

Equity Research | China | Technology

15 May 2018

## Solid long-term growth outlook intact

- AAC's 1Q18 results came in slightly behind our and street expectations. Management guided down FY18 revenue growth from 25% to double-digit growth rate.
- In 1Q18, AAC continued to make broad-based penetration into Chinese Android customers with speaker boxes designed with 'Super Linear Structure' ('SLS'), hybrid lens (WLG technique), linear haptics as well as 3D cover glass.
- We have trimmed our FY18E/FY19E revenue and profit estimates by 8.2%/12.4% and 12.4%/20.4%, respectively, and lowered our DCF-based price target to HKD150. Maintain Buy.

**A stable set of 1Q18 headlines.** As well expected, AAC's 1Q18 headlines saw headwinds in the face of a stagnant smartphone industry and RMB appreciation. Revenue rose 10.0% YoY, driven by sturdy growth momentum of speaker modules (revenue +48.2% YoY) business but was dragged by weak haptics (haptics/RF revenue dropped 11.0% YoY). Gross margin contracted to 38.0%, down by 3.6ppt YoY, mainly due to RMB appreciation (3.2ppt erosion attributable to RMB appreciation).

**Concrete progress of core businesses.** Acoustic segment revenue saw a solid 27% YoY growth in 1Q18, driven by robust shipments and ASP of SLS speaker module for Android flagships (adopted on a flagship launched in 1Q18). Riding on an increasing proportion of proprietary MEMS dies and ASIC chips, the MEMS microphone business saw an upsurge in revenue (+65% YoY in 1Q18) coupled with a boost in gross margins per our estimates. Despite haptics/RF saw an 11.0% YoY decline in revenue, it is notable that AAC has achieved deepened penetration into top-tier Android customers with its X-Axis haptic motors and 3D cover glass, which have already started mass shipments in 1Q18.

**Emerging businesses to bear fruit.** AAC's emerging optic business has expanded rapidly, with plastic lens shipments reaching 15-17mn sets in May-18 and are expected to expand to 25-30mn sets by 3Q18. Meanwhile, the interim target of WLG capacity to expand to 5mn/month (10mn by 4Q18) is well on-track. AAC is poised to begin mass shipments of hybrid lens for both the 3D sensing and imaging end-markets during 3Q-4Q18. We see promising outlook for hybrid lens using the WLG techniques given their superior optical performance and cost advantage.

**Solid long-term growth outlook intact.** We still see a promising FY18 underpinned by both wider and deeper penetration into the Android camp's procurement as well as its sturdy position in the Apple supply chain. In view of the weaker-than-expected haptics business, we have trimmed our FY18E/FY19E revenue and profit estimates by 8.2%/12.4% and 12.4%/20.4% respectively, and lowered our DCF-based price target to HKD150. Maintain Buy.

## AAC Technologies (2018.HK)

### Buy

(unchanged)

<b>Price Target</b>	<b>HK\$150</b>
(Revision)	(-16.7%)
(upside)	(29.5%)

EPS	2018E	2019E
revision	(-12.4%)	(-20.4%)

Close price	HKD115.8
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Market cap.	USD18,027mn
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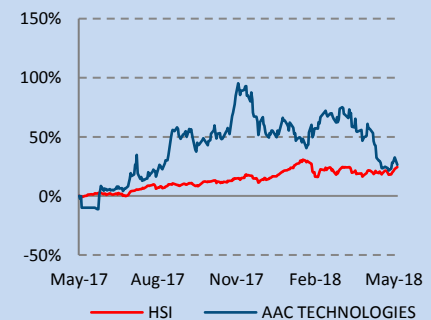
Free float	59.4%
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52-week range	HKD81.25-HKD185
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3-mth ave. T/O	HKD881.0mn
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*Price as of 14 May 2018*

### Stock rel HSI performance (%)


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**Figure 1: AAC 1Q18 results summary**

FY ended: Dec (RMBmn)	1Q16	2Q16	3Q16	4Q16	1Q17	2Q17	3Q17	4Q17	1Q18	YoY	QoQ
<b>Revenue</b>	<b>2,544.7</b>	<b>3,018.8</b>	<b>4,206.7</b>	<b>5,736.6</b>	<b>4,215.1</b>	<b>4,429.2</b>	<b>5,323.6</b>	<b>7,150.7</b>	<b>4,638.3</b>	<b>10.0%</b>	<b>-35.1%</b>
Cost of sales	(1,513.3)	(1,761.1)	(2,447.5)	(3,342.5)	(2,461.1)	(2,642.0)	(3,124.2)	(4,171.4)	(2,874.8)	16.8%	-31.1%
<b>Gross profit</b>	<b>1,031.5</b>	<b>1,257.8</b>	<b>1,759.1</b>	<b>2,394.1</b>	<b>1,753.9</b>	<b>1,787.3</b>	<b>2,199.4</b>	<b>2,979.3</b>	<b>1,763.5</b>	<b>0.5%</b>	<b>-40.8%</b>
Gross margin	40.5%	41.7%	41.8%	41.7%	41.6%	40.4%	41.3%	41.7%	38.0%	-3.6ppt	-3.7ppt
Other operating income	29.8	19.1	71.5	28.6	33.1	58.4	36.3	43.4	111.9	237.8%	158.2%
Distribution and selling expenses	(57.1)	(59.6)	(85.3)	(89.1)	(61.0)	(69.3)	(104.4)	(130.6)	(72.5)	18.9%	-44.4%
Administrative expenses	(98.6)	(109.5)	(129.9)	(134.1)	(125.9)	(119.3)	(170.3)	(194.5)	(139.5)	10.9%	-28.3%
Research & Development expenses	(227.0)	(263.5)	(331.2)	(344.0)	(337.0)	(391.3)	(410.7)	(524.6)	(362.0)	7.4%	-31.0%
Other expenses/gain	(3.8)	18.6	2.5	28.5	(4.1)	(12.3)	(4.6)	(63.6)	(15.1)	266.0%	-76.3%
Shares of associates and JVs	(1.5)	(1.8)	(2.5)	(2.7)	(1.4)	(2.3)	(2.1)	(0.7)	-	-100.0%	-100.0%
Profit from operations	673.2	861.1	1,284.3	1,881.3	1,257.6	1,251.2	1,543.5	2,108.7	1,286.3	2.3%	-39.0%
Finance costs	(9.5)	(10.5)	(19.1)	(27.7)	(31.7)	(36.0)	(44.1)	(52.9)	(50.8)	60.0%	-4.1%
<b>EBT</b>	<b>663.7</b>	<b>850.6</b>	<b>1,265.2</b>	<b>1,853.5</b>	<b>1,225.9</b>	<b>1,215.2</b>	<b>1,499.4</b>	<b>2,055.8</b>	<b>1,235.5</b>	<b>0.8%</b>	<b>-39.9%</b>
Taxation	(44.5)	(115.2)	(165.6)	(283.3)	(164.3)	(149.7)	(133.3)	(223.8)	(109.8)	-33.2%	-51.0%
<b>Net profit</b>	<b>619.2</b>	<b>735.4</b>	<b>1,099.6</b>	<b>1,570.3</b>	<b>1,061.6</b>	<b>1,065.5</b>	<b>1,366.1</b>	<b>1,831.9</b>	<b>1,125.8</b>	<b>6.0%</b>	<b>-38.5%</b>
Minority interest	0.5	(0.7)	(0.6)	(0.4)	0.0	0.3	0.2	0.0	-		
<b>Attributable profit</b>	<b>618.7</b>	<b>736.1</b>	<b>1,100.3</b>	<b>1,570.6</b>	<b>1,061.6</b>	<b>1,065.3</b>	<b>1,365.9</b>	<b>1,831.9</b>	<b>1,125.8</b>	<b>6.0%</b>	<b>-38.5%</b>
<b>Revenue by major product segments</b>											
Dynamic components	1,679.5	1,720.7	2,145.4	2,362.8	1,896.8	2,252.5	2,555.3	2,875.4	2,408.9	27.0%	-16.2%
Haptics & RF	661.6	1,147.1	1,893.0	3,276.3	2,191.8	1,957.4	2,415.6	3,994.4	1,950.7	-11.0%	-51.2%
MEMS components	178.1	120.8	126.2	40.1	126.5	132.9	299.4	286.0	208.6	65.0%	-27.1%

Source: Company, CSCI Research

**Income statement (RMBmn)**

Year end: Dec	2016	2017	2018E	2019E	2020E
Revenue	15,507	21,119	24,336	27,851	31,385
COGS	(9,064)	(12,399)	(14,462)	(16,624)	(18,855)
Gross profit	6,443	8,720	9,875	11,227	12,530
Selling and marketing	(291)	(365)	(445)	(496)	(543)
R&D	(1,166)	(1,664)	(1,954)	(2,305)	(2,441)
Admin	(472)	(610)	(683)	(738)	(775)
<b>Operating profit</b>	<b>4,514</b>	<b>6,081</b>	<b>6,793</b>	<b>7,688</b>	<b>8,771</b>
Other income, net	195	87	167	176	185
<b>EBIT</b>	<b>4,708</b>	<b>6,168</b>	<b>6,960</b>	<b>7,864</b>	<b>8,956</b>
Net interest	(67)	(165)	(219)	(223)	(196)
Associates and JVs	(9)	(7)	(7)	(8)	(9)
Exceptional items	-	-	-	-	-
<b>Pretax profit</b>	<b>4,633</b>	<b>5,996</b>	<b>6,734</b>	<b>7,633</b>	<b>8,751</b>
Taxation	(609)	(671)	(752)	(856)	(988)
<b>Net profit</b>	<b>4,024</b>	<b>5,325</b>	<b>5,981</b>	<b>6,777</b>	<b>7,762</b>
Non controlling interests	(1)	1	1	1	1
<b>Net profit for parent</b>	<b>4,026</b>	<b>5,325</b>	<b>5,981</b>	<b>6,776</b>	<b>7,761</b>
Basic, basic (RMB)	3.28	4.35	4.89	5.55	6.35
Basic, diluted (RMB)	3.28	4.35	4.89	5.55	6.35
DPS (HKD)	1.47	2.10	2.45	2.77	3.18

**Balance sheet (RMBmn)**

Year end: Dec	2016	2017	2018E	2019E	2020E
Cash	3,864	4,034	4,770	5,804	8,582
Short term investments	-	-	-	-	-
Accounts receivables	6,156	7,155	8,085	8,974	9,827
Inventory	2,623	3,398	4,077	4,689	5,251
Other current assets	186	20	25	31	38
<b>Total current assets</b>	<b>12,829</b>	<b>14,607</b>	<b>16,957</b>	<b>19,498</b>	<b>23,699</b>
PP&E	9,494	13,526	16,761	18,568	19,594
Intangible Assets	167	256	265	277	297
Associates and JVs	14	-	-	-	-
Other long term assets	1,753	2,333	2,579	2,581	2,588
<b>Total long term assets</b>	<b>11,428</b>	<b>16,115</b>	<b>19,605</b>	<b>21,426</b>	<b>22,479</b>
<b>TOTAL ASSETS</b>	<b>24,257</b>	<b>30,722</b>	<b>36,562</b>	<b>40,924</b>	<b>46,178</b>
Short term debt	3,303	4,349	4,784	4,306	3,875
Accounts payables	5,346	6,369	7,452	8,570	9,855
Other current liabilities	476	379	512	653	775
<b>Total current liabilities</b>	<b>9,125</b>	<b>11,097</b>	<b>12,749</b>	<b>13,528</b>	<b>14,505</b>
Long term debt	789	1,941	2,523	2,018	1,615
Deferred tax	48	46	51	56	61
Other long term liabilities	80	87	100	115	133
<b>Total long term liabilities</b>	<b>917</b>	<b>2,074</b>	<b>2,673</b>	<b>2,189</b>	<b>1,808</b>
<b>TOTAL LIABILITIES</b>	<b>10,042</b>	<b>13,171</b>	<b>15,422</b>	<b>15,717</b>	<b>16,313</b>
Shareholders' funds	14,189	17,551	21,139	25,205	29,862
Minority Interests	26	-	1	2	3
<b>TOTAL LIAB AND EQUITY</b>	<b>24,257</b>	<b>30,722</b>	<b>36,562</b>	<b>40,924</b>	<b>46,178</b>
Net cash / (debt)	(228)	(2,256)	(2,537)	(520)	3,092

**Cash flow statement (RMBmn)**

Year end: Dec	2016	2017E	2018E	2019E	2020E
<b>EBIT</b>	<b>4,708</b>	<b>6,168</b>	<b>6,960</b>	<b>7,864</b>	<b>8,956</b>
Depreciation & amortisation	711	962	1,308	1,918	2,558
Net interest	(67)	(165)	(219)	(223)	(196)
Taxes paid	(609)	(671)	(752)	(856)	(988)
Changes in working capital	(286)	(1,602)	(529)	(386)	(134)
Others	354	595	712	738	381
<b>Cash flow from operations</b>	<b>4,812</b>	<b>5,287</b>	<b>7,479</b>	<b>9,055</b>	<b>10,576</b>
Capex	(3,399)	(5,098)	(5,203)	(4,431)	(4,001)
Acquisitions	(6)	(79)	(75)	(41)	(43)
Disposals	19	16	83	108	151
Others	(732)	153	(174)	36	33
<b>Cash flow from investing</b>	<b>(4,117)</b>	<b>(5,009)</b>	<b>(5,369)</b>	<b>(4,328)</b>	<b>(3,860)</b>
Dividends	(1,314)	(1,662)	(2,392)	(2,710)	(3,105)
Issue of shares	-	(513)	-	-	-
Change in debt	2,201	2,362	1,017	(983)	(834)
Others	(90)	(201)	1	1	1
<b>Cash flow from financing</b>	<b>797</b>	<b>(14)</b>	<b>(1,374)</b>	<b>(3,692)</b>	<b>(3,938)</b>
<b>Change in cash</b>	<b>1,491</b>	<b>264</b>	<b>736</b>	<b>1,034</b>	<b>2,778</b>
Free cash flow	1,360	79	2,362	4,716	6,681

**Key ratios**

Year end: Dec	2016	2017	2018E	2019E	2020E
<b>Operating ratios</b>					
EBIT margin (%)	30.4	29.2	28.6	28.2	28.5
Net margin (%)	26.0	25.2	24.6	24.3	24.7
Effective tax rate (%)	13.1	11.2	11.2	11.2	11.3
Revenue growth (%)	32.1	36.2	15.2	14.4	12.7
Net income growth (%)	29.6	32.3	12.3	13.3	14.5
EPS growth adj (%)	29.6	32.3	12.3	13.3	14.5
DPS growth (%)	22.5	42.9	16.5	13.3	14.5
<b>Efficiency ratios</b>					
ROE (%)	28.4	30.3	28.3	26.9	26.0
ROCE (%)	31.1	31.4	29.2	28.7	28.3
Asset turnover (x)	0.6	0.7	0.7	0.7	0.7
Op cash / EBIT (x)	1.0	0.9	1.1	1.2	1.2
Depreciation / CAPEX (x)	0.2	0.2	0.3	0.4	0.6
Accounts receivable days	121.8	115.0	114.3	111.8	109.3
Accounts payable days	166.4	172.4	174.4	175.9	178.3
<b>Leverage ratios</b>					
Net gearing (%)	1.6	12.9	12.0	2.1	(10.4)
Net debt / EBITDA (x)	(0.0)	(0.3)	(0.3)	(0.0)	0.3
Interest cover (x)	70.5	37.4	31.8	35.3	45.6
Current ratio (x)	1.4	1.3	1.3	1.4	1.6
<b>Valuation</b>					
PER (x)	30.6	21.3	18.9	16.7	14.6
EV/EBITDA (x)	21.8	15.5	13.0	10.9	9.3
PBR (x)	8.7	6.5	5.4	4.5	3.8
Dividend yield (%)	1.3	1.8	2.1	2.4	2.7

Source: Company, Bloomberg, CSCI Research estimates



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## Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

<b>Buy</b>	12-month absolute total return: $\geq 10\%$
<b>Hold</b>	12-month absolute total return: $> -10\%$ but $< 10\%$
<b>Sell</b>	12-month absolute total return: $\leq -10\%$

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