

AAC Tech (2018 HK)

Weak smartphone demand to dent business

- AAC Tech's ("the Group" or "AAC") product shipments will be affected by sluggish smartphone shipment and fierce market competition
- Product ASP pressured by market competition and lack of product specification upgrade
- We lower 2022-23E net profit by 49.9%/8.2% due to weak smartphone shipment and rising operating costs.
- ROA and ROE to decline by 1.6ppt/3.0ppt to 1.7%/3.1% for 2022E.
- Recommend **SELL** and TP of HK\$ 12.50, which implies 18.9x/9.2x 2022E-23E P/E

We lower 2022E-23E revenue by 1.9%/6.5%. AAC's product ASP will continue to be affected by fierce market competition and the lack of product specification upgrade. Sluggish smartphone shipment growth will impact product shipment. Revenue of AAC's major segment, acoustics business, declined 6.4% YoY in 2Q22 due to fallen ASP and shipment.

Gross margin to lower 5.6ppt to 19.1% in 2022E. AAC's gross margin recorded four consecutive quarters of YoY decline. We expect rising raw material costs and falling product ASP will continue to shave margins.

We trim net profit in 2022E-23E by 49.9%/8.2%. Net margin is estimated to drop 3.8ppt YoY to 3.7% in 2022E on declining gross margin and higher operating expenses.

Valuation. We recommend **SELL** with TP of HK\$ 12.50, which represents 18.9x/9.2x 2022E-23E P/E.

Risks: (1) Concentration risk; (2) Revenue is likely to be pressured by slowdown in smartphone shipment; (3) Fierce industry competition; (4) ROA and ROE to decline in 2022E

Results and Valuation

FY ended Dec 31	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	17,140	17,667	19,040	20,904	23,201
Chg (% YoY)	(4.2%)	3.1%	7.8%	9.8%	11.0%
Net profit (RMB mn)	1,507	1,316	696	1,429	1,876
Chg (% YoY)	(32.2%)	(12.6%)	(47.2%)	105.4%	31.3%
EPS (RMB)	1.247	1.091	0.576	1.182	1.552
Chg (% YoY)	(32.1%)	(12.5%)	(47.2%)	105.4%	31.3%
BPS (RMB)	17.508	18.048	18.623	19.628	20.948
Chg (% YoY)	9.4%	3.1%	3.2%	5.4%	6.7%
P/E (x)	9.9	11.1	22.1	10.8	8.2
P/B (x)	0.70	0.67	0.68	0.65	0.61
ROE (%)	7.4%	6.1%	3.1%	6.2%	7.7%
ROA (%)	4.1%	3.3%	1.7%	3.4%	4.4%
DPS (RMB)	0.255	0.167	0.000	0.177	0.233
Dividend Yield (%)	2.01%	1.31%	0.00%	1.39%	1.83%

*Exchange rate assumption for FY22E-24E: HKD 1 = RMB 0.87

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Aug 31, 2022

Rating: **SELL**

TP: HK\$ 12.50

Analyst : Ricky Lai
 Tel: (852) 2147 8895
 rickylai@abci.com.hk

Share price (HK\$)	14.62
Est. share price return	(14.5%)
Est. dividend yield	0.0%
Est. total return	(14.5%)
Previous rating & TP	SELL; HK\$14.0
Previous report date	May 20, 2022

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (HK\$)	13.42/43.70
Issued shares (mn)	1,208.5
Market cap (HK\$ mn)	17,668.3
Avg daily turnover (HK\$ mn)	1,150.0
<u>Major shareholder(s)</u>	
WU Ingrid Chun Yuan	41.2%
JP Morgan	12.0%
K&G International Limited	10.6%

Source(s): Bloomberg

Share Performance (%)

	Absolute	Relative*
1-mth	(7.4%)	(3.9%)
3-mth	(19.0%)	(9.8%)
6-mth	(14.0%)	(13.5%)

*Relative to HSI

Source(s): Bloomberg



Business affected by weak smartphone shipments, overseas market inflation, and fierce market competition

Revenue grew 4.6% YoY in 2Q22, compared to 20.6% YoY in 1Q22 due to lower product ASP and sluggish sales in acoustics business. Affected by lower product ASP, gross margin dropped 6.7ppt YoY to 18.3% in 2Q22. AAC has recorded four consecutive quarters of YoY decline in gross margin. We believe margins will be further dragged by rising raw materials costs and fallen product ASP in 2022E.

By segment, revenue from acoustics business dropped 6.4% YoY in 2Q22; optics business grew 14.9% YoY; electromagnetic drives and precision mechanics climbed 17.4%; sensor and semiconductor business revenue edged up 1.3% YoY.

Acoustics business is AAC's major business accounting for 42.3% of total revenue in 2Q22. However, its revenue fell 6.4% YoY in 2Q22 on weak smartphone shipments and intensifying market competition.

We lower 2022E-23E revenue by 1.9%/6.5% due to decline in product ASP, weak smartphone shipment and keen market competition. Overseas smartphone demand will be affected by inflation and weak economic growth. Product ASP, due to the lack of specification upgrade and market rivalries, will be pressured. We forecast gross margin to fall 5.6ppt YoY to 19.1% in 2022E due to lower product ASP accompanied by rises in raw material and labour costs. We expect gross margin to rebound by 3.4ppt/1.8ppt to 22.5%/24.3% in 2023E-24E as product ASP to improve with higher proportion of higher margin products shipments due to smartphone shipments rebound in 2H23. AAC's net profit is expected to grow 105.4%/31.3% in 2023E-24E due to gross margin improvement and better revenue growth.

Exhibit 1: AAC's quarter results comparison table

	2Q21	3Q21	4Q21	1Q22	2Q22
Revenue growth (YoY)	0.9%	(6.1%)	0.6%	14.1%	4.6%
Gross margin	25.0%	22.7%	20.5%	19.5%	18.3%
Gross margin change (YoY)	1.7ppt	(0.9ppt)	(7.6ppt)	(11.6ppt)	(6.7ppt)
Net profit margin	9.0%	4.3%	4.4%	4.2%	3.2%
Net profit margin change (YoY)	2.7ppt	(5.2ppt)	(11.4ppt)	(8.2ppt)	(5.8ppt)

Source(s): Group

Exhibit 2: Changes in our financial estimates

(RMB mn)	OLD			NEW			CHANGE		
	2022E	2023E	2024E	2022E	2023E	2024E	2022E	2023E	2024E
Revenue	19,402	22,350	25,011	19,040	20,904	23,201	(1.9%)	(6.5%)	(7.2%)
Net profit	1,388	1,557	2,062	696	1,429	1,876	(49.9%)	(8.2%)	(9.0%)
EPS (RMB)	1.148	1.288	1.705	0.576	1.182	1.552	(49.8%)	(8.2%)	(9.0%)

Source(s): Group, ABCI Securities estimates

Valuations

Recommend SELL with TP at HK\$12.50

We derive the Group's TP at HK\$12.50, based on the DCF analysis (WACC: 12.3%; perpetuity growth rate: 2.0%). The TP represents 18.9x/9.2x 2022E-23E P/E.



Risk factors

Fierce competition in the electronic component sector

The electronic component sector in China is highly competitive with numerous companies, including Goertek (002241 CH) and Luxshare (002475 CH). AAC may face pressure in product shipment and ASP if competition intensifies.

Business may be affected by trade tension

The Group's product shipments may be affected by escalating tension, sanctions, and disputes among countries. Export sales accounted for 42.0% and 45.0% of total revenue in 1H21 and 1H22, respectively.

Our forecasts may deviate from actual results

Our forecasts are made based on a number of assumptions, such as shipment and ASP estimates. We revise down the revenue growth of AAC for 2022E-24E, but actual results may deviate from our estimates.

Sluggish smartphone shipments

AAC's revenue growth may be affected by the slowdown in smartphone shipments.

Concentration risk

AAC's five largest customers accounted for 84.7% of total revenue in 1H22. As such, any changes in market share and demand from these customers may have material impacts on AAC's revenue growth. Acoustics business is AAC's major business whose revenue accounted for 42.3% of total in 2Q22. Changes in the segment may affect the Group's earnings significantly.



Financial Statements

Consolidated income statement (2020A-2024E)

FY Ended Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Acoustics products revenue	7,560	8,582	8,925	9,506	10,266
Electromagnetic drives & precision mechanics revenue	6,847	5,639	6,259	7,041	7,957
Optics products revenue	1,634	2,389	2,700	3,105	3,633
Sensor & semiconductor products revenue	1,083	1,013	1,099	1,176	1,253
Other products revenue	16	43	56	76	92
Total revenue	17,140	17,667	19,040	20,904	23,201
Cost of goods sold	(12,913)	(13,302)	(15,395)	(16,194)	(17,557)
Gross profit	4,227	4,365	3,646	4,710	5,643
Other income, gains and losses	502	345	415	435	457
R&D costs	(1,920)	(1,726)	(1,695)	(1,881)	(2,134)
Distribution and selling expenses	(285)	(333)	(343)	(397)	(487)
Administrative expenses	(672)	(824)	(857)	(1,003)	(1,137)
Others(*)	148	0	(79)	3	1
Finance cost	(353)	(415)	(340)	(333)	(330)
Profit before tax	1,648	1,413	747	1,534	2,013
Tax	(147)	(120)	(63)	(130)	(171)
Profit for the period	1,501	1,293	683	1,404	1,843
Net profit attributable to shareholders	1,507	1,316	696	1,429	1,876
Non-controlling interests	(6)	(23)	(12)	(25)	(33)
EPS (RMB)	1.247	1.091	0.576	1.182	1.552

Source(s): Group, ABCI Securities estimates

*include Share of result of an associate, Exchange (loss) gain



Consolidated balance sheet (2020A-2024E)

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
PPE	18,592	19,987	20,987	21,616	22,265
Right-of-use assets	1,896	2,034	2,135	2,242	2,354
Others	1,574	2,046	1,914	2,052	2,202
Total non-current assets	22,062	24,067	25,036	25,911	26,821
Bank balances & cash	7,540	6,051	4,186	3,591	3,464
Inventories	3,995	5,695	5,889	6,089	6,296
Trade and other receivables	5,176	6,013	6,313	6,629	6,960
Others	138	195	197	198	199
Total current assets	16,850	17,955	16,585	16,507	16,921
Total assets	38,911	42,022	41,620	42,417	43,742
Bank loans	3,349	2,902	2,322	2,206	2,096
Trade and other payables	5,205	6,148	6,332	6,522	6,718
Others	827	618	659	703	751
Total current liabilities	9,380	9,668	9,313	9,431	9,564
Bank loans	2,543	330	297	356	446
Unsecured notes	2,512	6,573	5,916	5,324	4,792
Contingent settlement provision	1,672	1,739	1,565	1,408	1,268
Others	984	1,210	1,310	1,425	1,555
Total non-current liabilities	7,711	9,852	9,088	8,514	8,060
Total liabilities	17,090	19,520	18,401	17,945	17,624
Shareholders' equity	21,159	21,811	22,506	23,721	25,315
Minority interests	662	691	713	752	802
Total equity	21,821	22,502	23,219	24,472	26,117

Source(s): Group, ABCI Securities estimates



Consolidated Cash Flow Statement (2020A-2024E)

As of Dec 31 (RMB mn)	2020A	2021A	2022E	2023E	2024E
Operating profit before change in working capital	1,648	1,413	747	1,534	2,013
Change in working capital	(527)	(2,123)	(314)	(329)	(346)
Others	2,472	2,907	1,245	2,639	2,837
Operating cash flow	3,593	2,196	1,678	3,844	4,504
Deposits paid for acquisition of PPE	(2,161)	(2,167)	(2,275)	(2,480)	(2,703)
Others	(1,101)	(2,079)	(261)	(1,300)	(1,238)
Investing cash flow	(3,262)	(4,246)	(2,536)	(3,780)	(3,941)
Change in bank Loan	356	(2,653)	(613)	(57)	(21)
Others	2,226	3,266	(340)	(547)	(611)
Financing cash flow	2,582	613	(954)	(604)	(632)
Net increase in cash & cash equivalents	2,913	(1,437)	(1,812)	(540)	(69)
Cash & cash equivalents at beginning of year	4,814	7,540	6,051	4,186	3,591
Effect of changes in foreign exchange rate	(187)	(52)	(54)	(55)	(57)
Cash & cash equivalents at end of year	7,540	6,051	4,186	3,591	3,464

Source(s): Group, ABCI Securities estimates

Financial ratios (2020A-2024E)

As of Dec 31	2020A	2021A	2022E	2023E	2024E
Gross profit margin	24.7%	24.7%	19.1%	22.5%	24.3%
Net profit margin	8.8%	7.5%	3.7%	6.8%	8.1%
ROA	4.1%	3.3%	1.7%	3.4%	4.4%
ROE	7.4%	6.1%	3.1%	6.2%	7.7%
Costs ratio					
% to revenue					
R&D costs/ revenue	11.2%	9.8%	8.9%	9.0%	9.2%
Distribution and selling expenses/ revenue	1.7%	1.9%	1.8%	1.9%	2.1%
Administrative expenses/ revenue	3.9%	4.7%	4.5%	4.8%	4.9%
YoY growth					
Revenue	(4.2%)	3.1%	7.8%	9.8%	11.0%
Gross profit	(17.2%)	3.3%	(16.5%)	29.2%	19.8%
Net profit	(32.2%)	(12.6%)	(47.2%)	105.4%	31.3%

Source(s): Group, ABCI Securities estimates

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

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 2009 (HSI total return index 2009-21 averaged 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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**Office address: ABCI Securities Company Limited, 13/F Fairmont House, 8 Cotton Tree Drive, Central, Hong Kong.
Tel: 852) 2868 2183**