

AAC Technologies (2018 HK)

Worst is over but GPM pressure to persist; Maintain Sell

AAC reported 1Q20 net profit decline of 88% YoY, largely in-line with profit warning earlier (down 85-90% YoY), and revenue decline of 5% YoY is better than our/market expectations. While China smartphone market is recovering in 2Q20E, we think overseas demand weakness, inferior product mix and margin pressure across all segments will continue to drag AAC's earnings in next few quarters. We trimmed FY20-22E EPS by 4-15% to reflect lower blended GPM, and our new FY20-22E EPS are 28%/31%/21% below consensus. Maintain Sell with new TP of HK\$ 36.0 based on roll-over 18x FY21E P/E.

- **1Q20 in-line but GPM worse than expected.** AAC 1Q20 net profit decline of 88% YoY came in at midpoint of earlier guidance, while revenue drop of 5% YoY is better than our/market estimates, due to higher casing/optics revenue. By segment, we estimate acoustic/haptics (65% of sales) were down 24%/9% YoY, offset by lower-margin casings/optics growth of 44%/62% YoY. 1Q20 GPM continued to worsen and reached historical low at 23.1%, which is below 24.3%/25.2% for our/market estimates.
- **Optics: Good progress but guidance remains too aggressive.** We think optics is the only bright spot for AAC, but recent progress is slower than previous guidance in late-March. Mgmt. postponed various targets: 1) plastic lens shipment: 60kk/100kk per month by 2Q20/3Q20 (from Apr/July prev.), 2) 7P lens: mass production in 4Q20 (from 3Q20 prev.), 3) camera module: mass production in 2H20E (from May prev.). Other guidance included 30%/40%/40%+ GPM by 2Q/June/2H20E (vs ~10% in 1Q20), and 30mn WLG shipment in FY20E. Overall, we believe optics guidance remains too aggressive, given Xiaomi/Huawei pressure in 2Q20E (AAC's major optics clients) and lack of WLG visibility on flagship model weakness.
- **Our FY20/21E EPS are 28%/31% below consensus.** We trimmed our FY20-22E EPS by 4-15% to reflect inferior product mix, higher margin pressure and shipment weakness into 2H20E. We estimate net profit will continue to decline 23%/9%/2% YoY in 2Q/3Q/4Q20E, mainly driven by lack of acoustics/haptics upgrade in 2H20 iPhones, slower optics shipment/margin ramp, and higher mix of lower-margin casing segments.
- **Maintain Sell with new TP of HK\$36.0.** We expect more earnings downward revisions following 1Q20 results, iPhone launch delay and slower global smartphone recovery. Our new TP of HK\$36.0 is based on roll-over target multiple of 18x FY21E P/E (from 18x FY20 P/E). Upside risks include stronger lens, better iPhone and less margin pressure.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	18,131	17,884	18,134	19,453	20,350
YoY growth (%)	(14.1)	(1.4)	1.4	7.3	4.6
Net income (RMB mn)	3,796	2,222	1,685	2,171	2,474
EPS (RMB)	3.12	1.84	1.39	1.79	2.04
YoY growth (%)	(28.5)	(41.1)	(24.2)	28.8	13.9
Consensus EPS (RMB)	NA	1.84	1.93	2.59	3.03
P/E (x)	12.3	20.8	27.4	21.3	18.7
P/B (x)	2.5	2.4	2.3	2.1	2.0
Yield (%)	4.7	3.3	2.5	1.6	1.9
ROE (%)	20.0	11.3	8.4	10.1	10.7

Source: Company data, Bloomberg, CMBIS estimates

SELL (Maintain)

Target Price	HK\$36.0
(Previous TP	HK\$29.0)
Up/Downside	-15%
Current Price	HK\$42.65

China Technology Sector

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Stock Data

Mkt. Cap. (HK\$m)	51,543
Avg. 3mths t/o (HK\$m)	586.06
52W High/Low (HK\$)	72.90/ 32.85
Total Issued Shares (mn)	1,209
Source: Bloomberg	

Shareholding Structure

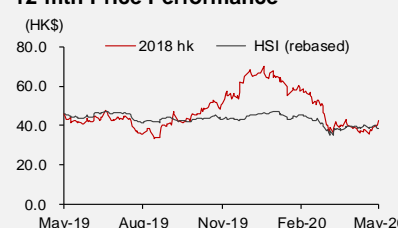
Chunyuan Wu	21.75%
Zhengmin Pan	19.24%
JPMorgan Chase	12.39%
Source: HKEx	

Share Performance

	Absolute	Relative
1-mth	2.3%	4.9%
3-mth	-30.3%	-18.6%
6-mth	-20.4%	-12.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte Touche Tohmatsu

Related Reports:

1. AAC tech (2018 HK) - Profit warning affirms our cautious view; Maintain Sell – 9 Apr 2020
2. AAC Tech (2018 HK) – Awaiting better visibility in 2Q – 26 Mar 2020
3. AAC Tech (2018 HK) – Worst is likely over but most positives are priced in – 11 Nov 2019

1Q20 Results Review

Figure 1: 1Q20 results review

RMB mn	1Q19	4Q19	1Q20	QoQ	YoY	CMBIS estimates		Consensus	
						1Q20E	Diff %	1Q20E	Diff %
Revenue	3,753	5,305	3,560	-33%	-5%	2,217	61%	3,261	9%
Gross Profit	1,129	1,539	823	-47%	-27%	559	47%	911	-10%
Operating Profit	488	801	95	-88%	-81%	67	42%	253	-62%
Net profit	432	757	53	-93%	-88%	62	-14%	56	-6%
EPS (RMB)	0.36	0.63	0.04	-93%	-88%	0.05	-14%	0.05	-7%
Gross Margin	30.1%	29.0%	23.1%			25.2%	-2.1 ppt	24.3%	-1.2 ppt
Operating Margin	13.0%	15.1%	2.7%			3.0%	-0.3 ppt	7.8%	-5.1 ppt
Net Margin	11.5%	14.3%	1.5%			2.8%	-1.3 ppt	1.7%	-0.2 ppt

Source: Company data, Bloomberg, CMBIS

Figure 2: Revenue breakdown

RMB mn	FY18	FY19	1Q20	2Q20E	3Q20E	4Q20E	FY20E	FY21E	FY22E
Revenue									
Dynamic components	8,675	8,167	1,421	1,497	2,167	2,115	7,201	7,527	7,790
MEMS components	814	929	199	249	318	285	1,051	1,104	1,159
Haptics & RF	8,073	7,694	1,691	1,484	2,040	2,610	7,826	7,498	7,472
Others (incl. optics)	569	1,094	249	481	613	714	2,057	3,324	3,929
Total	18,131	17,884	3,560	3,711	5,139	5,725	18,134	19,453	20,350
Revenue mix									
Dynamic components	48%	46%	40%	40%	42%	37%	40%	39%	38%
MEMS components	4%	5%	6%	7%	6%	5%	6%	6%	6%
Haptics & RF	45%	43%	47%	40%	40%	46%	43%	39%	37%
Others (incl. optics)	3%	6%	7%	13%	12%	12%	11%	17%	19%
YoY Growth (%)									
Dynamic components	-9%	-6%	-24%	-15%	-5%	-6%	-12%	5%	4%
MEMS components	-4%	14%	29%	10%	10%	10%	13%	5%	5%
Haptics & RF	-22%	-5%	11%	-1%	-4%	6%	2%	-4%	0%
Others (incl. optics)	63%	92%	32%	47%	89%	106%	88%	62%	18%
Total	-14%	-1%	-5%	-3%	3%	8%	1%	7%	5%
Gross profit margin									
Dynamic components	37.2%	31.0%	26.0%	26.0%	32.0%	29.5%	28.8%	29.0%	30.5%
MEMS components	26.6%	27.5%	16.5%	26.0%	30.5%	30.0%	26.6%	28.0%	28.5%
Haptics & RF	40.6%	29.6%	23.6%	22.8%	25.5%	27.9%	25.4%	26.9%	26.9%
Others (incl. optics)	4.0%	3.2%	9.5%	15.0%	18.0%	20.0%	17.0%	23.0%	25.0%
Total	37.2%	28.6%	23.1%	23.3%	27.7%	27.6%	25.9%	27.1%	28.0%

Source: Company data, CMBIS

Figure 3: P&L forecast

RMB mn	FY18	FY19	1Q20	2Q20E	3Q20E	4Q20E	FY20E	FY21E	FY22E
Revenue	18,131	17,884	3,560	3,711	5,139	5,725	18,134	19,453	20,350
...YoY	-14.1%	-1.4%	-5.1%	-2.7%	2.5%	7.9%	1.4%	7.3%	4.6%
Cost of sales	(11,388)	(12,777)	(2,737)	(2,847)	(3,717)	(4,145)	(13,446)	(14,178)	(14,653)
Gross profit	6,743	5,107	823	864	1,422	1,580	4,688	5,275	5,697
GPM (%)	37.2%	28.6%	23.1%	23.3%	27.7%	27.6%	25.9%	27.1%	28.0%
...YoY	-22.7%	-24.3%	-27.1%	-9.5%	-4.1%	2.6%	-8.2%	12.5%	8.0%
SG&A	(966)	(918)	(239)	(179)	(226)	(307)	(951)	(992)	(1,038)
...% of rev	-5.3%	-5.1%	-6.7%	-4.8%	-4.4%	-5.4%	-5.2%	-5.1%	-5.1%
R&D	(1,512)	(1,717)	(489)	(408)	(442)	(487)	(1,826)	(1,848)	(1,893)
...% of rev	-8.3%	-9.6%	-13.7%	-11.0%	-8.6%	-8.5%	-10.1%	-9.5%	-9.3%
Operating	4,265	2,472	95	277	754	786	1,911	2,434	2,766
OPM (%)	23.5%	13.8%	2.7%	7.5%	14.7%	13.7%	10.5%	12.5%	13.6%
...YoY	-29.9%	-42.0%	-80.5%	-21.8%	-9.0%	-2.0%	-22.7%	27.4%	13.6%
Net profit	3,796	2,222	53	261	629	743	1,685	2,171	2,474
NPM (%)	20.9%	12.4%	1.5%	7.0%	12.2%	13.0%	9.3%	11.2%	12.2%
...YoY	-28.7%	-41.5%	-87.8%	-22.8%	-9.6%	-1.9%	-24.2%	28.8%	13.9%

Source: Company data, CMBIS

Earnings Revision

Our FY20/21E EPS are 28%/31% below consensus

We cut our FY20-22E EPS by 4-15% to reflect lower revenue and margin assumptions. Our EPS are lower than consensus by 21-31% mainly due to lower gross margin and revenue estimates for acoustics/haptics/casing/optics segments.

Figure 4: CMBIS earnings revisions

RMB mn	New			Old			Change (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	18,134	19,453	20,350	16,456	19,424	20,928	10%	0%	-3%
Gross Profit	4,693	5,280	5,702	4,449	5,607	6,165	5%	-6%	-8%
Operating Profit	1,911	2,434	2,766	1,949	2,843	3,187	-2%	-14%	-13%
Net profit	1,685	2,171	2,474	1,751	2,561	2,881	-4%	-15%	-14%
EPS (RMB)	1.39	1.79	2.04	1.45	2.12	2.38	-4%	-15%	-14%
Gross Margin	25.9%	27.1%	28.0%	27.0%	28.8%	29.4%	-1.2 ppt	-1.7 ppt	-1.4 ppt
Operating Margin	10.5%	12.5%	13.6%	11.8%	14.6%	15.2%	-1.3 ppt	-2.1 ppt	-1.6 ppt
Net Margin	9.3%	11.2%	12.2%	10.6%	13.2%	13.8%	-1.3 ppt	-2 ppt	-1.6 ppt

Source: Company data, CMBIS estimates

Figure 5: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	18,134	19,453	20,350	19,161	22,356	22,356	-5%	-13%	-9%
Gross Profit	4,693	5,280	5,702	5,485	6,765	6,765	-14%	-22%	-16%
Operating Profit	1,911	2,434	2,766	2,591	3,455	3,455	-26%	-30%	-20%
Net profit	1,685	2,171	2,474	2,328	3,115	3,115	-28%	-30%	-21%
EPS (RMB)	1.39	1.79	2.04	1.93	2.59	2.59	-28%	-31%	-21%
Gross Margin	25.9%	27.1%	28.0%	28.6%	30.3%	30.3%	-2.8 ppt	-3.1 ppt	-2.3 ppt
Operating Margin	10.5%	12.5%	13.6%	13.5%	15.5%	15.5%	-3 ppt	-2.9 ppt	-1.9 ppt
Net Margin	9.3%	11.2%	12.2%	12.2%	13.9%	13.9%	-2.9 ppt	-2.8 ppt	-1.8 ppt

Source: Bloomberg, CMBIS estimates

Valuation

Maintain Sell with new TP HK\$36.0 (15% downside)

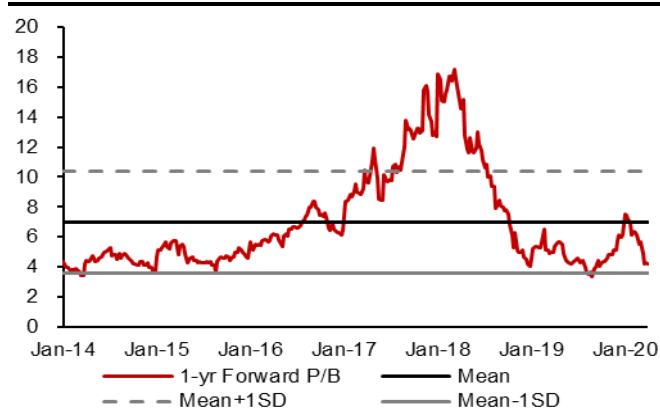
We maintain Sell for our cautious view on iPhone launch delay, over-bullish optics guidance and demand uncertainty. We believe there is still downside on consensus earnings due to product launch delays and demand weakness. Our new TP of HK\$36.0 is based on roll-over same 18x FY21E P/E (from 18x FY20E P/E). Upside risks include stronger lens, better iPhone and better GPM.

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	18,134	19,453	20,350
COGS	(11,388)	(12,777)	(13,446)	(14,178)	(14,653)
Gross profit	6,743	5,107	4,688	5,275	5,697
Selling and marketing	(317)	(275)	(279)	(292)	(305)
Administrative	(650)	(643)	(671)	(700)	(733)
R&D	(1,512)	(1,717)	(1,826)	(1,848)	(1,893)
Operating profit	4,265	2,472	1,911	2,434	2,766
Financial cost	(218)	(248)	(275)	(275)	(275)
Other income/(losses)	264	329	368	308	320
Pre-tax profit	4,310	2,552	2,004	2,467	2,811
Tax	(514)	(330)	(318)	(296)	(337)
Minority interest	-	-	-	-	-
Net profit	3,796	2,222	1,685	2,171	2,474

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before taxation	4,310	2,552	2,004	2,467	2,811
Depreciation	1,750	1,803	2,003	2,203	2,403
Change in working capital	1,149	(627)	171	(766)	417
Others	(420)	(85)	(40)	(6)	(52)
Net cash from operating	6,789	3,644	4,138	3,899	5,580
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)	(275)	(275)	(275)
Dividend paid	(2,182)	(1,531)	(1,161)	(760)	(866)
Other	(294)	0	0	0	0
Net cash from financing	(3,247)	(1,779)	(1,436)	(1,035)	(1,141)
Net change in cash	(57)	(1,068)	(98)	64	1,638
Cash at beg of year	4,034	4,059	2,991	2,893	2,957
Exchange difference	81	0	0	0	0
Cash at end of year	4,059	2,991	2,893	2,957	4,596

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Current assets	11,985	11,918	11,151	12,947	13,650
Cash & equivalents	4,126	2,991	2,893	2,957	4,596
Trade and other rev.	4,474	6,930	4,598	7,693	5,200
Inventories	3,319	1,931	3,594	2,232	3,790
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	31,028	33,421	34,520
Current liabilities	8,317	8,754	8,259	9,241	8,733
Short-term borrowings	3,493	3,493	3,493	3,493	3,493
Trade & other payables	4,548	4,989	4,491	5,458	4,939
Tax payables	205	202	205	220	230
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	10,878	11,860	11,351
Share capital	99	99	99	99	99
Reserves	18,835	19,527	20,051	21,462	23,070
Minority interest	-	-	-	-	-
Shareholders' equity	18,934	19,626	20,150	21,561	23,169
Total equity & liabilities	29,869	30,998	31,028	33,421	34,520

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Dynamic components	47.8	45.7	39.7	38.7	38.3
MEMS (microphone)	4.5	5.2	5.8	5.7	5.7
Electro. (haptics)	44.5	43.0	43.2	38.5	36.7
Other	3.1	6.1	11.3	17.1	19.3
Growth (%)					
Revenue	(14.1)	(1.4)	1.4	7.3	4.6
Gross profit	(22.7)	(24.3)	(8.2)	12.5	8.0
Operating Income	(29.9)	(42.0)	(22.7)	27.4	13.6
Net profit	(28.7)	(41.5)	(24.2)	28.8	13.9
Profitability (%)					
Gross Margin	37.2	28.6	25.9	27.1	28.0
Operating Margin	23.5	13.8	10.5	12.5	13.6
Net margin	20.9	12.4	9.3	11.2	12.2
Balance sheet ratios					
Net debt/total equity (x)	0.1	0.1	0.2	0.1	0.1
Current ratio (x)	1.4	1.4	1.4	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	8.4	10.1	10.7
ROA	12.7	7.2	5.4	6.5	7.2
Per share data (RMB)					
EPS	3.12	1.84	1.39	1.79	2.04
DPS	1.79	1.27	0.96	0.63	0.72

Source: Company data, CMBIS estimates

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