** We expect acoustics and haptics/casings to recover with 1% and 2% YoY in FY20E, following decline for past two years. AAC's SLS penetrated into 60% of Android shipments in 3Q (vs 50%/35% in 2Q/1Q), on track to reach 65% by 4Q19E (revised down from 70%). That said, we expect GPM pressure into FY20E given limited upgrade and competition with Luxshare/Goertek.
- Our EPS are 9-17% below consensus; Maintain Sell.** We lifted our FY19-21E EPS by 2-11% to reflect higher revenue/margin assumptions. Given narrowing NP decline in 4Q19E/FY20E, we assign new multiple of 18x (15% below 5-yr avg.) to derive new TP of HK\$45.0. With 13% downside and most positives already priced in, we recommend to take profit and maintain Sell. Upside risks include stronger lens, better iPhone and less margin pressure.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	21,119	18,131	17,520	19,657	20,556
YoY growth (%)	36.2	(14.1)	(3.4)	12.2	4.6
Net income (RMB mn)	5,325	3,796	2,172	2,718	2,913
EPS (RMB)	4.36	3.12	1.79	2.24	2.40
YoY growth (%)	32.8	(28.5)	(42.5)	25.1	7.2
P/E (x)	10.6	14.9	25.8	20.6	19.3
P/B (x)	3.2	3.0	2.8	2.6	2.4
Yield (%)	2.9	3.9	2.2	1.7	1.8
ROE (%)	30.3	20.0	10.9	12.6	12.4
Net gearing (%)	13	9	9	8	1

Source: Company data, CMBIS estimates

SELL (Maintain)

Target Price	HK\$45.0
(Previous TP)	HK\$29.6)
Current Price	HK\$51.6
Up/Downside	-13.0%

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\$m)	62,359
Avg. 3mths t/o (HK\$m)	444.13
52W High/Low (HK\$)	63.95/ 32.85
Total Issued Shares (mn)	1,218.0

Source: Bloomberg

Shareholding Structure

Chunyuan Wu	21.75%
Zhengmin Pan	19.24%
JPMorgan Chase	11.87%

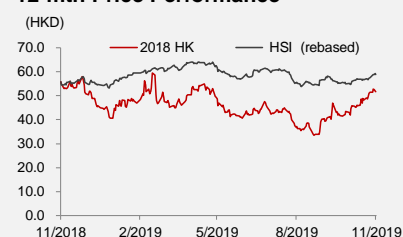
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	20.0%	12.4%
3-mth	39.1%	31.4%
6-mth	6.2%	11.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte Touche Tohmatsu

Related Reports:

- AAC Tech (2018 HK) – Outlook remains challenging; Maintain Sell - 26 Aug 2019
- AAC Tech (2018 HK) – 1H Preview – 12 Aug 2019
- China Tech – Global landscape is at inflection point – 18 Jun 2019

Earnings Revision

Figure 1: 3Q19 results review

RMB mn	3Q18	2Q19	3Q19	QoQ	YoY	CMBI estimates		Consensus	
						3Q19E	Diff %	3Q19E	Diff %
Revenue	4,869	3,815	5,012	31%	3%	4,556	10%	4,864	3%
Gross Profit	1,804	955	1,483	55%	-18%	1,281	16%	1,181	26%
Operating Profit	1,174	354	829	134%	-29%	698	19%	824	1%
Net profit	973	338	695	106%	-29%	637	9%	754	-8%
EPS (RMB)	0.80	0.28	0.57	106%	-28%	0.53	9%	0.63	-8%
Gross Margin	37.1%	25.0%	29.6%			28.1%	1.5 ppt	31.5%	-1.9 ppt
Operating Margin	24.1%	9.3%	16.5%			15.3%	1.2 ppt	16.9%	-0.4 ppt
Net Margin	20.0%	8.9%	13.9%			14.0%	-0.1 ppt	15.5%	-1.6 ppt

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Revenue breakdown

RMB mn	FY17	FY18	1Q19	2Q19	3Q19	4Q19E	FY19E	FY20E	FY21E
Revenue									
Dynamic components	9,580	8,675	1,880	1,766	2,278	1,753	7,677	7,723	7,908
MEMS components	848	814	154	226	289	212	882	926	972
Haptics & RF	10,341	7,882	1,530	1,500	2,055	2,520	7,605	7,757	7,560
Others (incl. optics)	350	760	189	323	389	456	1,357	3,252	4,116
Total	21,119	18,131	3,753	3,815	5,012	4,941	17,520	19,657	20,556
Revenue mix									
Dynamic components	45%	48%	50%	46%	45%	35%	44%	39%	38%
MEMS components	4%	4%	4%	6%	6%	4%	5%	5%	5%
Haptics & RF	49%	43%	41%	39%	41%	51%	43%	39%	37%
Others (incl. optics)	2%	4%	5%	8%	8%	9%	8%	17%	20%
YoY Growth (%)									
Dynamic components	20%	-9%	-22%	-6%	-9%	-7%	-12%	1%	2%
MEMS components	58%	-4%	-14%	37%	8%	5%	8%	5%	5%
Haptics & RF	49%	-24%	-20%	-2%	7%	0%	-4%	2%	-3%
Others (incl. optics)	364%	117%	36%	61%	102%	101%	79%	140%	27%
Total	36%	-14%	-19%	1%	3%	2%	-3%	12%	5%
Gross profit margin									
Dynamic components	40.8%	37.2%	32.9%	27.2%	33.3%	33.0%	31.7%	31.0%	31.0%
MEMS components	22.4%	26.6%	18.5%	26.9%	31.3%	32.0%	28.1%	28.0%	28.0%
Haptics & RF	43.6%	41.1%	32.3%	27.1%	29.5%	33.0%	30.7%	28.7%	29.6%
Others (incl. optics)	22.3%	7.6%	-6.2%	2.3%	7.2%	10.0%	5.1%	30.0%	30.0%
Total	41.3%	37.2%	30.1%	25.0%	29.6%	30.8%	29.1%	29.8%	30.1%

Source: Company data, CMBIS estimates

Figure 3: P&L forecast

RMB mn	FY17	FY18	1Q19	2Q19	3Q19	4Q19E	FY19E	FY20E	FY21E
Revenue	21,119	18,131	3,753	3,815	5,012	4,941	17,520	19,657	20,556
...YoY	36.2%	-14.1%	-19.1%	0.8%	2.9%	2.1%	-3.4%	12.2%	4.6%
Cost of sales	(12,399)	(11,388)	(2,623)	(2,860)	(3,528)	(3,417)	(12,429)	(13,799)	(14,359)
Gross profit	8,720	6,743	1,129	955	1,483	1,523	5,091	5,859	6,196
GPM (%)	41.3%	37.2%	30.1%	25.0%	29.6%	30.8%	29.1%	29.8%	30.1%
...YoY	35.3%	-22.7%	-36.0%	-28.3%	-17.8%	-17.4%	-24.5%	15.1%	5.8%
SG&A	(975)	(966)	(230)	(182)	(221)	(301)	(935)	(1,022)	(1,069)
...% of rev	-4.6%	-5.3%	-6.1%	-4.8%	-4.4%	-6.1%	-5.3%	-5.2%	-5.2%
R&D	(1,664)	(1,512)	(412)	(419)	(433)	(395)	(1,659)	(1,769)	(1,850)
...% of rev	-7.9%	-8.3%	-11.0%	-11.0%	-8.6%	-8.0%	-9.5%	-9.0%	-9.0%
Operating profit	6,081	4,265	488	354	829	827	2,497	3,067	3,277
OPM (%)	28.8%	23.5%	13.0%	9.3%	16.5%	16.7%	14.3%	15.6%	15.9%
...YoY	34.7%	-29.9%	-59.0%	-53.8%	-29.4%	-27.2%	-41.5%	22.8%	6.8%
Net profit	5,325	3,796	432	338	695	794	2,172	2,718	2,913
NPM (%)	25.2%	20.9%	11.5%	8.9%	13.9%	16.1%	12.4%	13.8%	14.2%
...YoY	32.3%	-28.7%	-61.6%	-48.2%	-28.6%	-24.0%	-42.8%	25.1%	7.2%

Source: Company data, CMBIS estimates

Our FY20-21E EPS are 11-17% below consensus

We lifted our EPS by 2-11% to reflect higher revenue/margin assumptions. Our EPS are lower than consensus by 9-17% mainly due to more conservative gross margin and revenue estimates for acoustics/haptics segment.

Figure 4: Earnings revision

RMB mn	New			Old			Change (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	17,520	19,657	20,556	16,398	18,327	19,780	7%	7%	4%
Gross Profit	5,096	5,864	6,202	4,640	5,435	5,943	10%	8%	4%
Operating Profit	2,497	3,067	3,277	2,206	2,919	3,227	13%	5%	2%
Net profit	2,172	2,718	2,913	1,959	2,575	2,862	11%	6%	2%
EPS (RMB)	1.79	2.24	2.40	1.62	2.12	2.36	11%	6%	2%
Gross Margin	29.1%	29.8%	30.1%	28.3%	29.6%	30.0%	0.8 ppt	0.2 ppt	0.1 ppt
Operating Margin	14.3%	15.6%	15.9%	13.5%	15.9%	16.3%	0.8 ppt	-0.3 ppt	-0.4 ppt
Net Margin	12.4%	13.8%	14.2%	11.9%	14.0%	14.5%	0.5 ppt	-0.2 ppt	-0.3 ppt

Sources: Company data, CMBIS estimates

Figure 5: CMBI estimates vs consensus

RMB mn	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	17,520	19,657	20,556	17,510	19,382	20,839	0%	1%	-1%
Gross Profit	5,096	5,864	6,202	5,252	6,188	6,804	-3%	-5%	-9%
Operating Profit	2,497	3,067	3,277	2,723	3,560	4,119	-8%	-14%	-20%
Net profit	2,172	2,718	2,913	2,360	3,006	3,422	-8%	-10%	-15%
EPS (RMB)	1.79	2.24	2.40	1.96	2.53	2.91	-9%	-11%	-17%
Gross Margin	29.1%	29.8%	30.1%	30.0%	31.9%	32.7%	-0.9 ppt	-2.1 ppt	-2.5 ppt
Operating Margin	14.3%	15.6%	15.9%	15.6%	18.4%	19.8%	-1.3 ppt	-2.8 ppt	-3.8 ppt
Net Margin	12.4%	13.8%	14.2%	13.5%	15.5%	16.4%	-1.1 ppt	-1.7 ppt	-2.3 ppt

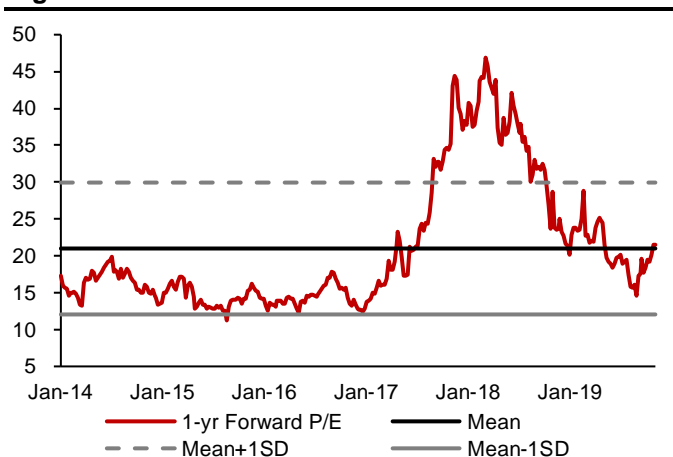
Source: Bloomberg, CMBIS estimates

Valuation

Maintain Sell with new TP HK\$45.0 (13% downside)

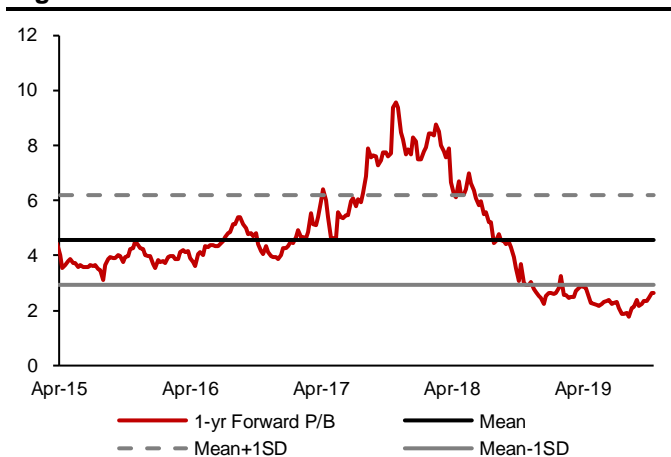
We maintain Sell rating and raised TP to HK\$45.0 based on new multiple of 18x FY20E P/E (15% below 5-yr avg.), given stabilising revenue and earnings decline in 4Q19E/FY20E. However, since most positives from Apple recovery are reflected and we are conservative on optics guidance, we believe valuation of 20.6x FY20E P/E is too high (vs 21.0x 5-yr avg.). Upside risks include stronger lens, better iPhone and less GPM pressure.

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						Cash flow summary					
YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E	YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	21,119	18,131	17,520	19,657	20,556	Profit before taxation	5,996	4,310	2,513	3,089	3,310
COGS	(12,399)	(11,388)	(12,429)	(13,799)	(14,359)	Depreciation	1,306	1,750	1,739	1,953	2,168
Gross profit	8,720	6,743	5,091	5,859	6,196	Change in working capital	(1,602)	1,149	(456)	(877)	565
Selling and marketing	(365)	(317)	(279)	(334)	(349)	Others	(413)	(420)	(115)	(114)	(155)
Administrative	(610)	(650)	(655)	(688)	(719)	Net cash from operating	5,287	6,789	3,681	4,051	5,888
R&D	(1,664)	(1,512)	(1,659)	(1,769)	(1,850)	Capex	(3,900)	(2,941)	(2,100)	(3,000)	(3,000)
Operating profit	6,081	4,265	2,497	3,067	3,277	Other	(1,109)	(658)	68		
Financial cost	(165)	(218)	(232)	(232)	(232)	Net cash from investing	(5,009)	(3,599)	(2,032)	(3,000)	(3,000)
Other income/(losses)	80	264	249	254	265	Net borrowings	2,362	(555)	0	0	0
Pre-tax profit	5,996	4,310	2,513	3,089	3,310	Interest paid	(165)	(216)	(232)	(232)	(232)
Tax	(671)	(514)	(341)	(371)	(397)	Dividend paid	(1,662)	(2,182)	(1,248)	(951)	(1,020)
Minority interest	1	-	-	-	-	Other	(549)	(294)			
Net profit	5,325	3,796	2,172	2,718	2,913	Net cash from financing	(14)	(3,247)	(1,480)	(1,184)	(1,252)
						Net change in cash	264	(57)	169	(132)	1,636
						Cash at beg of year	3,864	4,034	4,059	4,228	4,095
						Exchange difference	(95)	81	0	0	0
						Cash at end of year	4,034	4,059	4,228	4,095	5,731

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E	YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Current assets	14,607	11,985	12,806	13,681	15,201	Sales mix (%)					
Cash & equivalents	4,034	4,126	4,228	4,095	5,731	Dynamic components	45.4	47.8	43.8	39.3	38.5
Trade and other rev.	7,155	4,474	6,725	5,638	7,386	MEMS (microphone)	4.0	4.5	5.0	4.7	4.7
Inventories	3,398	3,319	1,788	3,882	2,019	Electro. (haptics)	49.0	43.5	43.4	39.5	36.8
Other current assets	20	65	65	65	65	Other	1.7	4.2	7.7	16.5	20.0
Non-current assets	16,115	17,884	18,245	19,291	20,124	Growth (%)					
PPE	13,526	15,440	15,801	16,847	17,680	Revenue	36.2	(14.1)	(3.4)	12.2	4.6
Lease prepayments	538	622	622	622	622	Gross profit	35.3	(22.7)	(24.5)	15.1	5.8
Intangible assets	256	367	367	367	367	Operating Income	34.7	(29.9)	(41.5)	22.8	6.8
Other non-curr. assets	1,795	1,455	1,455	1,455	1,455	Net profit	32.3	(28.7)	(42.8)	25.1	7.2
Total assets	30,722	29,869	31,050	32,972	35,324	Profitability (%)					
Current liabilities	11,097	8,317	8,573	8,728	9,187	Gross Margin	41.3	37.2	29.1	29.8	30.1
Short-term borrowings	4,349	3,493	3,493	3,493	3,493	Operating Margin	28.8	23.5	14.3	15.6	15.9
Trade & other payables	6,369	4,548	4,812	4,942	5,391	Net margin	25.2	20.9	12.4	13.8	14.2
Tax payables	332	205	198	222	232	Balance sheet ratios					
Other current liabilities	47	71	71	71	71	Net debt/total equity (x)	0.1	0.1	0.1	0.1	0.0
Non-current liabilities	2,074	2,618	2,618	2,618	2,618	Current ratio (x)	1.3	1.4	1.5	1.6	1.7
Government grants	87	118	118	118	118	Receivable turnover days	88	88	90.0	90.0	90.0
Deferred tax liabilities	46	72	72	72	72	Inventory turnover days	89	89	75.0	75.0	75.0
Other non-current liab.	1,941	2,429	2,429	2,429	2,429	Payable turnover days	85	85	70.0	70.0	70.0
Total liabilities	13,171	10,935	11,192	11,346	11,805	Returns (%)					
Share capital	99	99	99	99	99	ROE	30.3	20.0	10.9	12.6	12.4
Reserves	17,452	18,835	19,760	21,527	23,420	ROA	17.3	12.7	7.0	8.2	8.2
Minority interest						Per share data (RMB)					
Shareholders' equity	17,551	18,934	19,859	21,626	23,519	EPS	4.36	3.12	1.79	2.24	2.40
Total equity & liabilities	30,722	29,869	31,050	32,972	35,324	DPS	1.36	1.79	1.03	0.78	0.84

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

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIS

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : 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.

For recipients of this document in the United States

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.