

AAC Technologies | 2018.HK

2Q13 results review

Rating	Buy	Maintain
Target Price	HKD 44.30	From 49.70
Current price	HKD 35.35	Upside +25%

2Q13 weaker-than-expected, but 3Q13E taking off again

AAC reported a slightly disappointing 2Q13 results, with 1.1% qoq revenue increase and 33.3% yoy net profit growth. Weaker-than-expected 2Q13 results is likely a function of soft high-end smartphone sales leading to order cuts from Apple's iPhone 5 and Samsung's Galaxy S4. However, management has guided double digit qoq sales growth in 3Q13E, which is believed to be achievable by Apple and Samsung's new product launch.

GPM expansion on new product launch and scale

GPM and NPM have only slightly risen to 42.8%/28.1% in 1Q13 from 42.7%/28.0% in 4Q12, of which expansion is slower-than-expected and not consistent with guidance of FY13E GPM stabilizing versus FY12. For 3Q13E, AAC has guided for a slight improvement in GPM, with new product launch and increasing scale. And the company has provided positive outlook on dual-speaker design trend (such as HTC's new One), which will provide GPM upside in future.

Saturating high-end smartphone market stimulates acoustic design upgrade

Market concerns AAC will slow down with the saturating high-end smartphone market. But instead, we believe moderate growth of high-end smartphones will stimulate acoustic design upgrade to differentiate themselves under stiff competition. Taking HTC as example, new HTC One has adopted dual front speaker solutions. We expect AAC's customers to refresh their acoustic design in FY14E, which support volume and ASP upside.

Reiterating BUY with lowering TP to HK\$44.30

We revise down our FY13/14/15E earnings by 13.2%/13.4%/10.5%, attributed to, 1) weaker-than-expected high-end smartphones' orders; and 2) slower-than-expected margin expansion. However, 3Q13E will take off again with Apple and Samsung's new product launch. And there will be another wave of innovations in FY14E. The company is trading at 14.7x FY13E PER, which is 28.2% lower than the average 20.5x of the peers. We reiterate BUY with TP lowering to HK\$44.30 from HK\$49.70 based on 18.5x FY13E PER.

Company update

20 August 2013

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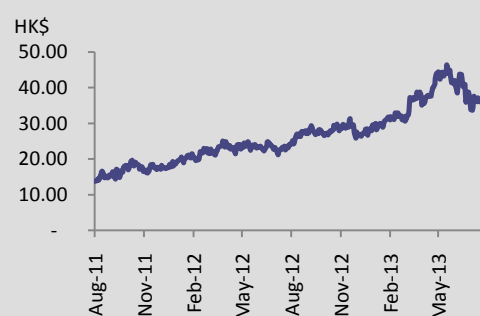
Trading data

52-Week Range (HK\$)	23.65/47.95
3 Mth Avg Daily Vol (m)	6.51
No of Shares (m)	1,228.00
Market Cap (HK\$m)	43,409.80
Major Shareholders (%)	Benjamin Pan (43%)
Auditors	Deloitte
Result Due	3Q13: Nov

Company description

Founded in 1993, AAC Technologies is the leading miniature acoustic component supplier for handheld devices with 30% global market share. Currently Apple and Nokia are its key customers. About 60% sales are generated by smartphone and tablet related business.

Price chart



RMB million	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue	4,060	6,283	8,479	10,777	12,643
Net Profit	1,036	1,763	2,324	2,935	3,460
Consensus NP			2,313	2,738	3,151
EPS (RMB)	0.84	1.44	1.89	2.39	2.82
P/E (x)	33.1	19.4	14.7	11.7	9.9

Sources: Bloomberg, CIRL estimates

2Q13 weaker-than-expected, but 3Q13E taking off again

AAC reported a slightly disappointing 2Q13 results, with 1.1% qoq revenue increase (1.9% below consensus) and 33.3% yoy net profit growth (0.3% below consensus). Weaker-than-expected 2Q13 results is likely a function of soft high-end smartphone sales leading to order cuts from Apple (AAPL.US)'s iPhone 5 and Samsung (5930.KS)'s Galaxy S4.

For 3Q13E, management has guided double digit qoq sales growth, which is believed to be achievable by the launch of Apple's iPhone 5S/ iPhone 5C/ iPad 5 and Samsung's Note 3, and continued momentum from Chinese customers.

GPM expansion on new product launch and scale

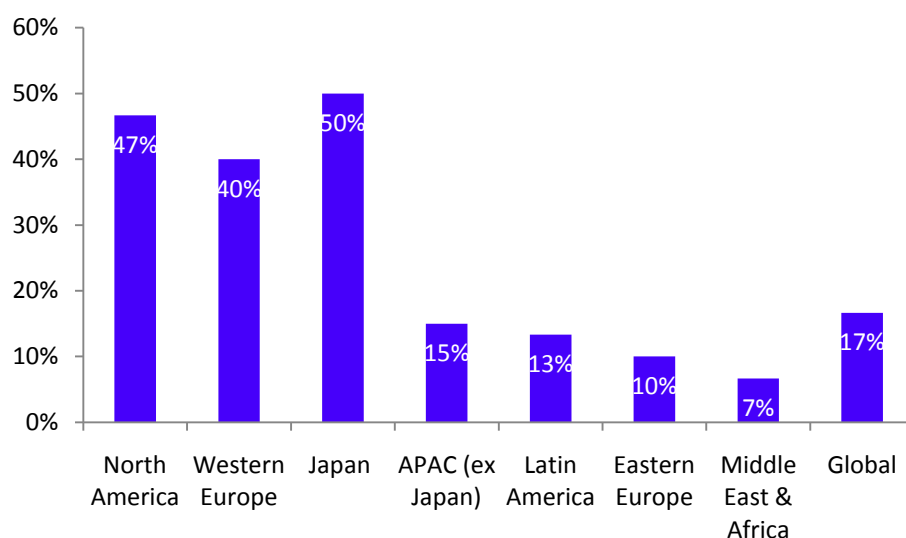
GPM and NPM have only slightly risen to 42.8%/28.1% in 1Q13 from 42.7%/28.0% in 4Q12, of which expansion is slower-than-expected and not consistent with guidance of FY13E GPM stabilizing versus FY12.

For 3Q13E, AAC has guided for a slight improvement in GPM, with new product launch and increasing scale. And the company has provided positive outlook on dual-speaker design trend (such as HTC (2498.TT)'s new HTC One), which will provide GPM upside in future.

Saturating high-end smartphone market stimulates acoustic design upgrade

High-end smartphones has started to saturate, on the back of high penetration rate of 40.0%-50.0% in developed markets such as North America and Western Europe, and slow innovation curve delaying replacement sales. The incremental growth will be come from new adoption demand in emerging markets with low penetration rates of 7%-15%.

Exhibit 1: 2012 smartphones penetration



Source: IDC, CIRL

Therefore, smartphone share shift towards the low-end. The smartphone shipment at ASP of >USD400 ASP has delivered CAGR of 75.9% in 2010-2012, but will see moderate CAGR of 13.7% in 2012-2015. Smartphone volumes at ASP of USD200-USD400 will also only deliver CAGR of 10.5% in 2012-2015. It is because of the continued shift towards low-end smartphones at ASP <USD200, which will deliver CAGR of 64.6% in 2012-2015.

Market concerns AAC will slow down with the saturating high-end smartphone market, in which it has >40.0% market share. But instead, we believe moderate growth of high-end smartphones will stimulate acoustic design upgrade to differentiate themselves under stiff competition. Taking HTC as example, new HTC One has adopted dual front speaker solutions. We expect AAC's customers to refresh their acoustic design in FY14E, which support volume and ASP upside.

Exhibit 2: Smartphones shift towards the low-end

	2010	2011	2012	2013E	2014E	2015E	2012-2015
Price (USD)							CAGR
<= \$100	7	5	7	21	57	146	175%
\$100 - \$200	74	82	129	221	378	460	53%
\$200 - \$300	74	112	179	213	240	256	13%
\$300 - \$400	49	84	104	122	133	126	7%
\$400 - \$500	43	71	102	138	160	187	22%
\$500+	53	119	195	259	250	249	8%
Total	300	473	716	974	1,218	1,424	26%

Source: CIRL

Exhibit 3: HTC promoting its dual front speakers function.


Source: HTC, CIRL

As for the fast growing low-end segment, AAC currently has only minimal market share. However, management is confident to gain share in the low end smartphone segment and maintain its margins, due to cost advantage with increasing scale and automation level. We believe low-end market growth and AAC's share growth will bring incremental profit.

Reiterating BUY with lowering TP to HK\$44.30

We revise down our FY13/14/15E earnings by 13.2%/13.4%/10.5% to RMB2,324.2mn/ RMB2,935.0mn/RMB3,459.9mn, mainly attributed to,

- 1) Soft high-end smartphone sales leading TO order cuts for Apple's iPhone 5 and Samsung's Galaxy S4; and
- 2) Slower-than-expected margin expansion owing to volume scaling up in a slower-than-expected pace.

Exhibit 4: Revising up earnings forecast

	FY13E (new)	FY13E (old)	Diff	FY14E (new)	FY14E (old)	Diff	FY15E (new)	FY15E (old)	Diff
Revenue	8,479	9,397	-9.8%	10,777	11,944	-9.8%	12,643	14,012	-9.8%
Net Profit	2,634	2,990	-11.9%	3,326	3,799	-12.4%	3,920	4,358	-10.0%
EPS (RMB)	2,324	2,678	-13.2%	2,935	3,387	-13.4%	3,460	3,865	-10.5%

Source: Company data, CIRC

However, 3Q13E results will take off again with Apple and Samsung's new product launch. And despite saturating high-end smartphone market, we expect AAC's customers to refresh their acoustic design such as dual-speaker design in FY14E, which support volume and ASP upside. The company is trading at 14.7x FY13E PER, which is 28.2% lower than the average 20.5x of the peers. We reiterate BUY with TP lowering to HK\$44.30 from HK\$49.70 based on 18.5x FY13E PER, representing 10% discount to its peers.

Exhibit 5: Peer comparison

		Market cap	PE (x)			PB (x)			Dividend yield (%)		
	Ticker	(HKD mn)	FY12A	FY13E	FY14E	FY12A	FY13E	FY14E	FY12A	FY13E	FY14E
China acoustic component vendors											
Goertek Inc -A	002241 CH	80,343.7	69.7	44.3	32.0	12.5	6.6	5.9	0.5	0.4	0.6
Average			69.7	44.3	32.0	12.5	6.6	5.9	0.5	0.4	0.6
Global acoustic component vendors											
Foster Electric	6794 JT	3,346.0	29.4	11.3	9.0	1.0	1.1	0.9	1.8	1.5	2.3
Plantronics Inc	PLT US	14,984.2	17.7	15.9	15.3	3.5	-	2.6	0.5	0.9	0.9
Dover Corp	DOV US	115,341.9	19.5	16.1	14.6	3.1	2.9	2.6	1.5	1.7	1.8
Merry Electron	2439 TT	3,172.4	25.1	15.2	12.6	2.6	2.4	2.3	2.7	3.3	4.4
Average			22.9	14.6	12.9	2.6	2.1	2.1	1.6	1.8	2.3
Aac Technologies	2018 HK	43,409.8	19.4	14.7	11.7	5.6	4.7	3.9	2.1	2.7	3.4

Source: Bloomberg, CIRC

Exhibit 6: Quarterly financials

	3Q11A	4Q11A	1Q12A	2Q12A	3Q12A	4Q12A	1Q13A	2Q13E
Income statement (RMBmn)								
Revenues	1,045	1,132	1,192	1,397	1,697	1,997	1,905	1,926
Cost of goods sold	(585)	(629)	(680)	(783)	(950)	(769)	(1,090)	(893)
Gross profit	460	503	512	613	747	901	814	825
SG&A	(78)	(62)	(61)	(49)	(138)	(99)	(86)	(97)
R&D	(96)	(120)	(97)	(96)	(122)	(146)	(148)	(137)
Operating profits	286	321	355	468	487	656	580	592
Interest expenses	(1)	(2)	(2)	(3)	(4)	(3)	(3)	(3)
Share of associates earnings	3	(19)	(2)	(14)	41	37	10	6
Pre tax profit	288	300	351	451	524	363	587	387
Tax	(28)	(36)	(38)	(46)	(52)	(122)	(54)	(55)
Minority interest	1	1	2	2	1	2	1	1
Net profit	262	265	314	406	473	243	534	333
As % of sales								
Gross profit	44.0%	44.5%	43.0%	43.9%	44.0%	45.2%	42.7%	42.8%
SG&A	-7.5%	-5.5%	-5.1%	-3.5%	-8.1%	-5.0%	-4.5%	-5.0%
R&D	-9.2%	-10.6%	-8.1%	-6.9%	-7.2%	-7.3%	-7.8%	-7.1%
Operating profits	27.4%	28.3%	29.7%	33.5%	28.7%	32.9%	30.4%	30.7%
Net profit	25.1%	23.4%	26.3%	29.1%	27.9%	12.2%	28.0%	17.3%
Growth qoq / yoy								
Revenues	14.6%	8.3%	5.3%	17.1%	21.5%	17.6%	-4.6%	1.1%
Gross profit	15.2%	9.4%	1.8%	19.7%	21.8%	20.7%	-9.7%	1.4%
Operating profits	10.4%	12.1%	10.5%	32.1%	4.1%	34.6%	-11.6%	2.1%
Net profit	10.4%	1.0%	18.6%	29.3%	16.5%	-48.6%	119.6%	-37.6%

Source: Company data, CIRC

Exhibit 7: Financial statement
Income statement

Year to Dec (RMB mn)	FY11A	FY12A	FY13E	FY14E	FY15E
Revenue	4,060	6,283	8,479	10,777	12,643
Gross profit (reported)	1,751	2,774	3,667	4,630	5,435
EBITDA	1,410	2,293	2,986	3,714	4,358
Depreciation	(243)	(326)	(352)	(388)	(438)
EBIT	1,166	1,966	2,634	3,326	3,920
Net interest income (exp.)	(6)	(12)	(13)	(17)	(19)
Associates	(19)	61	37	47	55
Exceptionals/others	0	0	0	0	1
Profit before tax	1,142	2,016	2,658	3,356	3,956
Tax expenses	(109)	(259)	(341)	(431)	(508)
Minority interest	3	6	8	10	12
Net profit	1,036	1,763	2,324	2,935	3,460
Dividends	-416	-707	-932	-1,177	-1,387

Balance sheet

Year to Dec (RMB mn)	FY11A	FY12A	FY13E	FY14E	FY15E
Cash & equiv	1,375	1,320	2,193	2,687	3,846
Trade receivables	1,178	1,854	2,157	2,840	2,906
Other receivables	0	0	0	0	0
Inventories	559	958	1,216	1,686	1,871
Other current assets	313	476	476	476	476
Fixed assets	2,697	3,624	4,419	5,524	6,621
Intangible assets	174	156	156	156	156
Investment, associates etc	418	538	575	622	676
Total assets	6,714	8,926	11,191	13,990	16,552
Account payables	432	809	875	1,253	1,217
Other payables	0	0	0	0	0
Short-term debt	891	1,575	2,389	3,217	3,889
Other current liabs	564	367	593	683	760
Long-term debts	0	9	9	9	9
Deferred tax and others	16	35	35	35	35
Other long-term liabs	0	0	0	0	0
Total liabilities	1,903	2,796	3,902	5,198	5,910
Share capital	100	100	100	100	100
Reserves	4,650	5,979	7,146	8,659	10,521
Shareholders' equity	4,750	6,078	7,245	8,759	10,621
Minorities	61	52	44	34	22
Total equity	4,811	6,130	7,289	8,793	10,643
Net cash (debt)	484	-265	-206	-539	-53

Cash flow

Year to Dec (RMB mn)	FY11A	FY12A	FY13E	FY14E	FY15E
Pre-tax profit	1,142	2,016	2,658	3,356	3,955
Taxes paid	(70)	(202)	(115)	(341)	(431)
Depreciation	236	326	352	388	438
Associates	19	(61)	(37)	(47)	(55)
CFO bef. WC change	1,327	2,079	2,858	3,356	3,908
Change in working cap	(375)	(1,095)	(495)	(775)	(288)
Cashflow from operation	952	984	2,363	2,582	3,620
CAPEX	(1,182)	(1,253)	(1,147)	(1,493)	(1,536)
Free cash flow	(230)	(270)	1,216	1,088	2,084
Dividends	(416)	(707)	(932)	(1,177)	(1,387)
Balance sheet adj.	(181)	(41)	0	0	0
Share issued	19	269	(225)	(245)	(210)
Others	0	0	0	0	0
Net cash flow	(809)	(749)	59	(333)	487
Net cash (debt) start	1,292	484	(265)	(206)	(539)
Net cash (debt) at year-end	484	-265	-206	-539	-53

Ratios

Year to Dec	FY11A	FY12A	FY13E	FY14E	FY15E
Growth rate (%)					
Revenue	21.2	54.8	35.0	27.1	17.3
EBITDA	8.5	62.6	30.3	24.4	17.3
EBIT	5.9	68.6	34.0	26.3	17.9
Net profit	5.0	70.1	31.9	26.3	17.9
Fully diluted EPS	5.0	70.1	31.9	26.3	17.9
Margins (%)					
Gross margin (reported)	43.1	44.2	43.2	43.0	43.0
EBITDA	34.7	36.5	35.2	34.5	34.5
EBIT	28.7	31.3	31.1	30.9	31.0
Net margin	25.5	28.1	27.4	27.2	27.4
Other ratios					
ROE (%)	21.5	28.8	31.9	33.4	32.5
ROA (%)	15.4	19.7	20.8	21.0	20.9
Net gearing (%)	(10.1)	4.3	2.8	6.1	0.5
Interest coverage (x)	211.5	163.4	202.3	201.0	201.9
Receivables days	97.8	88.1	86.3	84.6	82.9
Payables days	64.9	64.5	63.9	63.2	62.6
Inventory days	71.3	78.9	82.4	86.2	90.1
Effective tax rate (%)	9.5	12.8	12.8	12.8	12.8

Source: CIRC

Rating Policy

	Rating	Definition
Stock Rating	Buy	Outperform HSI by 15%
	Neutral	Between -15% ~ 15% of the HSI
	Sell	Underperform HSI by -15%
Sector Rating	Accumulate	Outperform HSI by 10%
	Neutral	Between -10% ~ 10% of the HSI
	Reduce	Underperform HSI by -10%

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Analyst Certification

I, Susanna Chui hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was / were, is / are or will be directly or indirectly, related to the specific recommendations or views expressed in this report / note.

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