Luxshare (002475 CH)

Expanding into iPhone assembly; Raise TP to RMB 74.2

Luxshare announced on 17 July that Luxshare and its parentco will acquire 100% of Wistron's two subsidiaries in Kunshan for a deal value of RMB3.3bn. Luxshare will invest no more than RMB600mn (7.2% of 1Q20 cash) for 18% stake of the assets. We think it will allow Luxshare to expand into iPhone assembly business as No.3 supplier (7-10% of share) behind Foxconn and Pegatron, and it is positive to Luxshare in long term given greater synergy with its other iPhone components (acoustics/haptics/wireless/LCP) and earnings upside after turning Wistron's OEM biz into profitability. We lifted FY20-22E EPS by 1-11 % to reflect better AirPods/Watch sales but does not factor in financial impact of this transaction. Reiterate BUY and lifted TP to RMB 74.2 based on rollover 42x FY21E P/E.

- **Long-term synergy with Apple ecosystem; Limited financial impact in near term.** We think the deal is a milestone for Luxshare to become a best-in-class vertically-integrated Apple supplier covering both assembly and components for iPhone, AirPods and Watch. Leveraging its strong partnership with Apple, we think Luxshare will continue to gain share on existing iPhone components, such as acoustics, haptics, wireless charging and LCP modules. Given that Wistron's iPhone OEM remains loss-making and no consolidation is required for Luxshare's 18% stake, we expect limited financial impact in FY20-21E and we have not included in our forecasts yet.
- **Implications to iPhone OEM supply chain.** We estimate Wistron currently accounted for 7-10% share allocation of total iPhone shipment, lagging behind Foxconn/Pegatron (60%/30% share). After deal is closed by end-FY20, we expect Wistron will focus on iPhone OEM in its India plant, while Luxshare will start to expand share in iPhone OEM in China, backed by its vertically-integrated supply chain and strong execution capability.
- **Raise FY20-22E EPS by 1-11 % for better AirPods/Watch.** In view of stronger AirPods/Watch demand and more positive iPhone outlook, we lifted FY20-22E EPS by 1-11% as we estimate Luxshare's AirPods shipment to reach 69mn/85mn and Watch sales to reach RMB 6bn/9bn in FY20/21E.
- **Beneficiary of Apple supplier diversification; Raise TP to RMB 74.2.** Our new TP of RMB 74.2 is based on rollover 42x FY21E P/E given strong earnings CAGR and promising growth profile in iPhone/AirPods/Watch. Upcoming catalysts include stronger AirPods and 5G iPhone launch.

Earnings Summary

(YE31Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	35,850	62,516	98,936	126,353	146,236
YoY growth (%)	57.1	74.4	58.3	27.7	15.7
Net income (RMB mn)	2,723	4,714	7,139	9,446	11,724
EPS (RMB)	0.51	0.88	1.33	1.77	2.19
YoY growth (%)	61.0	72.9	51.7	32.3	24.1
Consensus EPS (RMB)	NA	NA	1.04	1.44	1.77
P/E (x)	108.4	62.7	41.3	31.2	25.2
P/B (x)	17.7	13.6	10.4	8.0	6.3
Yield (%)	0.1	0.2	0.3	0.4	0.5
ROE (%)	16	21.7	25.3	25.7	24.9
Net gearing (%)	20	Net Cash	10	Net Cash	Net Cash

Source: Company data, CMBIS estimate

BUY (Maintain)

Target Price	**RMB74.2**
(Previous TP	RMB55.4)
Up/Downside	**+34.5%**
Current Price	**RMB55.16**

China Technology Sector

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Stock Data

Mkt. Cap. (RMBmn)	385,230
Avg. 3mths t/o (RMBmn)	3,767.28
52W High/Low (RMB)	61.12/ 14.84
Total Issued Shares (mn)	6,984

Source: Bloomberg

Shareholding Structure

Luxshare Ltd	42.92%
HK Securities Clearing	3.96%
China Universal AM	1.76%

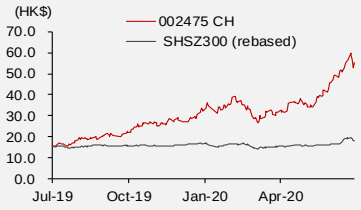
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	21.0%	9.1%
3-mth	70.4%	43.9%
6-mth	71.1%	56.5%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: BDO

Related Reports:

1. Luxshare (002475 CH, Buy) - Strong 2019 finish; Well-positioned in 5G cycle - 28 Feb 2020

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Earnings Revision

Figure 1: Earnings revision

	New			Old			Diff (%)		
RMB mn	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	98,936	126,353	146,236	92,759	113,375	133,200	7%	11%	10%
Gross Profit	20,116	25,766	30,426	19,536	24,023	28,258	3%	7%	8%
Operating Profit	8,589	11,295	13,967	8,731	10,940	12,978	-2%	3%	8%
Net profit	7,139	9,446	11,724	7,074	8,911	10,606	1%	6%	11%
EPS (RMB)	1.33	1.77	2.19	1.32	1.66	1.98	1%	6%	11%
Gross Margin	20.3%	20.4%	20.8%	21.1%	21.2%	21.2%	-0.7 ppt	-0.8 ppt	-0.4 ppt
Operating Margin	8.7%	8.9%	9.6%	9.4%	9.6%	9.7%	-0.7 ppt	-0.7 ppt	-0.2 ppt
Net Margin	7.2%	7.5%	8.0%	7.6%	7.9%	8.0%	-0.4 ppt	-0.4 ppt	0.1 ppt

Source: Bloomberg, CMBIS

Figure 2: CMBI estimates vs consensus

	CMBI			Consensus			Diff (%)		
RMB mn	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	98,936	126,353	146,236	89,658	122,076	148,303	10%	4%	-1%
Gross Profit	20,116	25,766	30,426	17,359	23,696	28,842	16%	9%	5%
Operating Profit	8,589	11,295	13,967	8,110	11,149	14,078	6%	1%	-1%
Net profit	7,139	9,446	11,724	6,625	9,374	11,830	8%	1%	-1%
EPS (RMB)	1.33	1.77	2.19	1.04	1.44	1.77	29%	23%	24%
Gross Margin	20.3%	20.4%	20.8%	19.4%	19.4%	19.4%	1 ppt	1 ppt	1.4 ppt
Operating Margin	8.7%	8.9%	9.6%	9.0%	9.1%	9.5%	-0.4 ppt	-0.2 ppt	0.1 ppt
Net Margin	7.2%	7.5%	8.0%	7.4%	7.7%	8.0%	-0.2 ppt	-0.2 ppt	0 ppt

Source: Bloomberg, CMBIS

Figure 3: Revenue breakdown

RMB mn	FY18	FY19	FY20E	FY21E	FY22E
Computer Connectors	**3,733**	**4,113**	**4,525**	**4,751**	**4,988**
…YoY	*-14%*	*10%*	*10%*	*5%*	*5%*
Automotive Interconnect	**1,728**	**2,361**	**2,834**	**3,542**	**4,782**
…YoY	*53%*	*37%*	*20%*	*25%*	*35%*
Comm. Interconnection	**2,152**	**2,237**	**3,020**	**4,077**	**5,708**
…YoY	*30%*	*4%*	*35%*	*35%*	*40%*
Consumer Electronics	**26,807**	**51,990**	**85,836**	**109,901**	**124,635**
…YoY	*76%*	*94%*	*65%*	*28%*	*13%*
Type-C (Non-Apple)	2,500	2,750	3,025	3,328	3,660
Dongle	2,000	600	-	-	-
Lightning, wireless, LCP	6,500	9,100	10,390	11,201	12,031
Acoustics/haptics	2,592	5,231	5,556	6,534	6,986
Apple Watch	1,500	3,000	6,000	9,000	14,000
AirPods	11,088	29,232	57,750	75,166	80,948
Others	627	2,077	3,115	4,673	7,010
Other Connectors	**1,431**	**1,814**	**2,721**	**4,082**	**6,123**
…YoY	*184%*	*27%*	*50%*	*50%*	*50%*
Total	**35,850**	**62,516**	**98,936**	**126,353**	**146,236**
…YoY	*57%*	*74%*	*58%*	*28%*	*16%*

Source: Company data, CMBIS

Figure 4: P&L forecast

RMB mn	FY17	FY18	FY19	FY20E	FY21E	FY22E
Revenue	**22,826**	**35,850**	**62,516**	**98,936**	**126,353**	**146,236**
…YoY	*66%*	*57%*	*74%*	*58%*	*28%*	*16%*
Cost of sales	18,260	28,304	50,068	78,820	100,587	115,810
Gross profit	4,566	7,546	12,448	20,116	25,766	30,426
GPM (%)	**20.0%**	**21.0%**	**19.9%**	**20.3%**	**20.4%**	**20.8%**
…YoY	*54%*	*65%*	*65%*	*62%*	*28%*	*18%*
SG&A	891	1,288	2,246	3,554	4,539	5,092
…% of rev	4%	4%	3.6%	3.6%	3.6%	3.5%
R&D	1,542	2,515	4,385	6,940	8,863	10,258
…% of rev	7%	7%	7.0%	7.0%	7.0%	7.0%
Operating profit	**2,052**	**3,294**	**5,745**	**8,589**	**11,295**	**13,967**
OPM (%)	9.0%	9.2%	9.2%	8.7%	8.9%	9.6%
…YoY	*57%*	*60%*	*74%*	*50%*	*31%*	*24%*
Net profit	**1,691**	**2,723**	**4,714**	**7,139**	**9,446**	**11,724**
NPM (%)	7.4%	7.6%	7.5%	7.2%	7.5%	8.0%
…YoY	*46%*	*61%*	*73%*	*51%*	*32%*	*24%*

Source: Company data, CMBIS

Valuation

Reiterate BUY and rasied TP to RMB 74.2 (35% upside)

We derived our 12m TP of RMB 74.2 based on rollover 42x FY21E P/E. We believe this is justified as Luxshare continues to deliver strong earnings growth, market share gain and product expansion to capture 5G and wireless opportunities in next 3-5 years.

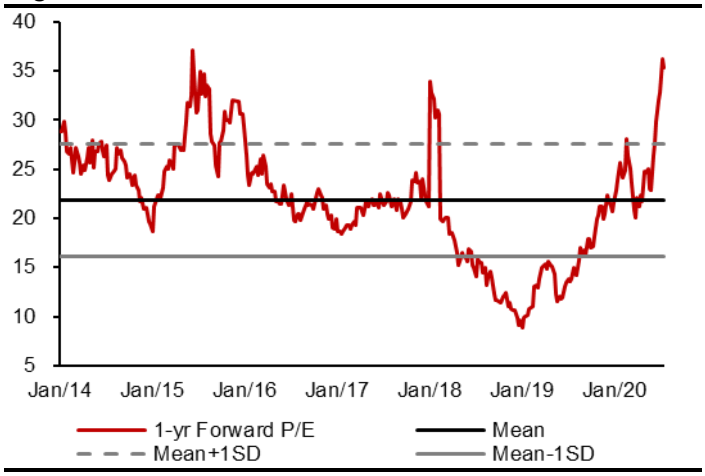
Upcoming catalysts include stronger AirPods shipment, launch of iPhone in 2H20E and China 5G subs ramp. Major risks include weaker AirPods demand, weaker yield improvement and slower integration of acquired businesses.

Figure 5: Peers' valuation

Company	Ticker	Rating	Market Cap US$(mn)	Price (LC)	TP (LC)	Up/ Down -side	P/E (x) FY20E	P/E (x) FY21E	P/B (x) FY20E	P/B (x) FY21E	ROE (%) FY20E	ROE (%) FY21E
A-listed components												
Luxshare	002475 CH	Buy	55,093	55.16	74.2	35%	41.5	31.2	10.4	8.0	25.2	25.8
Goertek	002241 CH	Hold	14,990	32.30	*9.1	NA	75.1	67.3	6.1	5.8	8.1	8.6
O-film	002456 CH	NR	7,492	19.44	NA	NA	41.3	29.2	4.8	4.1	11.7	14.2
Sunway	300136 CH	NR	7,131	51.48	NA	NA	36.7	27.1	8.2	6.3	23.6	24.3
BOE	000725 CH	NR	22,780	4.63	NA	NA	43.7	24.4	1.7	1.6	3.5	6.0
Hans Laser	002008 CH	NR	6,226	40.80	NA	NA	35.4	27.6	4.5	4.0	12.3	14.0
Lens Tech	300433 CH	NR	19,485	31.08	NA	NA	35.8	30.0	5.1	4.4	15.2	15.7
Everwin	300115 CH	NR	3,042	23.38	NA	NA	43.1	30.8	4.4	3.9	10.2	12.0
Holitech	002217 CH	NR	2,358	5.29	NA	NA	-	-	-	-	-	-
			Average				**44.1**	**33.4**	**5.7**	**4.8**	**13.7**	**15.1**
H-listed components												
FIT Hon Teng	6088 HK	Buy	3,639	4.10	4.2	1%	24.1	14.8	1.6	1.5	6.6	9.9
AAC Tech	2018 HK	Sell	8,214	52.70	36.0	-32%	34.0	26.4	2.8	2.6	8.3	9.9
Sunny Optical	2382 HK	Buy	18,376	129.90	148.0	14%	30.3	22.2	7.8	6.0	25.9	27.2
Tongda	698 HK	Hold	372	0.45	0.5	12%	20.2	6.3	0.4	0.4	2.2	7.1
BYDE	285 HK	Buy	5,986	20.60	22.2	8%	25.3	19.0	2.3	2.1	9.0	10.9
Q tech	1478 HK	Buy	1,624	10.74	16.0	49%	15.3	12.0	3.2	2.6	20.7	21.5
TK Group	2283 HK	Buy	230	2.14	2.3	9%	3.9	3.3	1.4	1.4	35.7	41.7
Truly	732 HK	NR	390	0.92	NA	NA	-	-	-	-	-	-
SMIC	981 HK	NR	39,955	29.00	NA	NA	89.1	79.6	2.7	2.6	3.7	3.5
YOFC	6869 HK	NR	2,516	14.48	NA	NA	12.3	9.9	1.0	1.0	8.9	10.1
O-NET	877 HK	NR	668	6.21	NA	NA	22.4	18.1	2.0	1.8	7.9	9.2
Cowell	1415 HK	NR	355	3.31	NA	NA	8.7	7.2	1.1	1.0	11.2	13.8
			Average				**26.0**	**19.9**	**2.4**	**2.1**	**12.7**	**15.0**

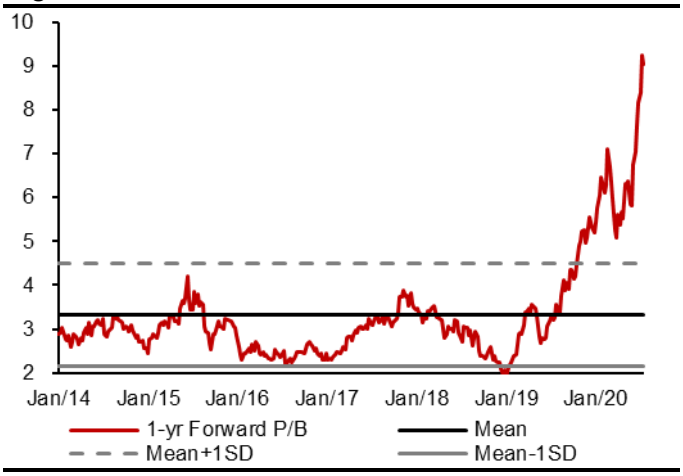
Source: Bloomberg, CMBIS, * TP under review

Figure 6: 12M forward P/E band



Source: Bloomberg, CMBIS

Figure 7: 12M forward P/B band



Source: Bloomberg, CMBIS

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	**35,850**	**62,516**	**98,936**	**126,353**	**146,236**
Cost of sales	28,304	50,068	78,820	100,587	115,810
Gross profit	**7,546**	**12,448**	**20,116**	**25,766**	**30,426**
Selling exp	388	676	1,070	1,367	1,582
Admin exp (excl. R&D)	900	1,570	2,484	3,172	3,510
R&D exp	2,515	4,385	6,940	8,863	10,258
Finance costs	302	332	365	402	442
Other operating exp.	147	(259)	667	667	667
Operating profit	**3,294**	**5,745**	**8,589**	**11,295**	**13,967**
Other non-oper exp.	(12)	(110)	(110)	(110)	(110)
Pre-tax profit	**3,282**	**5,635**	**8,480**	**11,186**	**13,858**
Income tax expense	469	831	1,250	1,649	2,043
Minority interests	91	91	91	91	91
Net profit to shareholders	**2,723**	**4,714**	**7,139**	**9,446**	**11,724**

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net profit	2,813	4,927	7,230	9,537	11,815
Depreciation/amortization	1,212	1,606	1,925	2,372	2,824
Change in working capital	(1,273)	491	(5,770)	2,110	(3,915)
Others	390	442	365	402	442
Net cash from operating	**3,142**	**7,466**	**3,750**	**14,420**	**11,166**
Capex	5,156	6,363	6,000	6,500	7,000
Other	(10,084)	(12,660)	(12,000)	(13,000)	(14,000)
Net cash from investing	**(4,928)**	**(6,298)**	**(6,000)**	**(6,500)**	**(7,000)**
Share issuance	98				
Dividend paid	390	536	735	1,067	1,382
Other	965	536	(836)	(1,536)	(2,207)
Net cash from financing	**1,453**	**1,072**	**(100)**	**(469)**	**(824)**
Net change in cash	(333)	2,241	(2,350)	7,452	3,342
Cash at beginning of year	3,994	3,810	6,147	3,797	11,249
Exchange difference	149	97	0	0	0
Cash at the end of year	**3,810**	**6,147**	**3,797**	**11,249**	**14,591**

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Current assets	**23,078**	**30,751**	**43,423**	**51,605**	**64,478**
Cash & equivalents	3,820	6,180	3,830	11,282	14,624
Account receivables	11,216	13,310	24,157	23,657	30,638
Inventories	4,735	7,701	11,876	13,107	15,657
Prepayment	93	212	212	212	212
Other current assets	3,215	3,347	3,347	3,347	3,347
Non-current assets	**13,363**	**18,627**	**22,702**	**26,830**	**31,006**
PPE	9,457	13,707	17,782	21,910	26,086
Deferred income tax	91	139	139	139	139
Other non-current assets	3,815	4,780	4,780	4,780	4,780
Total assets	**36,441**	**49,378**	**66,125**	**78,435**	**95,484**
Current liabilities	**17,179**	**24,860**	**35,112**	**38,953**	**45,569**
Deferred income	31	102	102	102	102
Account payables	10,238	17,475	26,727	29,568	35,184
Tax payable	161	328	328	328	328
Other current liabilities	6,749	6,956	7,956	8,956	9,956
Non-current liabilities	**2,588**	**2,768**	**2,768**	**2,768**	**2,768**
Deferred income	212	598	598	598	598
Deferred tax liability	426	256	256	256	256
Other non-curr. liabilities	1951	1914	1914	1914	1914
Total liabilities	**19,767**	**27,628**	**37,880**	**41,721**	**48,337**
Share capital	4,115	5,349	5,349	5,349	5,349
Reserves	11,383	14,948	21,442	29,912	40,345
Minority interest	1,177	1,453	1,453	1,453	1,453
Shareholders' equity	**16,675**	**21,750**	**28,244**	**36,714**	**47,147**
Total equity and liabilities	**36,441**	**49,378**	**66,125**	**78,435**	**95,484**

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Computer connectors	10	7	5	4	3
Automotive interconnect	5	4	3	3	3
Comm. interconnect	6	4	3	3	4
Consumer electronics	75	83	87	87	85
Other connectors	4	3	3	3	4
Growth (%)					
Revenue	57.1	74.4	58.3	27.7	15.7
Gross profit	65.3	65.0	61.6	28.1	18.1
Operating profit	60.5	74.4	49.5	31.5	23.7
Net profit	61.0	73.1	51.5	32.3	24.1
Profit & loss ratio (%)					
Gross margin	21.0	19.9	20.3	20.4	20.8
Operating margin	9.2	9.2	8.7	8.9	9.6
Net profit margin	7.6	7.5	7.2	7.5	8.0
Balance sheet ratio					
Net debt/total equity (x)	0.2	Net cash	0.1	Net cash	Net cash
Current ratio (x)	1.3	1.2	1.2	1.3	1.4
Receivable turnover days	94	72	72	72	72
Inventory turnover days	53	45	45	45	45
Payable turnover days	107	101	101	101	101
Profitability (%)					
ROE	16.3	21.7	25.3	25.7	24.9
ROA	7.5	9.5	10.8	12.0	12.3
Per share data (RMB)					
EPS	0.51	0.88	1.33	1.77	2.19
DPS	0.05	0.12	0.18	0.24	0.30

Source: Company data, CMBIS estimates

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