

AAC Tech (2018 HK)

Improving business model; BUY

- We forecast AAC Tech's ("the Company" or "AAC") 2021E revenue to grow by 24.9% based on increased 5G smartphone contribution and its rising market share
- We forecast gross margin to go up by 4.7ppt YoY to 29.4% in 2021E on increased contributions of high-end products and optics business
- Net profit margin to benefit from higher gross margin and economies of scope
- Recommend **BUY** and TP of HK\$58.0, which implies 20.2x/17.2x 2021-22E P/E

We expect revenue to grow by 24.9% YoY in FY21E. AAC's revenue is expected to be driven by optics business, rebounding smartphone shipments, and high-end product demand. The Company's market share will improve through increasing the varieties of electronic products with distinguishing features.

2021E gross profit margin to improve 4.7ppt. AAC's gross margin is expected to benefit from better product mix, optics business growth, and cost optimization. Increasing 5G smartphone demand in the mix can boost its high-end component shipments.

We revise up net profit in 2021E-22E by 57.7%/ 54.3%, respectively. We expect the R&D expenses/ revenue ratio to decline in 2021E because R&D expenses for the optics business will decrease. Net profit in 2021E would jump 93.9% YoY due to improved gross margin and lower R&D expenses/ revenue ratio.

Valuation. We recommend **BUY** with TP of HK\$58.0, which represents 20.2x/17.2x 2021-22E P/E.

Risks: (1) Chip shortage may affect business; (2) Sino-US trade tension add to uncertainty; (3) Optics business development may slow; (4) Slowdown in smartphone shipment growth may decrease revenue.

Results and Valuation

FY ended Dec 31	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	17,884	17,140	21,414	25,038	27,624
Chg (% YoY)	(1.4%)	(4.2%)	24.9%	16.9%	10.3%
Net profit (RMB mn)	2,222	1,507	2,921	3,432	3,889
Chg (% YoY)	(41.5%)	(32.2%)	93.9%	17.5%	13.3%
EPS (RMB)	1.836	1.247	2.417	2.840	3.218
Chg (% YoY)	(40.9%)	(32.1%)	93.9%	17.5%	13.3%
BPS (RMB)	15.999	18.056	20.032	22.345	24.931
Chg (% YoY)	3.3%	12.9%	10.9%	11.5%	11.6%
P/E (x)	22.5	31.2	16.1	13.7	12.1
P/B (x)	2.6	2.2	1.9	1.7	1.6
ROAE (%)	11.6%	7.4%	13.1%	13.8%	14.0%
ROAA (%)	6.9%	4.1%	7.4%	8.2%	8.5%
DPS (RMB)	0.4	0.3	0.5	0.6	0.7
Dividend Yield (%)	0.9%	0.7%	1.3%	1.5%	1.7%

*Exchange rate assumption for FY21E-23E: HKD 1 = RMB 0.84

Source(s): Bloomberg, ABCI Securities estimates

Company Report

May 26, 2021

Rating: BUY

TP: HK\$ 58.0

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Share price (HK\$)	46.35
Est. share price return	25.1%
Est. dividend yield	1.3%
Est. total return	26.4%
Previous rating & TP	SELL; HK\$40.0
Previous report date	Aug 31, 2020

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L(HK\$)	63.95/37.80
Issued shares (mn)	1,208.5
Market cap (HK\$ mn)	56,014.0
Avg daily turnover (HK\$ mn)	1,670.0
Major shareholder(s)	
WU Ingrid Chun Yuan	40.7%
JP Morgan	12.9%
GIC Private Ltd.	6.0%

Source(s): Bloomberg

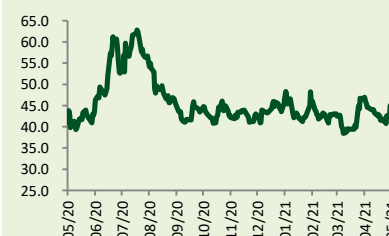
Share Performance (%)

	Absolute	Relative*
1-mth	(6.9)	(5.1)
3-mth	(10.4)	(16.2)
6-mth	(19.5)	(34.6)

*Relative to HSI

Source(s): Bloomberg

Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities estimates



Revenue is expected to grow 24.9% YoY in 2021E

AAC's 1Q21 net profit grew significantly by 909.6% due the low base in 1Q20; on a QoQ basis, the figure dropped 30.0%. Compared to 1Q19, AAC's net profit grew 23.1%.

Acoustic business revenue was up 47.5% YoY in 1Q21, thanks to its increasing share in the Android smartphone market. Optic business revenue surged 175.7 YoY in 1Q21, driven by rising Android smartphone demand. AAC will expand the high-end optics lens market with the launch of high-end hybrid lens. MEMS product revenue grew 42.2% YoY in 1Q21, benefiting from true wireless stereo earphone shipments. We expect AAC to benefit from better shipments of optics business and increasing 5G smartphone contributions amid chip shortage. We revise up 2021-22E revenue forecast by 1.5%/ 7.3%, respectively.

AAC's revenue is expected to improve in 2021E, driven by prospering optics business and rising 5G smartphone contributions despite chip shortage. We revise up 2021E-22E revenue forecast by 1.5%/ 7.3%, respectively.

Exhibit 1: AAC's 1Q21 financial analysis

RMB mn	1Q21	Compared to 1Q20	Compared to 1Q19	Compare to 4Q20
Total revenue	4,292	20.6%	14.4%	(10.3%)
Gross profit	1,337	62.5%	18.4%	(0.4%)
Gross margin	31.1%	8.0ppt	1.0ppt	3.0ppt
Net profit	532	909.6%	23.1%	(30.0%)
Net profit margin	12.4%	10.9ppt	0.9ppt	(3.5ppt)

Source(s): Company

Gross profit is expected to grow margin to improve 4.7ppt YoY in 2021E

Gross margin improved 8.0ppt YoY to 31.1% in 1Q21. Compared to 1Q19, 1Q21 gross margin grew by 1.0ppt. We expect AAC's product mix will improve with higher product shipments for 5G smartphones. Gross margin in 2021E is expected to improve on better product mix, increased optics business contribution, cost optimization. We forecast gross margin to go up by 4.7ppt/ 0.4ppt to 29.4%/29.8% in 2021-22E.

Exhibit 2: AAC's gross profit margin analysis

	FY19A	FY20A	FY21E	FY22E	FY23E
Dynamic components	31.0%	27.9%	33.7%	34.2%	34.9%
Electromagnetic drives and precision mechanics	29.6%	23.8%	26.8%	27.0%	27.3%
Optics products	1.7%	18.8%	28.5%	29.3%	30.0%
MEMS components	27.5%	17.5%	17.3%	17.5%	17.7%
Other products	73.2%	(48.7%)	(40.0%)	(35.0%)	(33.0%)
Overall gross profit margin	28.6%	24.7%	29.4%	29.8%	30.3%

Source(s): Company, ABCI Securities estimates



Exhibit 3: AAC's product mix (% to revenue)

	FY19A	FY20A	FY21E	FY22E	FY23E
Dynamic components	45.7%	44.1%	43.1%	41.8%	41.4%
Electromagnetic drives and precision mechanics	43.0%	39.9%	38.2%	36.9%	36.0%
Optics products	6.0%	9.5%	12.6%	15.4%	17.0%
MEMS components	5.2%	6.4%	6.0%	5.8%	5.6%
Other products	0.1%	0.1%	0.1%	0.1%	0.1%

Source(s): Company, ABCI Securities estimates

Exhibit 4: Changes in our financial estimates

(RMB mn)	OLD			NEW			CHANGE		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	21,092	23,333	N/A	21,414	25,038	27,624	1.5%	7.3%	N/A
Net Profit	1,852	2,223	N/A	2,921	3,432	3,889	57.7%	54.4%	N/A

Source(s): Company, ABCI Securities estimates

Valuations

Recommend BUY with TP at HK\$58.0

We derive the Company's TP at HK\$58.0, based on the DCF analysis (WACC: 12.1%; perpetuity growth rate: 2.6%). The TP represents 20.2x/17.2x 2021-22E P/E. We recommend BUY with 25.1% upside potential.

Exhibit 5: Peer comparison

Ticker	Price*	P/E				P/B				ROE	ROA	EV/EBITDA	
		19A	20A	21E	22E	19A	20A	21E	22E	21E	21E	21E	
HK Listed													
FIH Mobile Ltd	2038 HK	1.14	n.a.	8.3	6.7	n.a.	0.5	0.6	0.5	n.a.	4.5	1.1	0.4
AAC Technologies	2018 HK	46.35	17.0	16.7	20.0	17.5	1.9	1.8	1.7	1.5	11.4	6.5	8.5
Comba Telecom	2342 HK	1.92	49.0	21.6	15.8	15.8	2.1	1.8	1.6	1.6	5.9	2.0	n.a.
Q Technology	1478 HK	12.66	17.5	14.3	10.9	10.3	3.3	2.9	2.1	2.0	21.0	5.9	8.0
Cowell e Holdings	1415 HK	4.10	7.8	7.5	5.5	5.0	0.6	0.6	0.5	0.4	10.3	5.5	1.8
Average			22.8	13.7	11.8	12.2	1.7	1.5	1.3	1.4	10.6	4.2	4.7
A-shr													
Goertek Inc	002241 CH	40.58	49.0	31.0	24.0	20.0	3.0	2.9	2.5	2.3	11.0	5.5	16.6
Lens Technology	300433 CH	29.01	28.0	20.0	17.0	13.0	3.3	3.0	2.6	2.0	15.0	7.7	10.5
Luxshare	002475 CH	39.79	40.5	37.0	27.0	22.0	11.5	8.5	7.0	5.5	25.3	11.3	25.5
Average			43.3	29.3	22.7	18.3	5.9	4.8	4.0	3.3	17.1	8.2	17.5

*Based on closing price on May 25, 2021

Source(s): Bloomberg, ABCI Securities



Consolidated income statement (2019A-2023E)

FY Ended Dec 31 (RMB mn)	2019A	2020A	2021E	2022E	2023E
Acoustics business revenue	8,167	7,560	9,223	10,468	11,410
Electromagnetic drives & precision mechanics business revenue	7,694	6,847	8,183	9,246	9,940
Optics business revenue	1,070	1,634	2,697	3,856	4,705
MEMS business revenue	929	1,083	1,294	1,449	1,550
Others	24	16	17	18	19
Total revenue	17,884	17,140	21,414	25,038	27,624
Cost of goods sold	(12,777)	(12,913)	(15,127)	(17,584)	(19,248)
Gross profit	5,107	4,227	6,287	7,454	8,376
Other income	247	502	578	618	649
R&D costs	(1,717)	(1,920)	(2,184)	(2,604)	(2,901)
Distribution and selling expenses	(275)	(285)	(343)	(426)	(470)
Administrative expenses	(643)	(672)	(792)	(926)	(1,022)
Others	19	0	0	0	0
Exchange (loss) gain	63	148	89	53	32
Finance cost	(248)	(353)	(289)	(239)	(211)
Profit before tax	2,552	1,648	3,345	3,930	4,453
Tax	(330)	(147)	(435)	(511)	(579)
Net profit	2,222	1,507	2,921	3,432	3,889
Non-controlling interests	(0)	(6)	(11)	(13)	(15)
EPS (RMB)	1.836	1.247	2.417	2.840	3.218

Source(s): Company, ABCI Securities estimates



Financial Statements

Consolidated balance sheet (2019A-2023E)

As of Dec 31 (RMB mn)	2019A	2020A	2021E	2022E	2023E
PPE	16,911	18,592	13,161	14,440	15,864
Others	2,489	3,470	8,878	8,852	8,798
Total non-current assets	19,400	22,062	22,039	23,292	24,663
Cash & cash equivalents	5,512	7,540	9,607	12,352	15,916
Inventories	3,664	3,995	3,795	3,606	3,425
Others	5,631	5,314	4,802	4,341	3,927
Total current assets	14,808	16,850	18,204	20,299	23,269
Total assets	34,207	38,911	40,244	43,590	47,931
Bank borrowings	1,876	3,349	3,014	2,712	2,441
Trade and note payable	5,474	5,205	5,465	5,738	6,025
Others	361	827	863	904	947
Total current liabilities	7,711	9,380	9,342	9,354	9,413
Bank borrowings	3,850	2,543	1,780	1,246	1,059
Others	3,286	5,168	4,913	5,987	7,329
Total non-current liabilities	7,136	7,711	6,693	7,233	8,388
Total liabilities	14,846	17,090	16,035	16,587	17,802
Shareholders' equity	19,351	21,159	23,474	26,184	29,216
Minority interests	10	662	735	819	914
Total equity	19,361	21,821	24,209	27,004	30,130

Source(s): Company, ABCI Securities estimates



Consolidated Cash Flow Statement (2019A-2023E)

As of Dec 31 (RMB mn)	2019A	2020F	2021E	2022E	2023E
Operating profit before change in working capital	2,552	1,648	3,345	3,930	4,453
Change in working capital	(728)	(527)	973	925	885
Others	2,019	2,472	733	517	456
Operating cash flow	3,843	3,593	5,050	5,371	5,793
CAPEX	(1,268)	(2,161)	(1,945)	(2,042)	(2,226)
Others	(2,126)	(1,101)	(1,887)	(1,876)	(1,861)
Investing cash flow	(3,395)	(3,262)	(3,831)	(3,918)	(4,087)
Change in bank Loan	(263)	356	(1,098)	(835)	(458)
Others	518	2,226	2,138	2,325	2,520
Financing cash flow	255	2,582	1,040	1,490	2,062
Net increase in cash & cash equivalents	704	2,913	2,259	2,943	3,768
Cash & cash equivalents at beginning of year	4,059	4,814	7,540	9,607	12,352
Effect of changes in foreign exchange rate	51	(187)	(192)	(198)	(204)
Cash & cash equivalents at end of year	4,814	7,540	9,607	12,352	15,916

Source(s): Company, ABCI Securities estimates



Financial ratios (2019A-2023E)

As of Dec 31	2019A	2020A	2021E	2022E	2023E
Gross profit margin	28.6%	24.7%	29.4%	29.8%	30.3%
Net profit margin	12.4%	8.8%	13.6%	13.7%	14.1%
ROAA	6.9%	4.1%	7.4%	8.2%	8.5%
ROAE	11.6%	7.4%	13.1%	13.8%	14.0%
Costs ratio					
% to revenue					
R&D costs/ revenue	9.6%	11.2%	10.2%	10.4%	10.5%
Distribution and selling expenses/ revenue	1.5%	1.7%	1.6%	1.7%	1.7%
Administrative expenses/ revenue	3.6%	3.9%	3.7%	3.7%	3.7%
YoY growth					
Revenue	(1.4%)	(4.2%)	24.9%	16.9%	10.3%
Gross profit	(8.6%)	(3.9%)	4.7%	0.4%	0.6%
Net profit	(41.5%)	(32.2%)	93.9%	17.5%	13.3%

Source(s): Company, ABCI Securities estimates



Risk factors

Fierce competition in the electronic component sector

The electronic component sector in China is highly competitive with numerous companies. AAC may face pressure in product shipment and ASP if competition intensifies.

Our forecasts may deviate from actual results

We make our forecasts relies on a number of assumptions, such as shipment and ASP and estimates. Therefore, the actual results may deviate from our estimates.

Slowdown in smartphone shipments

AAC's revenue growth may be affected by the slowdown in smartphone shipments due to chip shortage.

R&D expenses disturb profit growth

R&D expenses accounted for 11.2% and 10.6% of revenue in 2020 and 2021, respectively. R&D expenses are major operating expenses compared to marketing expenses and administrative expenses. We assume R&D expenses / revenue ratio will decline from 11.2% in 2020 to 10.2%-10.5% in 2021-23E.

Disclosures

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Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate $<$ Market return rate (+10%)
Sell	Stock return $<$ - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2008 (For reference: HSI total return index 2008-20CAGR at 9.2%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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