AAC Technologies | 2018.HK

Improved earnings visibility favours re-rating

Rating	BUY	Upgrade
Target Price	HK$ 37.24	
Current price	HK$ 31.25	Upside: +19.2%

1H24 net profit beat on GM recovery across the board; Business outlook more +ve than in FY23 result

AAC's 1H24 revenue and net profit attributable to shareholders arrived at RMB11,247mn/RMB537mn respectively (+22.0%/+257% Yoy).Topline was largely in-line with Bloomberg consensus,while net profit was 9% above consensus estimates and reached 36% of FY24E market forecasts, thanks to better than expected GM. AAC do not declare interim dividends in 1H24.

AAC's 1H24 blended GM reached 20% for the first time since 1H21, and arrived at 21.5% (2.5ppts/1.3ppts higher than 1H24E/FY24E market estimates), thanks to GM Yoy recovery across the board, in which optics GM turned positive. AAC remained positive on its automotive related business exposure for its acoustics (software+hardware solutions in smart cockpit for OEMs, including leading Chinese NEV) and optics segment (automotive lens and CCM). It seems to us that Management's tone on business outlook is more optimistic than in FY23 result, and they provided a clearer vision in mid-term for each business segment. Below are the 1H24 reslt highlights:

Acoustics (~31% of 1H24 revenue): Sales rose 4.1% Yoy to RMB3,466mn, with GM up 4.4ppt Yoy to 29.9%, thanks to steady share gain in mid-high end market and improved product mix. In 1H24, AAC shipped >12mn (+200% yoy) SLS and 4.5mn units of 2-in-1 acoustic and electromagnetic product. Meanwhile AAC also launched high-performance speakers with industry-leading thinness in foldables. Though AAC expects stable global smartphone shipment in 2H24 and would arrive at 1.15-1.2bn units by end-2024, Management sees stable high-end Android demand and new products would drive ASP to go up by double-digits in FY24E, which would support GM to stay above 30% level and trending towards mid-30s. Meanwhile, spec upgrade by AI phone will be more visible in 2H25 / 2026.

AAC currently runs a flexible business model for automotive acoustics, that can offer combination of products and services to meet clients' demand. For instance, comprehensive solution from ultra-flagship to high cost-performance by covering a set of audio solutions including single component (amplifier module, speaker set), tuning services, software systems and a flexible combination of both. As acoustic system would become one of the core components of the intelligent cockpit, we believe AAC could ride on their ongoing expertise and leadership in acoustic solutions to fulfill clients' need , this would be a new market niche for AAC to further explore and expand in mid-long run.

PSS - automotive & consumer acoustics (13.5% of revenue): AAC disclosed PSS consolidated financials for the first time, with revenue came in at RMB1.5bn (13.5% of total revenue) and GM at 25% (above Group average and ~16% of AAC's 1H24 GP). Management expects growth from PSS would be stable in the near term. A recap that PSS is a leading automotive and consumer speaker OEM based in Belgium, with wide client base including European, US auto OEMs (incl. Tesla) and Chinese EV OEMs (incl. new entrant Xiaomi). PSS has >3,000 employees, with R&D facilities in Belgium, US, China and Malaysia and manufacturing facilities in Belgium, Hungary, China, Malaysia and Mexico.

AAC Management previously estimates PSS has 15-20% market share in global automotive speaker market, they can leverage on PSS to strengthen AAC's presence in global automotive acoustics equipment industry. AAC Management expects there's room for margin expansion post acquisition, driven by better efficiency and integration of resources.

Result Takeaway

Hayman Chiu
hayman.chiu@cinda.com.hk
(852) 2235 7677

Trading data

52-Week Range (HK$)	34.60/12.86
3 Mth Avg Daily Vol (m)	6.54
No of Shares (m)	1,198.5
Market Cap (HK$m)	37,453.1
Major Shareholders (%)	Benjamin Pan (43%)
Auditors	Deloitte
Result Due	FY25E: Mar 2025

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 is generated by smartphone and tablet related business

Haptics and precision mechanics (~33% of 1H24 revenue): Revenue grew 1.1% Yoy to RMB3,660mn with GM rose 3.6 ppts Yoy to 22.9%, thanks to breakthrough in metal hinges (shipment >500k units), heat dissipation components (revenue doubled Yoy to RMB150mn) and metal casings. Management noted that haptics and precision mechanics' GM each improved by 3-6 ppts Yoy, in which GM of electromagnetic drives/ precision mechanics and heat dissipation was ~30%/18%/30% respectively.

Management expects segment revenue would accelerate driven by haptic upgrade demand, while heat dissipation products annual revenue would reach RMB1bn in the next 3 years driven by AI phone. AAC's x-axis haptics motor have been adopted in more models launched by major global smartphone brands, and have been expanding into other non-smartphone products including trackpads, game controllers, intelligent vehicles and XR devices.

Market has been anticipating that AAC would be one of the beneficiaries' of the new solid-state button design , which would give them incremental shipment volume (increase from 1 to 3 Taptic Engines being used in each iPhone). Apple sticked to its classic volume button design on the iPhone 15 Pro (Pro+Pro Max) models (vs. solid-state/ immovable button design that provide haptics feedback), as the new solution would have a much more complex design. It is now expected that the solid-state button design might be adopted in iPhone 16 Pro models, according to our latest channel check. In addition the rumoured new Capture Button that will be available on all iPhone 16 series, to handle the video-taking capabilities of the device. The new Capture Button will be a solid-state capacitive button, with haptic feedback provided by an in-built Taptic engine, which users can swipe along the button to zoom in and out, while shooting photographs and videos, working in a similar way to the volume control on Apple AirPod Pros.

Optics (~20% of 1H24 revenue): Revenue grew 25.0% Yoy to RMB2,210mn due to improved industry and competitive landscape, which drove both shipment and ASP in lenses and CCM, hence driving blended GM turned positive at 4.7% (+21.7 ppts Yoy), in which lens and CCM GM came in at 16.7%/5.7% respectively (+16.7ppts/+11.8ppts Yoy). Management also shared that 1G6P hybrid lens shipment grew ~40% Yoy to 1.4mn units, 6P lens accounted for >15% of total shipment, while also winning 7P lens projects, their WLG technology has also gained positive feedback from smartphone OEMs for its outstanding optical performance. For WLG, 10mn/>1mn units will be for smartphone and non-smartphone (e.g. auto, drones and wearable camera etc.). AAC proactively collaborates with clients in developing optics products (e.g. telephoto lenses, micro prisms) for future adoption in more high-end and flagship models.

Management expects CCM shipment and revenue would each grow by 20/40% in FY24E, which we view higher ASP products to drive revenue growth. We believe better improved industry dynamics, healthy inventory level and economy of scale pave way for improved product mix which would drive both ASP and GM, optics' profitability would further improve in 2H24E/FY25E, AAC would be capable to narrow the GM gap with leading players in lenses and CCM. AAC also expects optics' net profit to turn around in 4Q24.

FY24E-26E earnings to grow 17% CAGR; Improved earnings visibility + enters new round of earnings upcycle; Upgrade to BUY

We expect AAC's sales and net profit to grow 10.5%/17.0% CAGR in FY24E-26E respectively, on higher sales forecasts on AAC's core business segments, accompanied by higher GM assumption, as well as contribution from PSS. AAC is trading at 18.5x FY25E PE (~AAC's 5-year average) As we see AAC's earnings visibility to improve and about to enter a new round of earnings upcycle from FY24E, we upgrade AAC's rating from NEUTRAL to BUY with new TP at HK$37.24, which translates to 22.0x FY24E target PE (~1 s.d above AAC's 5-year average).

Exhibit 1: We lift FY24E-25E earnings forecasts and introduce FY26E estimates

	FY24E (new)	FY24E (old)	Diff	FY25E (new)	FY25E (old)	Diff	FY26E (new)	Yoy
Revenue	26,366	26,052	1.2%	29,478	29,003	1.6%	32,223	9.3%
Operating Profit	2,756	2,394	15.1%	3,200	2,974	7.6%	3,628	13.4%
Net Profit	1,666	1,509	10.4%	1,951	1,901	2.7%	2,280	16.8%
EPS (RMB)	1.34	1.21	10.4%	1.57	1.53	2.7%	1.83	16.8%

Source: CIRL estimates

Exhibit 2: Projects that AAC has involved

Source: Comapny data

Exhibit 3: PSS current customers include global renowned auto OEMs

Source: Company data

Exhibit 4: AAC's P&L (1H21-1H24)

	1H21	2H21	1H22	2H22	1H23	2H23	1H24
Income statement (RMB mn)							
Revenue	8,609	9,058	9,412	11,213	9,219	11,200	11,247
Cost of goods sold	-6,194	-7,108	-7,629	-9,221	-7,922	-9,046	-8,842
Gross profit	2,415	1,950	1,783	1,992	1,297	2,155	2,405
SG&A	-539	-617	-660	-823	-651	-770	-863
R&D	-894	-832	-727	-819	-675	-898	-949
Operating profits	1,178	653	676	584	375	838	837
Interest expenses	-211	-205	-204	-199	-204	-187	-232
Share of associates earnings	0	0	-1	1	0	0	0
Pre-tax profit	982	449	425	429	175	651	628
Tax	-53	-67	-142	-89	-127	-125	-112
Minority interest	8	16	-68	-124	-103	-67	-21
Net profit	921	367	350	464	150	593	537
As % of sales							
Gross profit	28.1%	21.5%	18.9%	17.8%	14.1%	19.2%	21.4%
SG&A	-6.3%	-6.8%	-7.0%	-7.3%	-7.1%	-6.9%	-7.7%
R&D	-10.4%	-9.2%	-7.7%	-7.3%	-7.3%	-8.0%	-8.4%
Operating profits	13.7%	7.2%	7.2%	5.2%	4.1%	7.5%	7.4%
Net profit	10.7%	4.0%	3.7%	4.1%	1.6%	5.3%	4.8%
Growth HoH							
Revenue	-7.5%	5.2%	3.9%	19.1%	-17.8%	21.5%	0.4%
Gross profit	-0.2%	-19.3%	-8.6%	11.7%	-34.9%	66.1%	11.6%
Operating profits	-20.7%	-44.5%	3.4%	-13.6%	-35.7%	123.3%	-0.2%
Net profit	-27.3%	-60.2%	-4.5%	32.5%	-67.6%	294.8%	-9.5%

Source: Company data, CIRL

Exhibit 5: Financial statement

Income statement

Year to Dec (RMB mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	**20,625**	**20,419**	**26,366**	**29,479**	**32,224**
Gross profit (reported)	3,776	3,452	5,920	6,738	7,495
EBITDA	**4,251**	**4,183**	**5,648**	**5,903**	**6,181**
Depreciation	(2,987)	(2,969)	(2,891)	(2,703)	(2,553)
EBIT	**1,264**	**1,214**	**2,756**	**3,200**	**3,628**
Net interest income (exp.)	(403)	(391)	(527)	(531)	(483)
Associates	0	0	0	0	0
Exceptionals/others	0	0	0	0	0
Profit before tax	**861**	**823**	**2,229**	**2,670**	**3,145**
Tax expenses	(231)	(252)	(683)	(818)	(964)
Minority interest	(192)	(170)	(120)	(100)	(99)
Net profit	**821**	**740**	**1,666**	**1,951**	**2,280**
Dividends	-124	-111	-250	-293	-342

Balance sheet

Year to Dec (RMB mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash & equiv	7,155	6,846	8,188	10,136	12,241
Trade receivables	5,531	6,653	7,831	8,254	8,701
Other receivables	0	0	0	0	0
Inventories	4,401	2,992	3,691	4,127	4,511
Other current assets	28	35	35	35	35
Fixed assets	19,302	18,070	16,893	15,959	15,178
Intangible assets	275	275	275	275	275
Investment, associates etc	3,650	4,038	4,038	4,038	4,038
Total assets	**40,343**	**38,911**	**40,952**	**42,825**	**44,979**
Account payables	146	123	185	206	226
Other payables	0	0	0	0	0
Short-term debt	1,833	3,421	3,421	3,421	3,421
Other current liabs	7,076	6,585	7,168	7,303	7,448
Long-term debts	9,050	6,363	6,363	6,363	6,363
Deferred tax and others	43	47	47	47	47
Other long-term liabs	0	0	0	0	0
Total liabilities	**18,148**	**16,540**	**17,184**	**17,341**	**17,506**
Share capital	98	97	97	97	97
Reserves	21,559	21,784	23,061	24,677	26,565
Shareholders' equity	**21,656**	**21,881**	**23,158**	**24,774**	**26,663**
Minorities	539	490	610	710	809
Total equity	**22,196**	**22,371**	**23,768**	**25,484**	**27,472**
Net cash (debt)	-3,728	-2,939	-1,596	352	2,456

Cash flow

Year to Dec (RMB mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Pre-tax profit	861	823	2,229	2,670	3,145
Taxes paid	(277)	(265)	(101)	(683)	(818)
Depreciation	2,987	2,969	2,891	2,703	2,553
Associates	0	0	0	0	0
CFO bef. WC change	3,571	3,526	5,020	4,689	4,880
Change in working cap	2,444	(217)	(1,815)	(837)	(812)
Cashflow from operation	**6,015**	**3,309**	**3,205**	**3,852**	**4,068**
CAPEX	(2,301)	(1,737)	(1,714)	(1,769)	(1,772)
Free cash flow	**3,714**	**1,572**	**1,491**	**2,084**	**2,296**
Dividends	(124)	(111)	(250)	(293)	(342)
Balance sheet adj.	155	(388)	0	0	0
Sharse issued	(1,196)	(623)	(139)	(43)	(49)
Others	0	0	0	0	0
Net cash flow	**2,549**	**449**	**1,103**	**1,748**	**1,904**
Net cash (debt) start	(6,660)	(3,728)	(2,939)	(1,596)	352
Net cash (debt) at year-end	-4,112	-3,278	-1,836	152	2,256

Ratios

Year to Dec	FY22A	FY23A	FY24E	FY25E	FY26E
Growth rate (%)					
Revenue	16.7	(1.0)	29.1	11.8	9.3
EBITDA	(6.2)	(1.6)	35.0	4.5	4.7
EBIT	(30.9)	(4.0)	127.1	16.1	13.4
Net profit	(37.6)	(9.9)	125.0	17.2	16.8
Fully diluted EPS	(37.6)	(9.9)	125.0	17.2	16.8
Margins (%)					
Gross margin	18.3	16.9	22.5	22.9	23.3
EBITDA	20.6	20.5	21.4	20.0	19.2
EBIT	6.1	5.9	10.5	10.9	11.3
Net margin	4.0	3.6	6.3	6.6	7.1
Other ratios					
ROE (%)	3.7	3.3	7.0	7.7	8.3
ROA (%)	2.0	1.9	4.1	4.6	5.1
Net gearing (%)	18.5	14.7	7.7	(0.6)	(8.2)
Interest coverage (x)	3.1	3.1	5.2	6.0	7.5
Receivables days	102.1	108.9	100.3	99.6	96.0
Payables days	3.3	2.9	2.7	3.1	3.2
Inventory days	109.4	79.5	59.7	62.7	63.8
Effective tax rate (%)	26.9	30.7	30.7	30.7	30.7

Source: Company data, CIRL estimates

Risk Factors

Downside risks include: 1) Slowdown in flagship smartphone shipment in Android and iOS ; 2) Slower than expected ramp up in optics segment and SLS upgrade in Android camp and 3) AI triggers components upgrade not as expected

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%

Analysts List

Hayman Chiu	Research Director	(852) 2235 7677	hayman.chiu@cinda.com.hk
Lewis Pang	Associate Director	(852) 2235 7847	lewis.pang@cinda.com.hk
Edith Li	Senior Research Analyst	(852)2235 7515	edith.li@cinda.com.hk
Tracy Chan	Senior Research Analyst	(852)2235 7619	tracy.chan@cinda.com.hk

Analyst Certification

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