

# China / Hong Kong

## Flash Note

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DBS Group Research . Equity

12 Nov 2019

## AAC Technologies Holdings (2018 HK) : BUY

Mkt. Cap: US\$7,600m | 3m Avg. Daily Val: US\$60.4m

Last Traded Price ( 11 Nov 2019): HK\$48.80

Price Target 12-mth: HK\$56.00 (14.8% upside)

### Analyst

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### Company Guide



Summary of our point of view, and highlights the relevant data points, which are actively tracked

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## NDR takeaways: Optics business to hit inflection point in 1Q20

- **Optics: Segmental GPM to reach >40%, when AAC achieves monthly shipments of >60m, with ASP of >Rmb\$4.0 in 1Q20**
- **Acoustics: TWS business will accelerate clients' upgrade and GPM of speakers and receivers, versus negative perception of low margins**
- **Haptics: Haptics business for Android has just started, with shipment forecasts to be 15m in 2019 and grow multifold in 2020**
- **Reiterate BUY with TP of HK\$56**

### Forecasts and Valuation

FY Dec (RMB m)	2017A	2018A	2019F	2020F
Turnover	21,119	18,131	18,248	23,902
EBITDA	7,467	6,278	4,570	6,228
Pre-tax Profit	5,996	4,310	2,315	3,635
Net Profit	5,325	3,796	2,039	3,201
Net Profit Gth (Pre-ex) (%)	32.3	(28.7)	(46.3)	57.0
EPS (RMB)	4.35	3.11	1.67	2.62
EPS (HK\$)	4.85	3.47	1.86	2.93
EPS Gth (%)	32.6	(28.5)	(46.3)	57.0
Diluted EPS (HK\$)	4.85	3.47	1.86	2.93
DPS (HK\$)	1.98	1.39	0.75	1.17
BV Per Share (HK\$)	16.00	17.31	19.08	20.40
PE (X)	10.0	14.0	26.1	16.6
P/Cash Flow (X)	9.1	8.3	12.5	11.2
P/Free CF (X)	100.5	19.3	82.9	47.6
EV/EBITDA (X)	7.5	8.8	11.9	8.9
Net Div Yield (%)	4.1	2.9	1.5	2.4
P/Book Value (X)	3.0	2.8	2.6	2.4
Net Debt/Equity (X)	0.1	0.1	0.1	0.1
ROAE (%)	33.5	20.8	10.2	14.8

Earnings Rev (%):

Consensus EPS (RMB)

Other Broker Recs:

B:14

S:5

H:17

Source: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

### What's New

We hosted an NDR for AAC Technologies in Singapore on 11 November 2019. Investors were mostly interested in the outlook for (1) acoustics, (2) haptics, and (3) optics. Below are the key takeaways:

**Acoustics (45.5% of 3Q19 revenue).** Management disclosed that acoustics revenue contribution from Android clients already surpassed 50% in 4Q18. ASP of Super-linear structure's (SLS) Entry Version and Upgrade Version are >US\$1.20 and >US\$1.50 respectively, versus legacy products' <US\$0.50. The company indicated that SLS's gross profit margin (GPM) is at its corporate historical average level (which should mean c.40%). The margin decline was mainly because of legacy products, which have been seeing a double-digit ASP decline p.a. Therefore, SLS, which is expected to grow as a percentage of total Android acoustic shipments from 60% in 3Q19 to 65% in 4Q19, will drive segmental blended ASP, revenue, and margins.

As for market concerns about its venture into the low-margin true wireless stereo (TWS) business with GPM of c.15%, management explained that it is for more comprehensive acoustics solutions. This should accelerate clients' upgrade in speakers and receivers, and thus improve the ASP and GPM of speakers and receivers.

### Haptics and Precision Mechanics (39.3% of 3Q19 revenue).

Management stated that the bulk of its haptics revenue still comes from US clients. While its haptics revenue growth will still depend on US clients' haptics upgrade in 2020, its market share in 3Q19 has stabilised versus 1H19.



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There is huge potential for Android clients' haptics upgrade, as they have just started to upgrade to edge haptics in 2H19, of which shipments will be 15m in 2019 and grow multifold in 2020, with ASP of US\$1.00-1.50. While Android GPM is below corporate average (which should mean c.40%) currently, it is expected to improve to that level after scale increases.

**Optics and others (8.4% of 3Q19 revenue).** Investors questioned if segmental GPM could reach c.40% and 50%, when the company achieves monthly shipments of 60m and 100m respectively, as per the company's 3Q19 results conference call. Management clarified that a GPM of >40% will be attained, given monthly shipments of >60m, as well as one more mentioned condition which is ASP of >Rmb\$4.0. Management reiterated monthly plastic lens shipment to reach 60m and 100m by the end of 4Q19 and March/April 2020 respectively. As for ASP, management reiterated it to go up from current level of <Rmb4.0 to Rmb4.5 in March/April 2020 and c.Rmb5.0 in 2H20, with improving product mix from low-end 5P (DBS estimated ASP of c.Rmb3) to high-end 5P and low-end 6P (DBS estimated ASP of c.Rmb5-7) with improving yield rate.

Hybrid lens (plastic lens + glass lens based on wafer-level glass [WLG] technology) could be launched in FY20F, of which ASP is expected to be on par with high-end 6P and even 7P (DBS estimated ASP of c.Rmb10+), which will further drive ASP growth.

Market is concerned about its venture into the low-margin camera module (CCM) business with a GPM of only c.5-10%. Management does not treat it as separate business, but as integrated optics solutions for new optics products, especially high-margin WLG-based hybrid lens sets with a targeted GPM of c.40%, in which CCM suppliers have no experience. This is in line with our channel check that its yield rate hurdle was in the module process, which should be overcome by having its own assembly business.

**Reiterate BUY with TP of HK\$56.** We expect an inflection point in net profit to be reached in FY20F. We estimate revenue contribution from Android to increase from 41% in FY18 to 57% in FY19F. Therefore, we expect Android upgrades of: (1) haptics (edge haptics), (2) acoustics (super linear structure [SLS]), and (3) optics (hybrid lens) to drive AAC to resume growth in FY20F. We forecast net profit to resume growth of 57% in FY20F. AAC is trading at 17x FY20F PE, versus its 5-year trading band of 14-44x. We reiterate our BUY rating on AAC with a TP of HK\$56, based on 20x FY20F PE, which is 0.5SD below its 5-year average.

### Quarterly / Interim Income Statement (RMBm)

FY Dec	3Q2018	2Q2019	3Q2019	% chg_yoy	% chg_qoq
Revenue	4,869	3,815	5,012	2.9	31.4
Cost of Goods Sold	(3,065)	(2,860)	(3,529)	15.1	23.4
<b>Gross Profit</b>	<b>1,804</b>	<b>955</b>	<b>1,483</b>	<b>(17.8)</b>	<b>55.3</b>
Other Oper. (Exp)/Inc	(234)	(182)	(221)	(5.3)	21.6
<b>Operating Profit</b>	<b>1,571</b>	<b>773</b>	<b>1,262</b>	<b>(19.7)</b>	<b>63.2</b>
Other Non Opg (Exp)/Inc	55.3	93.8	51.9	(6.3)	(44.7)
Associates & JV Inc	0.0	0.0	0.0	nm	nm
Net Interest (Exp)/Inc	(57.7)	(57.9)	(60.5)	(4.9)	(4.5)
Exceptional Gain/(Loss)	0.0	0.0	0.0	nm	nm
<b>Pre-tax Profit</b>	<b>1,580</b>	<b>821</b>	<b>1,265</b>	<b>(19.9)</b>	<b>54.1</b>
Tax	(198)	(55.9)	(125)	(37.2)	122.8
Minority Interest	0.0	0.0	0.0	nm	nm
<b>Net Profit</b>	<b>1,394</b>	<b>777</b>	<b>1,153</b>	<b>(17.3)</b>	<b>48.3</b>
Net profit bef Except.	1,394	777	1,153	(17.3)	48.3
EBITDA	0.0	0.0	0.0	nm	nm
<b>Margins (%)</b>					
Gross Margins	37.1	25.0	29.6		
Opg Profit Margins	32.3	20.3	25.2		
Net Profit Margins	28.6	20.4	23.0		

Source: Company, DBS HK

## Flash Note

### Target Price & Ratings History



Source: DBS HK

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**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*\*Share price appreciation + dividends*

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