

2H14 recovery priced in

AAC 2Q14 net profit came in at RMB493m (up 1% qoq) on revenue of RMB1,862m (up 0.4% qoq). Despite the flattish growth which was mainly owing to the inventory adjustment of customers, AAC managed to expand its gross margin by 1.9pts qoq thanks to the increasing level of automation and better product mix. We think its current valuation is rich and has reflected iPhone6 momentum in 2H. We appreciate AAC's strenuous effort to expand sales growth potential by developing non-acoustic products, but the margin of the new products remains a key concern in the near term.

2Q14 gross margin up but earnings below consensus. AAC's 2Q14 net income was 6% below street estimates which was mainly due to slow-than-expected sales growth attributed to slower momentum at one of its US brand customers. Revenue contribution from dynamic components dropped to 78% in 2Q14 from 84% in 1Q14. Its top three customers accounted for 64% of sales in (vs. 72% in 1Q14), while PRC customers contributed 32% of total sales (vs. 25% in 1Q).

3Q14 outlook is well expected. Management expects to see continued sales growth in 2H14 with non-acoustic (haptics/RF antenna) products to contribute 15-20% of FY14E sales (vs. 7% in 2Q14) and gross margin expansion (42-43%) on increasing level of automation, strong volume momentum from Apple iPhone6 launch and increasing adoption of speakerbox with higher spec. by PRC customers. We are still cautious on its margin trend given the fierce competition for speakerbox, MEMS microphone and haptics in the longer term and the margin dilutive nature of the non-acoustic business at current stage.

Neutral rating with TP of HK\$47. We believe the penetrate rate for global high price point smartphone was high and China telecom operators' subsidy cut might affect the volume growth of iPhone6. The subsidy cut will also further impose price pressure on China OEMs. We think its current valuation has already priced in most of the cyclical strength given the stock is trading at 20x/18x our FY14/15 earnings estimates. Our TP of HK\$47 is based on 16x of our 2014 EPS estimate, which has already factored in the premium of management's solid execution and current visibility of the non-acoustic business.

Financials

RMB mn	2013A	2014E	2015E	2016E
Revenue	8,096	9,061	10,748	10,963
Revenue growth	29%	12%	19%	2%
Gross profit	3,459	3,733	4,245	4,319
Gross profit margin	43%	41%	40%	39%
Net profit	2,578	2,358	2,646	2,739
Net profit margin	32%	26%	25%	25%
EPS	2.10	1.92	2.16	2.23

Source: Company data, CSCI
**AAC Technologies
(2018.hk)**

Rating	Neutral
Target Price	HK\$47
Price	HK\$ 48.25
Upside	-3%

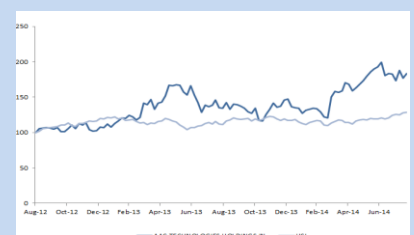
Market data	08/28/2014
52-wk range(HK\$):	29.55/54.5
Market cap.(HK\$ bn):	59.25
Shares out. (mn):	1,228
Major shareholders:	
Pan Benjamin Zhengmin	40.79%
Avg. Daily Vol. (mn):	3.48

Valuation	13A	14E	15E	16E
EPS (RMB)	2.10	1.92	2.16	2.23
PE (x)	18.1	19.8	17.6	17.0
PB (x)	5.9	4.7	4.0	3.5
Yield (%)	2.8	2.5	2.9	3.0

Stock rel HSI performance (%)

Since 28 Aug 2013

+84%/+29%


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28 Aug 2014

Financial Summary

Profit & Loss (RMB m)	2012A	2013A	2014F	2015F	2016F	Financial Ratios	2012A	2013A	2014F	2015F	2016F
Revenue	6,283	8,096	9,061	10,748	10,963	Revenue growth (%)	54.8%	29%	12%	19%	2%
Cost of sales	(3,509)	(4,637)	(5,328)	(6,502)	(6,644)	Operating profit growth (%)	54.7%	29%	1%	13%	5%
Gross profit	2,774	3,459	3,733	4,245	4,319	Reported profit growth (%)	70.1%	46%	-9%	12%	3%
R&D expenses	(462)	(553)	(680)	(785)	(756)	Adjusted profit growth (%)	70.1%	46%	-9%	12%	3%
SG&A expenses	(464)	(530)	(530)	(634)	(636)	Adjusted EPS growth (%)	70.1%	46%	-9%	12%	3%
Other operating expense	71	90	100	118	121	Dividend growth (%)	70.2%	53%	-10%	12%	3%
Operating profit	1,920	2,466	2,623	2,945	3,048	Dividend payout (%)	39.1%	41%	40%	40%	40%
Finance costs	12	12	11	11	11	Gross profit margin (%)	44.2%	43%	41%	40%	39%
Other income	108	381	20	20	20	Operating profit margin (%)	36.0%	36%	33%	31%	32%
Profit before taxation	2,016	2,835	2,632	2,954	3,057	Adjusted profit margin (%)	28.1%	32%	26%	25%	25%
Taxation	(259)	(263)	(268)	(301)	(312)	ROE (%)	28.8%	32%	24%	23%	21%
Non-controlling interests	(6)	(6)	(6)	(6)	(6)	ROA (%)	19.7%	24%	18%	17%	16%
Net profit	1,763	2,578	2,358	2,646	2,739	Net debt/equity (%)	-4.6%	-18%	-14%	-16%	-21%
						Net debt/total assets (%)	-3.1%	-13%	-10%	-12%	-16%
						Current ratio (%)	167.4%	217%	212%	220%	237%
						Interest cover (x)	-14688.3%	-224.1	-214.3	-240.6	-249.0
						Dividend cover (x)	202.7%	1.9	2.0	2.0	2.0

Balance Sheet (RMB m)	2012A	2013A	2014F	2015F	2016F	Cash Flows (RMB m)	2012A	2013A	2014F	2015F	2016F
Fixed assets	3,624	3,969	5,537	6,324	7,068	Operating profit	1,920	2,466	2,623	2,945	3,048
Associates & JCE	-	-	-	-	-	Depreciation & amortization	342	451	335	395	463
Others	538	694	592	599	621	Interest income	-	-	-	-	-
Non-current assets	4,319	4,875	6,341	7,135	7,901	Others	91	(517)	827	(407)	(379)
Inventories	958	832	1,110	1,355	1,384	Change in working capital	(559)	(116)	(608)	(429)	(56)
Debtors & prepayments	2,329	2,614	3,020	3,583	3,654	Tax paid	(259)	263	268	301	312
Bank deposits & cash	1,314	2,354	2,801	3,434	4,456	Operating activities	1,535	2,548	3,445	2,806	3,388
Others	6	2	2	2	2	CAPEX	(1,346)	(931)	(1,903)	(1,182)	(1,206)
Current assets	4,607	5,802	6,934	8,373	9,497	Purchase of assets	-	-	(6)	(6)	(6)
Bank & other borrowings	1,035	908	1,421	1,522	1,674	Disposal of non-current asset	7	197	-	-	-
Trade & payables	1,128	1,175	1,184	1,445	1,476	Proceeds from investments	-	-	-	-	-
Taxation	115	130	127	186	190	Others	(0)	18	(25)	(29)	(80)
Current liabilities	2,752	2,679	3,265	3,803	4,005	Investing activities	(1,339)	(716)	(1,934)	(1,217)	(1,292)
Bank & other borrowings	-	14	-	-	-	New loans raised	4,018	5,074	5,678	5,543	5,612
Others	44	52	42	42	42	Repayment of loans	(3,827)	(5,097)	(5,670)	(5,542)	(5,614)
Non-current liabilities	44	66	42	42	42	Dividends paid	(417)	(740)	(1,053)	(943)	(1,059)
Net assets	6,130	7,932	9,968	11,664	13,351	Others	(26)	(12)	(2)	(2)	(2)
Share capital	100	100	847	847	847	Financing activities	(251)	(775)	(1,047)	(944)	(1,063)
Premium & reserves	5,979	7,776	9,081	10,785	12,465	Inc(dec) in cash	(60)	1,040	465	645	1,033
Shareholders' funds	6,078	7,876	9,928	11,632	13,312	Cash at beginning of year	1,374	1,314	2,354	2,801	3,434
Non-controlling interests	52	56	40	32	39	Foreign ex change effect	-	-	-	-	-
Total equity	6,130	7,932	9,968	11,664	13,351	Cash at end of year	1,314	2,354	2,801	3,434	4,456

Source: CSCI

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	Relative Performance >15%;
Accumulate	Relative Performance is 5% to 15%;
Neutral	Relative Performance is -5% to 5%;
Reduce	Relative Performance is -5% to -15%;
Sell	Relative Performance is <-15%;

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