



Components Catwalk Vol.3

NEUTRAL (Unchanged)

SECTOR RESEARCH | Regional

iPhones update & MWC observation

- Reiterate contrarian view that Apple will likely launch two iPhones with larger screens in 3Q14 (Catwalk Vol.1). We now believe Apple could adopt gorilla glass plus sapphire laminate after assessing its patents.
- After reviewing most flagship smartphones during MWC, we believe the addressable market for lens will grow as Samsung, Sony and Huawei continuously enhance camera quality. We believe Apple and HTC will not miss the party. Largan (3008.TT, BUY, TP TWD1,400) remains our top pick among components.

Two larger screens, thinner, sapphire and OIS. The major selling points for the two new iPhones, which we expect to see in Sep 2014, should be larger screens and a thinner design. One is likely to be 4.7-4.8in while the other will be 5.5-5.8in. Both iPhones will likely use glass in addition to a sapphire laminate as cover. The rear camera might remain 8MP but with an optical image stabilizer (OIS).

Size matters. Demand for smartphones >4.5in will account for >50% of total smartphone in 2014, according to data from IDC. We believe Apple needs to address this demand. All of its major competitors showcased phones with screens of 5in or above during MWC indicating the importance of screen size.

Does GTAT have enough capacity to support sapphire cover? In 4Q13, Apple signed a USD578m deal with sapphire manufacturer GTAT. Street argues that the investment is insufficient to build capacity for the upcoming iPhones in 2H14. Apple's total capex for tooling and equipment for 2014 is expected to be USD10.5b (similar with TSMC). Without a more detailed capex breakdown, we should not underestimate the potential dollar investment in the sapphire capacity.

1Q14 iPhone demand likely weaker than expected. We believe Apple adjusted its 1Q production in response to relatively high inventory as well as seasonally slower demand. Current consensus estimates 30% QoQ decline in iPhone production. We won't be surprised to learn of a much sharper decline. Apple exited 4Q13 with inventory of 15m units which is tightly controlled. We also believe the agreement with China Mobile will have little impact on iPhones.

Largan beneficiary of growing lens addressable market. Our observations from MWC lead us to believe that most smartphone brands continue to enhance their flagship models with better camera quality. Though HTC did not debut its M8 device as expected, we assume it will use two rear cameras for 3D function.

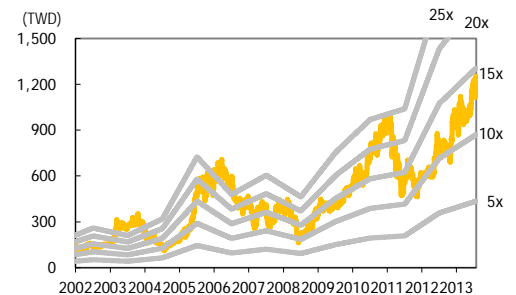
No innovation on casing. Both Samsung Galaxy S5 and Sony Z2 adopt bigger but similar casing designs to previous versions. We expect Apple and HTC to keep the current unibody metal casing design on the upcoming iPhones and M8. It is, in our view, not an exciting move for casing makers such as Catcher.

Analysts

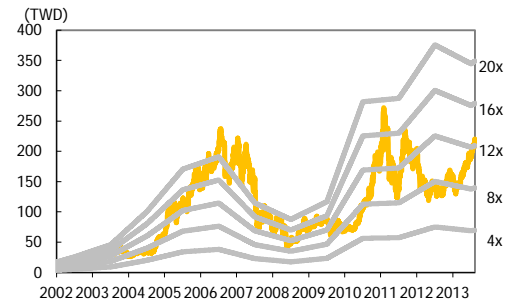
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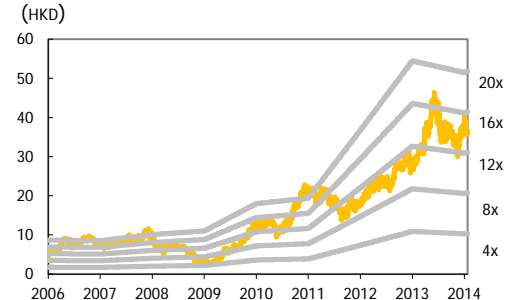
Largan forward PER



Catcher forward PER



AAC forward PER



Largan (3008 TT)	CPTWD1,235 2013F	TPTWD1,400 2014F
P/E (x)	17.4	14.3
P/B (x)	5.6	4.4
Catcher (2474 TT)	CPTWD220 2013F	TPTWD190 2014F
P/E (x)	11.8	12.6
P/B (x)	2.4	2.0
AAC (2018 HK)	CPHKD33.95 2013F	TPHKD31 2014F
P/E (x)	12.5	13.2
P/B (x)	4.2	3.4

Figure 1: Smartphone camera comparison

	Apple			Samsung	
Model	5S	6 (4.7 inch)	6 (5.5 inch)	Galaxy S4	Galaxy S5
Rear camera	8MP	8MP with OIS	8MP with OIS	13MP	16MP
Debut time	Sept, 2013	Sept, 2014	Sept, 2014	1Q13	1Q14
	Sony			HTC	
Model	Xperia Z1	Xperia Z2	Xperia M2	M7 (HTC One)	M8
Rear camera	20.7MP	20.7MP with SteadyShot	8MP	4MP with ultrapixel	Two rear cameras (13MP+8MP)
Debut time	3Q13	1Q14	1Q14	1Q13	1Q14
	Huawei			LG	
Model	Ascend P6	Ascend G6	MediaPad X1	G Pro	G Pro 2
Rear camera	8MP	5MP	13MP	13MP	13MP with OIS+
Debut time	3Q13	1Q14	1Q14	2Q13	1Q14

Source: Company data, Maybank KE

Figure 2: Worldwide smartphone shipments by screen size

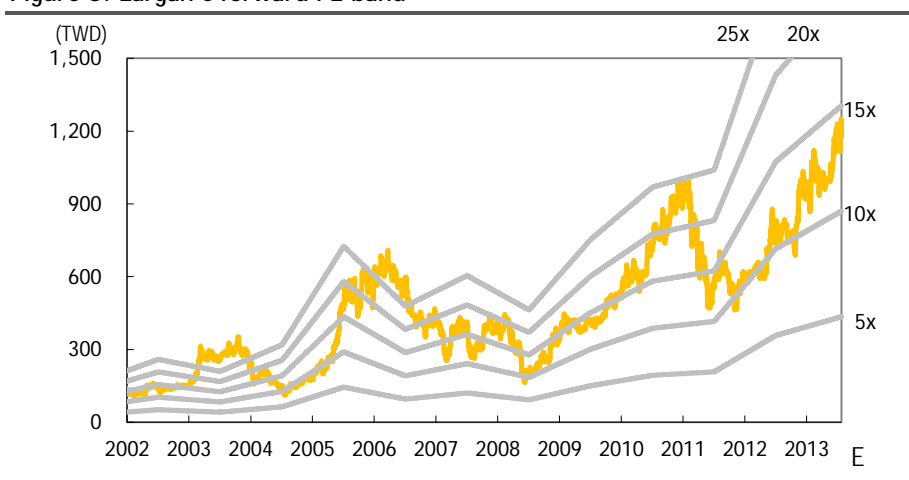
(m units)	2012	2013	2014	2015
2.5 - 2.99"	29.7	9.6	2.3	0
3 - 3.49"	97.4	49.9	21.5	5.1
3.5 - 3.99"	251.9	289.5	29.8	269.5
4 - 4.49"	203.9	285.7	313.3	344.6
4.5 - 4.99"	80.0	216.7	316.7	406.9
5 - 5.49"	21.0	77.7	144.8	206.6
5.5 - 5.99"	8.8	21.1	38.5	48.8
6 - 6.49"	-	1.0	1.1	1.9

Source: IDC, Maybank KE

Largan

Our target price of TWD1,400 is based on 16x target PER (8% discount vs mid-cycle P/E of 17.4x) to factor in low visibility for its end demand and highly volatile operational performance owing to more consumer electronics contribution.

Figure 3: Largan's forward PE band



Source: Company data, Maybank KE

Figure 4: Largan's financial model

(TWDm)	1Q13A	2Q13A	3Q13A	4Q13F	1Q14F	2Q14F	3Q14F	4Q14F	2012A	2013F	2014F
Revenue	5,103	5,857	7,171	9,302	5,916	7,059	9,565	12,961	20,072	27,433	35,501
COGS	2,966	2,902	3,792	4,812	3,448	3,507	5,041	7,191	11,710	14,472	19,187
Gross profit	2,136	2,955	3,379	4,490	2,468	3,553	4,524	5,770	8,362	12,960	16,315
OPEX	461	485	556	677	472	567	725	886	1,564	2,180	2,650
Operating profit	1,676	2,470	2,822	3,813	1,996	2,986	3,799	4,884	6,798	10,781	13,665
PBT	2,013	2,673	2,711	4,104	2,038	3,032	3,846	4,934	6,811	11,501	13,850
PAT	1,849	2,035	2,320	3,405	1,865	2,183	3,289	4,218	5,578	9,610	11,555
EPS (TWD)	13.79	15.18	17.30	25.39	13.91	16.28	24.52	31.46	41.59	71.66	86.16
Margin (%)											
Gross margin	41.9%	50.5%	47.1%	48.3%	41.7%	50.3%	47.3%	44.5%	41.7%	47.2%	46.0%
Operating margin	32.8%	42.2%	39.4%	41.0%	33.7%	42.3%	39.7%	37.7%	33.9%	39.3%	38.5%
Net margin	36.2%	34.8%	32.4%	36.6%	31.5%	30.9%	34.4%	32.5%	27.8%	35.0%	32.5%
Growth (%)											
Revenue YoY	40.2%	75.5%	58.9%	8.4%	15.9%	20.5%	33.4%	43.3%	25.6%	36.7%	30.6%
EPS YoY	109.6%	205.9%	100.0%	18.6%	0.9%	7.2%	41.7%	23.9%	7.3%	72.3%	20.3%
Revenue QoQ	-40.5%	14.8%	22.4%	29.7%	-34.6%	19.3%	35.5%	35.5%			
EPS QoQ	-35.6%	10.1%	14.0%	46.7%	-34.8%	17.0%	50.7%	28.3%			

Source: Company data, Maybank-KE

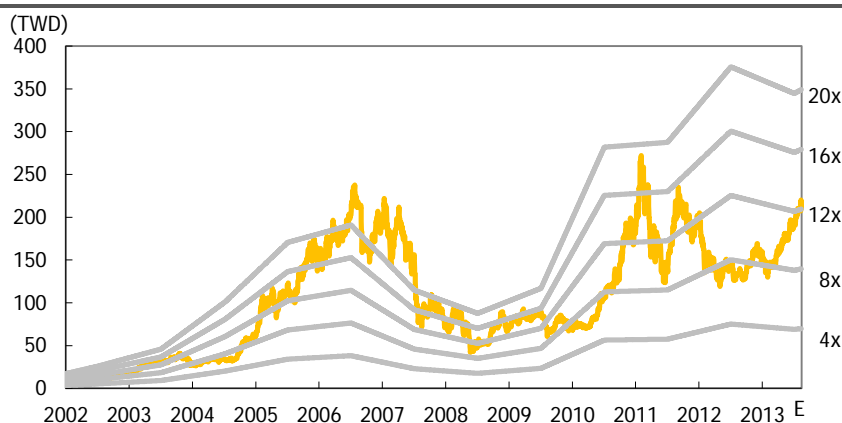
Downside risks are weaker-than-expected handset demand, especially in iPhones and the mid- to high-end segment; severe ASP erosion due to competition or faster-than-expected yield-rate improvement from Largan's major competitor (Genius); market share loss of key customers and other replacement technology (such as wafer-level lenses, please see more details in the following paragraph).

Wafer-level optics (WLO) is a potential threat for mechanical optics. Wafer-level optics is the design and manufacture of miniaturized optics at the wafer level using advanced semiconductor-like techniques. Therefore, current CMOS image sensor makers such as Sony, Omnivision and Aptina are the main WLO suppliers. Their proposed advantages are cost effectiveness and miniaturized optics that enable the reduced form factor of camera modules for mobile devices. However, the current yield rate for WLO is still unstable, especially for more than one lens element. As lens designs are moving into more lens elements (even VGAs are using 3-4P from previous 2P) as well, Largan will mainly focus on the higher-end camera-lens market (VGA/1MP will account for <1% of sales in 2014) Therefore, we do not think WLO is a threat for Largan in the foreseeable future.

Catcher

Our target price of TWD190 is based on 11x target PER (15% discount vs. mid-cycle P/E of 13x) to factor in the competition risks and potential competition from other materials.

Figure 5: Catcher's forward PE band



Source: Company data, Maybank KE

Figure 6: Catcher's financial model

(TWDm)	1Q13A	2Q13A	3Q13A	4Q13F	1Q14F	2Q14F	3Q14F	4Q14F	2012A	2013F	2014F
Revenue	9,232	10,460	10,438	13,115	9,594	10,011	13,626	15,663	37,029	43,245	48,893
COGS	5,380	5,808	6,090	7,647	5,644	5,676	7,722	8,987	20,990	24,925	28,029
Gross profit	3,852	4,652	4,348	5,468	3,950	4,335	5,904	6,676	16,039	18,321	20,864
OPEX	922	1,025	1,103	1,355	940	1,021	1,226	1,300	3,881	4,405	4,488
Operating profit	2,930	3,627	3,245	4,113	3,010	3,313	4,677	5,376	12,158	13,916	16,377
PBT	4,650	4,866	3,415	4,597	3,070	3,394	4,747	5,453	13,951	17,528	16,664
PAT	3,922	3,636	2,771	3,472	2,606	2,202	3,839	4,410	10,890	13,801	13,057
EPS (TWD)	5.23	4.85	3.69	4.63	3.47	2.93	5.12	5.88	14.51	18.39	17.40
EPS (TWD) - FD	5.18	4.80	3.66	4.58	3.44	2.91	5.07	5.82	14.37	18.21	17.23
Margin (%)											
Gross margin	41.7%	44.5%	41.7%	41.7%	41.2%	43.3%	43.3%	42.6%	43.3%	42.4%	42.7%
Operating margin	31.7%	34.7%	31.1%	31.4%	31.4%	33.1%	34.3%	34.3%	32.8%	32.2%	33.5%
Net margin	42.5%	34.8%	26.5%	26.5%	27.2%	22.0%	28.2%	28.2%	29.4%	31.9%	26.7%
Growth (%)											
Revenue YoY	6.7%	8.4%	18.4%	32.3%	3.9%	-4.3%	30.5%	17.3%	3.1%	16.8%	12.4%
EPS YoY	40.5%	138.8%	39.9%	-24.5%	-33.6%	-39.4%	38.5%	27.0%	2.0%	26.7%	-5.4%
Revenue QoQ	-6.9%	13.3%	-0.2%	25.7%	-28.2%	4.3%	36.1%	15.0%			
EPS QoQ	-14.7%	-7.3%	-23.8%	25.3%	-33.1%	-15.5%	74.3%	14.9%			

Source: Company data, Maybank-KE

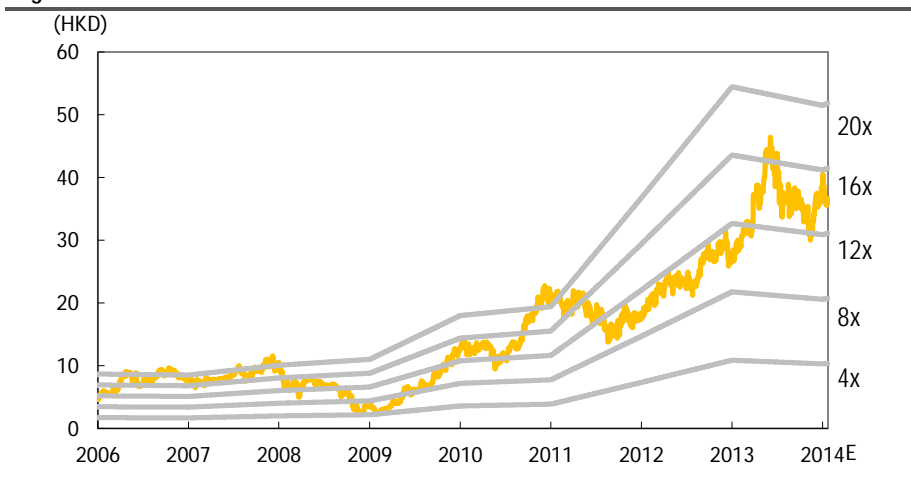
Upside risks are stronger-than-expected smartphone demand, especially in high-end smartphones; less-than-severe ASP/order allocation competition from tier-2 suppliers; and market share wins of key customers.

Downside risks are weaker-than-expected handset demand, especially in iPhones and the mid- to high-end segment; severe ASP erosion due to competition or faster-than-expected yield-rate improvement from Catcher's major competitors such as Casetek; and market share loss of key customers.

AAC

Our target price of HKD31 is based on 12x target multiple (15% discount vs. mid-cycle P/E of 14.2x) and an EPS base of 14F PE. Our 2014E EPS of HKD2.57 is 5% lower than consensus as we believe the slowing acoustics product migration and increasing competition will negatively drag down the company's EPS growth.

Figure 7: AAC's forward PE band



Source: Company data, Maybank KE

Figure 1: AAC's financial model

(CNYm)	1Q13A	2Q13A	3Q13A	4Q13F	1Q14F	2Q14F	3Q14F	4Q14F	2012A	2013F	2014F
Revenue	1,905	1,926	2,083	2,442	2,138	2,257	2,521	2,722	6,283	8,356	9,658
COGS	1,090	1,101	1,198	1,418	1,279	1,354	1,497	1,604	3,509	4,807	5,748
Gross profit	814	825	885	1,025	859	903	1,024	1,118	2,774	3,549	3,910
OPEX	281	256	262	347	304	278	287	373	925	1,145	1,244
Operating profit	533	569	623	678	555	625	737	745	1,849	2,404	2,666
PBT	587	595	994	707	578	649	763	774	2,016	2,883	2,768
PAT	534	542	898	638	516	579	681	691	1,763	2,611	2,469
EPS (CNY)	0.43	0.44	0.73	0.52	0.42	0.47	0.55	0.56	1.44	2.13	2.01
EPS (HKD)	0.56	0.56	0.94	0.66	0.54	0.60	0.71	0.72	1.84	2.72	2.57
Margin (%)											
Gross margin	42.7%	42.8%	42.5%	42.0%	40.2%	40.0%	40.6%	41.1%	44.2%	42.5%	40.5%
Operating margin	28.0%	29.6%	29.9%	27.8%	26.0%	27.7%	29.2%	27.4%	29.4%	28.8%	27.6%
Net margin	28.0%	28.1%	43.1%	26.1%	24.1%	25.6%	27.0%	25.4%	28.1%	31.3%	25.6%
Growth (%)											
Revenue YoY	-4.6%	1.1%	8.1%	17.2%	-12.5%	5.6%	11.7%	8.0%	54.8%	33.0%	15.6%
EPS YoY	-6.2%	1.5%	65.8%	-29.0%	-19.2%	12.3%	17.6%	1.4%	70.1%	48.1%	-5.6%
Revenue QoQ	59.7%	37.9%	22.7%	22.3%	12.3%	17.2%	21.0%	11.5%			
EPS QoQ	69.5%	33.6%	89.8%	12.1%	-3.4%	6.9%	-24.2%	8.3%			

Source: Company data, Maybank-KE

Upside risks are stronger-than-expected smartphone demand, especially for high-end smartphones; less-than-severe ASP/order allocation competition from tier 2 suppliers; faster-than-expected non-acoustic business contribution; and market share win of key customers.

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