

AAC Technologies (2018.HK)

Non-acoustic products continue to grow

Hong Kong | TMT | Company report

19 November 2015

The revenue of AAC Technology in the first three quarters of 2015 increased by 36.51% yoy, to RMB 7.891 billion; while gross profit and net profit in the period under review increased by 36.38% (to RMB 3.278 billion) and by 37.06% (to RMB 2.096 billion) respectively. The EPS in the first three quarters amounted to RMB 1.71. Main reasons of the increase in revenue lie on the technological upgrade of the Company's products and the new solutions for clients causing an increase of orders of both acoustic and non-acoustic products. Domestic clients' demand for upgrading speakers kept recovering. The excellent sales performance of Apple iPhone6S/6S+ and Apple Watch boosted the business expansion of haptics faster than expected. The proportion of non-acoustic business has exceeded 40% of the revenue.

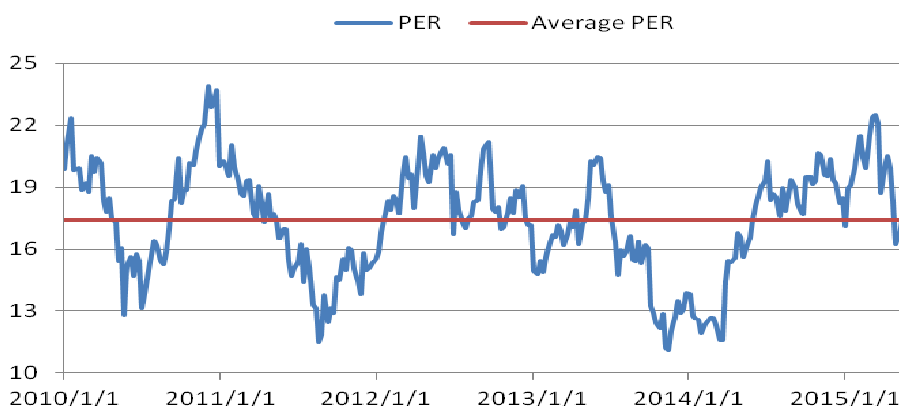
With the need of brand development by domestic mobile phone producers, the enhancement of acoustic devices would continue, so that the prices and profitability of related products may improve as a result. In the aspect of acoustic device production, AAC Technologies will not only gain from the consistent growth of proportion of Chinese clients in the global market, but also be benefitted from the extension of the Company's technology from high-end mobile phones to mid-/low-end ones.

The non-acoustic products continue to grow. We expect that flagship products launched by producers of mobile phones with Android system, which include smart phones, tablet PCs and wearable devices will still be extensively equipped with haptics. As AAC is the leading company in the production of haptics, it is expected that CAGR of the income from haptics would exceed 30%. Moreover, the Company's RF antenna integrated solutions is getting popularity among domestic clients, and it will become the key momentum of growth.

The prospect still bright

Historically, the business performance of AAC Technologies demonstrated seasonal features. This year the Company is benefitted from the driving force of high unit-priced non-acoustic products, the results in H2 may further beat expectation. Having considered the upgrade of acoustic equipment and the leading advantages of non-acoustic products, we keep our optimistic view towards the development of the Company. Since the Company produced speaker devices for smart phones, the Company's valuation ranged between 11x to 22x of P/E, with average of 17.4x. Taking into account of the development prospect with persistent growth, we grant the Company a valuation corresponding to 18x of 2015e EPS, with the target price of HKD54.64, and the rating of "Hold". (Closing price as at 17 Nov 2015)

Historical P/E valuation



Source: Bloomberg, Phillip Securities (HK) Research

Neutral (Downgrade)

CMP: HKD 55.05

(Closing price as at 17 Nov 2015)

TARGET: HKD 54.64 (-0.7%)

COMPANY DATA

O/S SHARES (MN) :	1,228
MARKET CAP (HKDMN) :	61,461
52 - WK HI/LO (HKD):	60/ 34

SHARE HOLDING PATTERN , %

Pan Zhengmin :	40.34
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PRICE PERFORMANCE , %

	1M	3M	1Y
AAC	17.62	30.67	27.33
HSI	22.20	38.24	34.83

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

CNY mn	FY13	FY14	FY15E	FY16E
Net Sales	8096	8879	11584	13692
Net Profit	2578	2318	3056	3601
EPS, CNY	2.10	1.89	2.49	2.93
PER, x	21.5	23.9	18.1	15.4
BVPS, CNY	6.46	7.44	8.97	10.73
P/BV, x	7.0	6.1	5.0	4.2
ROE, %	36.9	27.1	30.2	29.8
Debt/Equity (%)	34.61	44.46	42.86	42.86

Source: Company reports, Phillip Securities Est.

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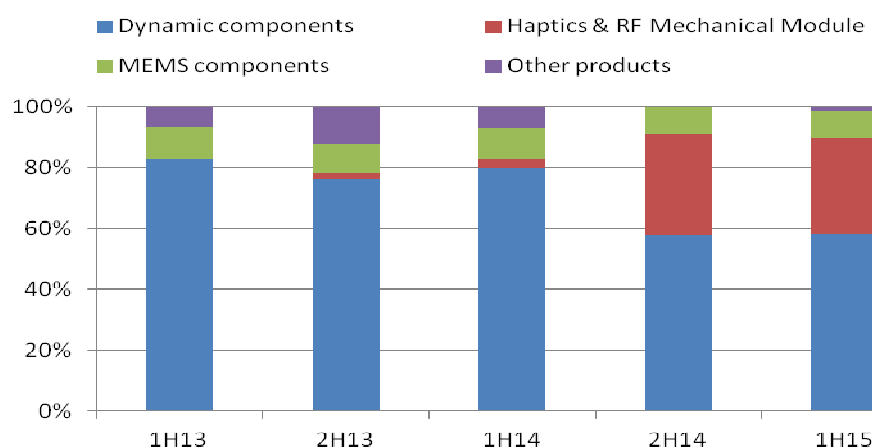
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Q3 results beat expectation

The revenue of AAC Technology in the first three quarters of 2015 increased by 36.51% yoy, to RMB 7.891 billion; while gross profit and net profit in the period under review increased by 36.38% (to RMB 3.278 billion) and by 37.06% (to RMB 2.096 billion) respectively. The earning per share in the first three quarters amounted to RMB 1.71. In Q3, the Company recorded the revenue of RMB 3.18 billion, up 32.5% qoq; while net profit in Q3 increased by 33.2% qoq, to RMB 851 million. The earning per share in Q3 was RMB 0.69.

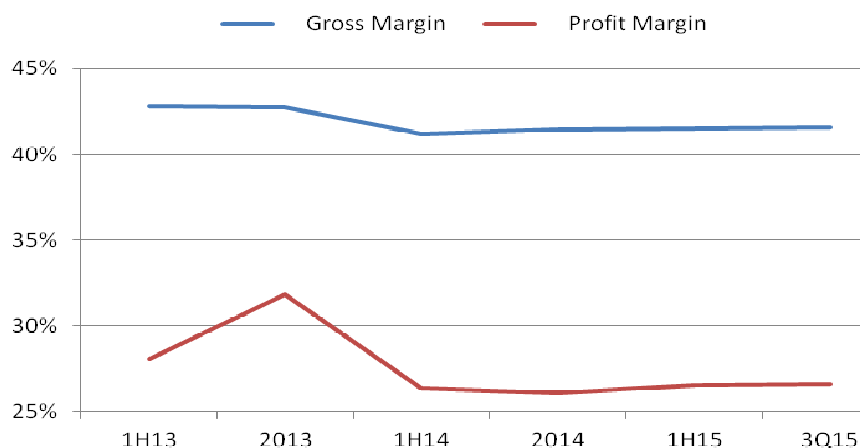
Overall, the business of the Company consistently demonstrated strong growth which beat market expectation. Main reasons of the increase in revenue lie on the technological upgrade of the Company's products and the new solutions for clients causing an increase of orders of both acoustic and non-acoustic products. Domestic clients' demand for upgrading speakers kept recovering. The excellent sales performance of Apple iPhone6S/6S+ and Apple Watch boosted the business expansion of haptics faster than expected. The proportion of non-acoustic business has exceeded 40% of the Company's revenue. In terms of profitability, the Company's gross profit margin in Q3 raised by 0.1 ppts qoq, to 41.6%, which reflected the enhancement of the Company's product structure.

Sales breakdown of AAC



Source: Company reports, Phillip Securities (HK) Research

The earning capabilities keep high



Source: Company reports, Phillip Securities (HK) Research

Acoustic products kept upgrading

Even though the market of smart phones is heading towards its ceiling, among the signature high-end models by producers like Huawei, Xiaomi etc., the new generation of speaker devices with better acoustic performance and new features (for example, waterproof function) has become more and more well-received by consumers. Some of the high unit price speaker devices supported the income growth of acoustic business of the Company. In our views, with the need of brand development by domestic mobile phone producers, the enhancement of acoustic devices would continue, so that the prices and profitability of related products may improve as a result. In the aspect of acoustic device production, AAC Technologies will not only gain from the consistent growth of proportion of Chinese clients in the global market, but also be benefitted from the extension of the Company's technology from high-end mobile phones to mid-/low-end ones. Moreover, the Company started production plants in Vietnam since 2014, with the number of staffs expanded 10 times from the initial number of 350. Diversification of production base can also serve to lower production cost, and thus enhance profitability.

Non-acoustic products continue to grow

Pressure-touch and haptics are becoming the key trend for interaction between users and phone devices. Benefitted from the outstanding performance of haptics, non-acoustic products can almost contribute half of the Company's revenue. Even though Apple cut the number of orders for components in Q4, it is expected that flagship products launched by producers of mobile phones with Android system, which include smart phones, tablet PCs and wearable devices will still be extensively equipped with haptics. As AAC is the leading company in the production of haptics, it is expected that CAGR of the income from haptics would exceed 30%.

Moreover, the Company's RF antenna integrated solutions is getting popularity among domestic clients, and it will become the key momentum of growth. Although the Company entered the market of mobile phone metal casing at a later stage, it can provide integrated solutions which include metal casing and RF antenna. Meanwhile, most of the Chinese OEM producers in this aspect have inadequate resources on research and development. Therefore, the gross profit margin of business of integrated solutions was as high as 40%, and the Company just ranked second only to Catcher Technology.

Catalyst

Better-than-expected development of non-acoustic business;
Better-than-expected growth of domestic customers.

Risk

Worse-than-expected decline of orders from Apple;
Intensified market competition and decline of selling prices of products.

Financials

Periodicity:	2012	2013	2014	2015F	2016F
Valuation ratios					
Price Earnings	31.4x	21.5x	23.9x	18.1x	15.4x
Price to Book	9.1x	7.0x	6.1x	5.0x	4.2x
Dividend Yield	1.3%	1.9%	1.7%	2.2%	2.6%
Per share data(RMB)					
EPS Adjusted	1.44	2.10	1.89	2.49	2.93
Book Value Per Share	4.95	6.46	7.44	8.97	10.73
Dividends Per Share	0.57	0.86	0.76	1.00	1.18
Growth & Margin					
Revenue growth	54.76%	28.86%	9.67%	30.47%	18.20%
Gross profit growth	55.47%	24.68%	6.33%	30.96%	18.54%
Net profit growth	73.27%	46.26%	-10.09%	31.82%	17.86%
Gross Margin	44.2%	42.7%	41.4%	41.6%	41.7%
Operating Margin	31.1%	31.3%	29.4%	29.0%	29.1%
Net Profit Margin	28.1%	31.8%	26.1%	26.4%	26.3%
Dividend Payout Ratio %	40.1%	41.0%	40.3%	40.2%	40.2%
Key ratios					
Return on Assets	22.5%	26.3%	19.4%	21.1%	24.3%
Return on Equity	32.6%	36.9%	27.1%	30.2%	29.8%
Effective Tax Rate	12.8%	9.3%	10.5%	9.5%	9.5%
Liability ratio	31.32%	25.71%	30.78%	30.00%	30.00%
Income Statement(RMB:mn)					
Revenue	6,283	8,096	8,879	11,584	13,692
- Cost of Goods Sold	3,509	4,637	5,201	6,767	7,983
Gross Income	2,774	3,459	3,678	4,817	5,710
- Selling, General & Admin Expenses	893	1,015	1,184	1,581	1,855
Operating Income	1,952	2,534	2,609	3,360	3,989
- Interest Expense	12	12	14	15	15
- Foreign Exchange Losses (Gains)	-45	-46	4	-30	-5
- Net Non-Operating Losses (Gains)	-30	-267	10	8	10
Pretax Income	2,016	2,835	2,581	3,367	3,969
- Income Tax Expense	259	263	270	320	377
Income Before XO Items	1,757	2,572	2,310	3,048	3,592
- Minority Interests	-6	-6	-7	-8	-9
Net Profit	1,763	2,578	2,318	3,056	3,601

Source: Company reports, Phillip Securities (HK) Research Estimates
(Financial figures as at 17 Nov 2015)

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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