

AAC Tech (2018 HK)

Pressure on net margin to persist; downgrade to SELL

- AAC Tech's ("the Company" or "AAC") product shipments in 2022E are affected by sluggish smartphone shipments
- Product ASP will be affected by market competition and lack of products specification upgrade
- Gross profit margin is expected to decline in 2022E due to a drop in product ASP, rise in labour and raw material costs
- Net profit to grow at a CAGR of 4.6% in 2021-24E
- Recommend **SELL** and TP of HK\$14.0, which implies 10.4x/9.9x 2022-23E P/E

We lower 2022E revenue by 22.5%. AAC's product ASP is affected by fierce market competition and lack of products specification upgrade. The sluggish smartphone shipment growth will impact product shipments. We predict revenue to grow 9.8% YoY in 2022E.

Gross profit margin to lower by 0.2ppt to 24.5% in 2022E. AAC's gross margin is expected to be affected by a drop in product ASP, in addition to the rise in labour and raw material costs.

We trim net profit in 2022E by 59.6%. We expect the R&D expenses-to-revenue ratio to rise in 2022E for new products innovations and development. Net profit margin is estimated to drop 0.3ppt YoY to 7.2% in 2022E on declining gross margin and higher operating expenses.

Valuation. We downgrade to **SELL** with TP of HK\$14.0, which represents 10.4x/9.9x 2022-23E P/E.

Risks: (1) Chips shortage affects business; (2) Concentration risk; (3) Revenue may be affected by slowdown in smartphone shipments growth; (4) Fierce competition from peers; (5) Increase in production cost and R&D expenses

Results and Valuation

FY ended Dec 31	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	17,140	17,667	19,402	22,350	25,011
Chg (% YoY)	(4.2%)	3.1%	9.8%	15.2%	11.9%
Net profit (RMB mn)	1,507	1,316	1,388	1,451	1,507
Chg (% YoY)	(32.2%)	(12.6%)	5.4%	4.5%	3.9%
EPS (RMB)	1.247	1.091	1.148	1.200	1.247
Chg (% YoY)	(32.1%)	(12.5%)	5.2%	4.5%	3.9%
BPS (RMB)	17.508	18.048	19.020	20.037	21.093
Chg (% YoY)	9.4%	3.1%	5.4%	5.3%	5.3%
P/E (x)	11.1	12.6	12.2	11.7	11.3
P/B (x)	0.79	0.76	0.74	0.70	0.67
ROE (%)	7.4%	6.1%	6.2%	6.1%	6.1%
ROA (%)	4.1%	3.3%	3.2%	3.2%	3.1%
DPS (RMB)	0.255	0.167	0.176	0.184	0.191
Dividend Yield (%)	1.82%	1.19%	1.25%	1.31%	1.36%

*Exchange rate assumption for FY22E-24E: HKD 1 = RMB 0.85

Source(s): Bloomberg, ABCI Securities estimates

Company Report

May 20, 2022

Rating: **SELL**

TP: HK\$ 14.0

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

Share price (HK\$)	16.52
Est. share price return	(15.25%)
Est. dividend yield	1.25%
Est. total return	(14.0%)
Previous rating & TP	BUY; HK\$58.0
Previous report date	May 26, 2021

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L(HK\$)	59.80/15.44
Issued shares (mn)	1,208.5
Market cap (HK\$ mn)	19,964.4
Avg daily turnover (HK\$ mn)	1,050.0
<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	2.7%	(5.2%)
3-mth	(3.3%)	(37.2%)
6-mth	(10.1%)	(39.5%)

*Relative to HSI

Source(s): Bloomberg



Net profit margin to drop 0.3ppt YoY in 2022E; revise down 2022E net profit by 59.6%

According to IDC, the global smartphone shipments declined by 8.9% YoY in 1Q22, due to unfavorable global economic environment. AAC's product demand in 2022E is expected to be affected by sluggish smartphone shipments. Product ASP will be affected by the lack of specification upgrade and fierce market competition. We expect product ASP to drop 5.0% YoY in 2022E. We forecast gross margin to lower by 0.2ppt YoY to 24.5% in 2022E due to product ASP decline, as well as rises in raw material and labour costs. We expect raw material and labour costs to increase 5.3%/3.5% in 2022E.

The R&D expenses-to-revenue ratio is forecast to rise 0.2ppt YoY to 10.0% in 2022E due to new product innovations and development. NPM is forecast to drop 0.3ppt YoY to 7.2% on lower GPM and higher R&D expenses-to-revenue ratio. Therefore, we cut 2022E net profit by 59.6% to RMB1,388mn, which represent 5.4% YoY growth in 2022E.

AAC reported total revenue and net profit attributable to shareholders to change by 14.1% YoY and -61.4% YoY to RMB4,896mn and RMB205mn in 1Q22, respectively. Based on our latest 2022E forecast, we predict its revenue to grow by 8.5% YoY in Apr-Dec 2022 and net profit to grow by 50.9% YoY in Apr-Dec 2022. Net profit margin will improve from 4.2% in 1Q22 to 8.2% in Apr-Dec 2022.

Exhibit 1: Changes in our financial estimates

(RMB mn)	OLD			NEW			CHANGE		
	2022E	2023E	2024E	2022E	2023E	2024E	2022E	2023E	2024E
Revenue	25,038	27,624	N/A	19,402	22,350	25,011	(22.5%)	(19.1%)	N/A
Net profit	3,432	3,889	N/A	1,388	1,451	1,507	(59.6%)	(62.7%)	N/A
EPS (RMB)	2.884	3.270	N/A	1.148	1.200	1.247	(60.2%)	(63.3%)	N/A

Source(s): Company, ABCI Securities estimates

Valuations

Recommend SELL with TP at HK\$14.0

We derive the Company's TP at HK\$14.0, based on the DCF analysis (WACC: 12.1%; perpetuity growth rate: 2.2%). The TP represents 10.4x/9.9x 2022-23E P/E. We trim net profit in 2022E by 59.6%. We expect the Company to face challenges from declining gross margin and higher operating expenses.



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. We expect product ASP to drop 5.0% in 2022E.

Business may be affected by trade tensions

The Company's product shipments may be affected by escalating tensions, sanctions, and disputes among countries. Export sales accounted for 52.9% and 52.2% of total revenue in 2020 and 2021, respectively.

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. We revise down revenue growth of AAC in 2022E and 2023E. The outcomes may be worse than our expectations.

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 87.3% of total revenue in 2021. If there are any changes in market share and demand from these five customers, AAC's revenue growth may be affected.



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	9,183	10,055	10,920
Electromagnetic drives & precision mechanics revenue	6,847	5,639	5,977	6,754	7,362
Optics products revenue	1,634	2,389	3,082	4,254	5,359
MEMS components revenue	1,083	1,013	1,089	1,193	1,254
Other products revenue	16	43	71	95	116
Total revenue	17,140	17,667	19,402	22,350	25,011
Cost of goods sold	(12,913)	(13,302)	(14,653)	(16,856)	(18,815)
Gross profit	4,227	4,365	4,749	5,494	6,195
Other income, gains and losses	502	345	370	388	408
R&D costs	(1,920)	(1,726)	(1,940)	(2,257)	(2,551)
Distribution and selling expenses	(285)	(333)	(388)	(447)	(525)
Administrative expenses	(672)	(824)	(931)	(1,073)	(1,226)
Others(*)	148	0	0	(1)	(1)
Finance cost	(353)	(415)	(369)	(547)	(683)
Profit before tax	1,648	1,413	1,489	1,557	1,617
Tax	(147)	(120)	(126)	(132)	(137)
Net profit to the Company	1,501	1,293	1,363	1,425	1,480
Net profit attributable to shareholders	1,507	1,316	1,388	1,451	1,507
Non-controlling interests	(6)	(23)	(24)	(26)	(27)
EPS (RMB)	1.247	1.091	1.148	1.200	1.247

Source(s): Company, ABCI Securities estimates

*include Share of results of an associate, Exchange 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
Others	3,470	4,080	4,049	4,294	4,556
Total non-current assets	22,062	24,067	25,036	25,911	26,821
Cash & cash equivalents	7,540	6,051	3,889	3,387	2,510
Inventories	3,995	5,695	5,889	6,089	6,296
Others	5,314	6,208	8,926	12,433	14,679
Total current assets	16,850	17,955	18,704	21,909	23,485
Total assets	38,911	42,022	43,740	47,820	50,306
Bank borrowings	3,349	2,902	2,612	3,918	4,898
Trade and note payable	5,205	6,148	6,455	6,778	7,117
Others	827	618	660	694	735
Total current liabilities	9,380	9,668	9,727	11,390	12,749
Bank borrowings	2,543	330	231	312	390
Others	5,168	9,522	10,068	11,136	10,868
Total non-current liabilities	7,711	9,852	10,299	11,448	11,258
Total liabilities	17,090	19,520	20,025	22,838	24,007
Shareholders' equity	21,159	21,811	22,986	24,215	25,491
Minority interests	662	691	728	767	808
Total equity	21,821	22,502	23,714	24,982	26,299

Source(s): Company, 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	1,489	1,557	1,617
Change in working capital	(527)	(2,123)	(191)	(197)	(203)
Others	2,472	2,907	1,211	1,355	1,561
Operating cash flow	3,593	2,196	2,510	2,716	2,976
Deposits paid for acquisition of PPE	(2,161)	(2,167)	(2,275)	(2,480)	(2,703)
Others	(1,101)	(2,079)	(1,373)	(1,300)	(1,238)
Investing cash flow	(3,262)	(4,246)	(3,648)	(3,780)	(3,941)
Change in bank Loan	356	(2,653)	(389)	1,387	1,058
Others	2,226	3,266	(582)	(769)	(913)
Financing cash flow	2,582	613	(971)	618	144
Net increase in cash & cash equivalents	2,913	(1,437)	(2,109)	(446)	(820)
Cash & cash equivalents at beginning of year	4,814	7,540	6,051	3,889	3,387
Effect of changes in foreign exchange rate	(187)	(52)	(54)	(55)	(57)
Cash & cash equivalents at end of year	7,540	6,051	3,889	3,387	2,510

Source(s): Company, ABCI Securities estimates

Financial ratios (2020A-2024E)

As of Dec 31	2020A	2021A	2022E	2023E	2024E
Gross profit margin	24.7%	24.7%	24.5%	24.6%	24.8%
Net profit margin	8.8%	7.5%	7.2%	6.5%	6.0%
ROA	4.1%	3.3%	3.2%	3.2%	3.1%
ROE	7.4%	6.1%	6.2%	6.1%	6.1%
Costs ratio					
% to revenue					
R&D costs/ revenue	11.2%	9.8%	10.0%	10.1%	10.2%
Distribution and selling expenses/ revenue	1.7%	1.9%	2.0%	2.0%	2.1%
Administrative expenses/ revenue	3.9%	4.7%	4.8%	4.8%	4.9%
YoY growth					
Revenue	(4.2%)	3.1%	9.8%	15.2%	11.9%
Gross profit	(17.2%)	3.3%	8.8%	15.7%	12.8%
Net profit	(32.2%)	(12.6%)	5.4%	4.5%	3.9%

Source(s): Company, ABCI Securities estimates

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Definition of equity rating

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**