Mon, 21 Oct 2019

Equity Research
TMT/China

Q Tech (1478 HK)

Yuji Fung
+852 2135 0236
yuji.fung@oriental-patron.com.hk

Dallas Cai
+852 2135 0248
dallas.cai@oriental-patron.com.hk

Company Update

BUY

UNCHANGED

Close price:	**HK$10.28**
Target Price:	**HK$15.40 (+50%)**
Prior TP	**HK$10.00**

Key Data

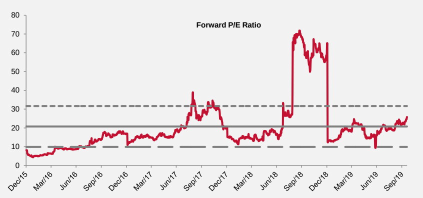
HKEx code		1478 HK
12 Months High	(HK$)	11.56
12 Month Low	(HK$)	3.58
3M AvgDail Vol.	(mn)	8.22
Issue Share	(mn)	1,142.48
Market Cap	(HK$mn)	11,744.65
Fiscal Year		12/2018
Major shareholder (s)		He Ningning (65.95%)

Source: Company data, Bloomberg, OP Research
Closing price are as of 18/10/2019

Price Chart

	1mth	3mth	6mth
Absolute %	**12.1**	**37.1**	**19.8**
Rel. MSCI CHINA %	**12.2**	**38.6**	**30.0**

PE



Company Profile

Q Technology is a leading PRC-based manufacturer focusing on mid-to-high end camera module and fingerprint module market for Chinese branded smart phone and tablet PC manufacturers.

Upgrade on diversified global footprint

- **Q-Tech's Indian phase 1 production base was officially put into production in mid Oct with planned CCM capacity of 4mn/month focusing on 13MP+ CCM which is expected to reach full capacity by end of 1H20E.**
- **We see Q-Tech is better positioned to mitigate the risk from trade war by diversifying not only its non-China customer base but also its production capacities.**
- **Reiterate BUY with TP HK$15.40 revised up from HK$10.00 based on 18x FY21E P/E (vs previously 15x FY20E P/E)**

Breakthrough in global production footprint as phase 1 of India production plant goes into operation focusing on 13MP or above CCM module, accounting for 8% of the enlarged capacity. Q Tech announced that Phase I of the Indian production base has kicked off commissioning on 16 Oct. with full CCM capacity of 4mn pcs per month (equivalent to 8% of the enlarged CCM capacity) is expected to reach by 1H20E after the trial run. Production at Indian factory is mainly for 13M pixel or above products. We expect the factory to ramp up to over 90% utilization (i.e. 4mn per month) by the end of 1H20E.

The planned new CCM capacity in India is likely to serve its clients who have strong demand locally including OPPO, vivo, Xiaomi, and Korea clients. We believe the new Indian capacity will allow higher production flexibility for and more intimate collaboration with the company's key clients and partially mitigate the political risk of trade war.

We see continuous optimization in product mix to resume earnings growth. We are positive on the company's potential in enhancing its product portfolio owing to (1) continuous spec upgrade in terms of both pixel (higher penetration of 13M+ and 20M+ CCM) and non-pixel aspects for 5MP to 8MP product (e.g. ultra-thin modules and telephoto cameras) to lift overall ASP and blended margin from 1H20E onwards.

Reiterate BUY on higher resilience to macro uncertainties. We reiterate our BUY rating on Q Tech with TP HK$15.40 revised up from HK$10.00 based on 18x FY21E PE (vs previously 15x FY20E P/E) given (1) stronger ability to diversify risks thanks to new overseas capacity and more balanced client portfolio and (2) promising upward margin trajectory on better competition landscape.

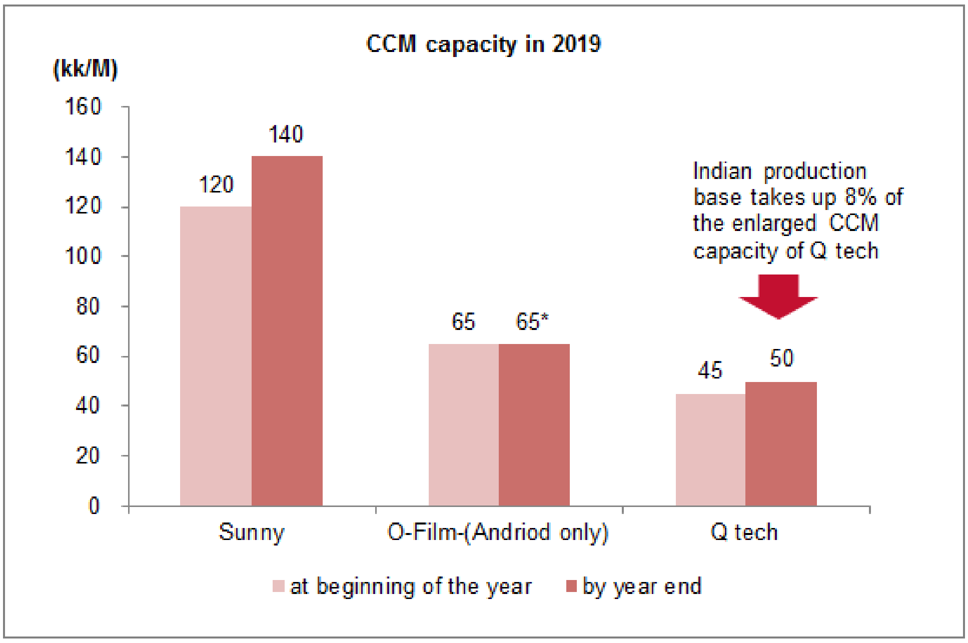
Risks: 1) RMB depreciating more than expected; 2) delay ramp up of non-China customers, 3) substantial erosion on under-glass FPM ASP/GPM.

Exhibit 1: Forecast and Valuation

Year to Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	7,939	8,135	11,564	15,515	17,615
Growth (%)	59	2	42	34	14
Net Profit	436	14	542	685	872
Growth (%)	129	(97)	3,664	26	27
Diluted EPS (HK$)	0.467	0.015	0.532	0.672	0.855
EPS growth (%)	118	(97)	3,402	26	27
Change to previous EPS (%)			0.0	0.0	
Consensus EPS (HK$)			0.414	0.546	
ROE (%)	23.5	0.7	22.8	22.9	23.1
P/E (x)	22.0	677.3	19.3	15.3	12.0
P/B (x)	4.5	4.6	3.9	3.1	2.4
Yield (%)	0.9	0.0	0.0	0.0	0.0
DPS (HK$)	0.096	0.000	0.000	0.000	0.000

Source: Bloomberg, OP Research

Exhibit 2: CCM capacity comparison among key players



Source: Company, OP Research estimates

Exhibit 3: Indian production base of Q Tech kicked of commissioning in mid Oct.

Source: Company

Financial Summary

Year to Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Income Statement (RMB mn)					
Compact camera module	5,896	6,273	9,080	13,198	15,249
Fingerprint module	2,035	1,832	2,454	2,287	2,335
Others	8	30	30	30	30
Turnover	**7,939**	**8,135**	**11,564**	**15,515**	**17,615**
YoY%	59	2	42	34	14
COGS	(7,056)	(7,782)	(10,612)	(14,195)	(16,045)
Gross profit	**883**	**353**	**952**	**1,320**	**1,570**
Gross margin	11.1%	4.3%	8.2%	8.5%	8.9%
Other income	11	83	22	33	42
Selling & distribution	(16)	(19)	(26)	(37)	(42)
Admin	(65)	(81)	(102)	(140)	(158)
R&D	(270)	(266)	(309)	(483)	(539)
Other opex	0	0	0	0	0
Total opex	**(351)**	**(366)**	**(437)**	**(661)**	**(739)**
Operating profit (EBIT)	**543**	**70**	**536**	**693**	**872**
Operating margin	6.8%	0.9%	4.6%	4.5%	5.0%
Provisions	0	0	0	0	0
Finance costs	(17)	(44)	(46)	(46)	(46)
Profit after financing costs	526	26	490	647	826
Associated companies & JVs	(17)	(25)	101	126	157
Pre-tax profit	510	1	591	772	983
Tax	(73)	13	(49)	(87)	(111)
Minority interests	0	0	0	0	0
Net profit	**436**	**14**	**542**	**685**	**872**
YoY%	129	(97)	3,664	26	27
Net margin	5.5%	0.2%	4.7%	4.4%	4.9%
EBITDA	**655**	**248**	**809**	**1,018**	**1,245**
EBITDA margin	8.3%	3.0%	7.0%	6.6%	7.1%
EPS (RMB)	**0.389**	**0.013**	**0.462**	**0.584**	**0.743**
YoY%	116	(97)	3,555	26	27
DPS (HK$)	0.096	0.000	0.000	0.000	0.000

Year to Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Cash Flow (RMB mn)					
EBITDA	655	248	809	1,018	1,245
Chg in working cap	1,583	(444)	93	(202)	(123)
Others	59	36	0	0	0
Operating cash	**2,297**	**(160)**	**902**	**816**	**1,122**
Interests paid	0	0	0	0	0
Tax	(75)	(13)	(2)	(49)	(87)
Net cash from operations	**2,222**	**(173)**	**900**	**767**	**1,034**
Capex	(949)	(522)	(694)	(621)	(528)
Investments	(1,141)	873	0	0	0
Dividends received	0	0	0	0	0
Sales of assets	0	0	0	0	0
Interests received	18	26	7	19	27
Others	(47)	9	0	0	0
Investing cash	**(2,119)**	**387**	**(687)**	**(602)**	**(501)**
FCF	**103**	**214**	**213**	**165**	**533**
Issue of shares	185	55	0	0	0
Buy-back	0	0	0	0	0
Minority interests	0	0	0	0	0
Dividends paid	0	0	0	0	0
Net change in bank loans	218	(346)	0	0	0
Interest paid	(54)	(136)	(46)	(46)	(46)
Others	(37)	(156)	0	0	0
Financing cash	**312**	**(584)**	**(46)**	**(46)**	**(46)**
Net change in cash	**414**	**(370)**	**167**	**119**	**487**
Exchange rate or other Adj	(14)	5	0	0	0
Opening cash	65	465	100	267	386
Closing cash	**465**	**100**	**267**	**386**	**873**
CFPS (HK$)	**2.379**	**(0.182)**	**0.883**	**0.752**	**1.014**

Year to Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Ratios					
Gross margin (%)	11.1	4.3	8.2	8.5	8.9
Operating margin (%)	6.8	0.9	4.6	4.5	5.0
Net margin (%)	5.5	0.2	4.7	4.4	4.9
Selling & dist'n exp/Sales (%)	0.2	0.2	0.2	0.2	0.2
Admin exp/Sales (%)	0.8	1.0	0.9	0.9	0.9
Payout ratio (%)	20.5	0.0	0.0	0.0	0.0
Effective tax (%)	13.9	(50.5)	10.0	13.5	13.5
Total debt/equity (%)	50.2	56.0	44.5	35.4	28.0
Net debt/equity (%)	28.6	51.3	34.4	23.8	7.3
Current ratio (x)	1.05	0.99	1.00	1.04	1.11
Quick ratio (x)	0.88	0.83	0.82	0.85	0.92
Inventory T/O (days)	36	33	33	33	33
AR T/O (days)	94	136	120	120	120
AP T/O (days)	146	144	144	144	144
Cash conversion cycle (days)	(17)	25	9	9	9
Asset turnover (x)	1.50	1.30	1.59	1.68	1.59
Financial leverage (x)	2.86	2.95	3.07	3.09	2.95
EBIT margin (%)	6.8	0.9	4.6	4.5	5.0
Interest burden (x)	0.94	0.02	1.10	1.12	1.13
Tax burden (x)	0.86	10.83	0.92	0.89	0.89
Return on equity (%)	**23.5**	**0.7**	**22.8**	**22.9**	**23.1**
ROIC (%)	**20.3**	**3.5**	**14.3**	**15.6**	**17.5**

Year to Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Balance Sheet (RMB mn)					
Fixed assets	1,481	1,889	2,311	2,596	2,732
Intangible assets & goodwill	1	1	1	1	1
Associated companies & JVs	258	229	330	456	613
Long-term investments	0	0	0	0	0
Other non-current assets	213	92	84	76	69
Non-current assets	**1,953**	**2,211**	**2,726**	**3,129**	**3,414**
Inventories	688	704	960	1,284	1,451
AR	2,035	3,031	3,802	5,101	5,791
Prepayments & deposits	0	0	0	0	0
Other current assets	959	394	394	394	394
Cash	465	100	267	386	873
Current assets	**4,147**	**4,229**	**5,422**	**7,165**	**8,509**
AP	2,830	3,061	4,175	5,584	6,312
Tax	8	2	49	87	111
Accruals & other payables	0	28	35	47	53
Bank loans & leases	1,078	1,178	1,178	1,178	1,178
CB & othe debts	0	0	0	0	0
Other current liabilities	18	0	0	0	0
Current liabilities	**3,934**	**4,270**	**5,437**	**6,896**	**7,655**
Bank loans & leases	0	0	0	0	0
CB & othe debts	0	0	0	0	0
Deferred tax & others	20	66	66	66	66
MI	0	0	0	0	0
Non-current liabilities	**20**	**66**	**66**	**66**	**66**
Total net assets	**2,146**	**2,103**	**2,645**	**3,331**	**4,202**
Shareholder's equity	**2,146**	**2,103**	**2,645**	**3,331**	**4,202**
Share capital	9	9	9	9	9
Reserves	2,137	2,094	2,636	3,322	4,193
BVPS (HK$)	**2.31**	**2.23**	**2.66**	**3.35**	**4.23**
Total debts	1,078	1,178	1,178	1,178	1,178
Net cash/(debts)	(613)	(1,078)	(911)	(792)	(305)

Source: Company, OP Research

Exhibit 4: Peer Group Comparison

Company	Ticker	Price	Mkt cap (US$m)	3-mth avg t/o (US$m)	PER Hist (x)	PER FY1 (x)	PER FY2 (x)	EPS FY1 YoY%	EPS FY2 YoY%	3-Yr EPS Cagr (%)	PEG (x)	Div yld Hist (%)	Div yld FY1 (%)	P/B Hist (x)	P/B FY1 (x)	EV/ Ebitda Hist	EV/ Ebitda Cur Yr	Net gearing Hist (%)	Gross margin Hist (%)	Net margin Hist (%)	ROE Hist (%)	ROE FY1 (%)	Shpx 1-mth %	Shpx 3-mth %
Q Technology Gro	**1478 HK**	**10.28**	**1,497**	**8.5**	**677.3**	**19.3**	**15.3**	**3,402.4**	**26.4**	**283.3**	**0.07**	**0.0**	**0.0**	**4.6**	**3.9**	**51.3**	**15.6**	**51.3**	**4.3**	**(9,670.0)**	**0.7**	**22.8**	**12.1**	**44.4**
HSI		26,719.58			10.4	10.7	10.0	(2.4)	6.3	3.9	2.77	3.7	3.9	1.18	1.15						11.4	10.8	(0.1)	(6.1)
HSCEI		10,540.04			8.4	8.4	7.9	0.1	6.7	5.2	1.62	3.7	3.9	1.11	1.07						13.1	12.8	0.6	(2.3)
CSI300		3,869.38			14.0	12.6	11.1	10.4	13.7			2.2	2.5	1.80	1.67						12.9	13.2	(1.0)	2.7
Adjusted sector avg*					**25.6**	**17.4**	**12.5**	**34.2**	**37.8**	**44.3**	**0.7**	**3.9**	**3.1**	**3.0**	**2.8**	**8.8**	**8.2**	**31.5**	**13.8**	**3.1**	**10.0**	**11.2**	**(1.4)**	**11.4**
Sunny Optical	2382 HK	118.80	16,614	101.5	47.1	34.2	25.0	37.4	37.2	33.2	1.03	0.5	0.9	11.77	9.81	29.1	23.5	0.0	18.9	9.6	30.5	31.8	1.6	38.2
Truly Intl Hldgs	732 HK	0.99	415	0.7	41.9	4.2	4.3	887.3	(1.3)	122.5	0.03	N/A	N/A	0.41	0.43	4.1	3.3	82.7	9.5	0.4	2.7	5.1	(16.1)	(10.0)
Cowell	1415 HK	1.28	136	0.2	9.6	12.6	6.8	(23.5)	84.6	20.8	0.60	8.7	6.1	0.44	0.41	(0.2)	(0.2)	0.0	9.8	2.6	5.4	5.1	(3.8)	(7.2)
Ofilm Group Co-A	002456 CH	10.15	3,888	215.8	N/A	27.5	15.5	N/A	77.5	(246.3)	N/A	N/A	0.2	3.12	2.62	17.9	9.0	175.2	12.1	(1.2)	(17.9)	12.4	(10.3)	28.2
Huizhou Speed -A	300322 CH	21.13	1,214	99.9	140.9	61.2	42.0	130.0	45.8	69.1	0.89	0.1	0.4	13.10	12.32	49.3	39.6	99.4	21.3	3.6	18.9	18.6	4.8	36.4
Crucialtec Co Lt	114120 KS	995.00	55	1.0	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	0.83	N/A	(4.6)	N/A	38.6	(8.8)	(64.1)	(45.6)	N/A	(4.8)	(15.7)
Lite-On Tech	2301 TT	48.05	3,675	12.8	14.0	13.3	12.3	5.8	8.1	5.3	2.48	6.1	6.1	1.61	1.49	6.4	5.5	0.0	13.1	3.8	13.2	11.3	(1.5)	2.0
Primax Elec	4915 TT	63.40	926	18.6	15.4	12.7	11.2	21.4	12.8	14.8	0.86	3.8	4.7	2.47	1.88	9.2	8.2	0.0	12.0	2.8	17.2	14.9	3.8	19.6

** Outliners and "N/A" entries are in red and excl. from the calculation of averages*

Source: Bloomberg, OP Research

Our recent reports

Date	Company / Sector	Ticker	Title	Rating	Analyst
18/10/2019	Xtep Intl	1368	3Q19 oprations in line	BUY	Dallas Cai/Megan Jin
17/10/2019	Anta Sports	2020	3Q19 retail performance up to expectations	BUY	Dallas Cai/Megan Jin
17/10/2019	361 Degrees Intl	1361	3Q19 operations in line with expectations	BUY	Megan Jin
14/10/2019	Sunny Optical	2382	Another month of robust HLS growth	BUY	Yuji Fung/Dallas Cai
11/10/2019	Q Tech	1478	September saw robust shipment growth momentum	BUY	Yuji Fung/Dallas Cai
02/10/2019	China Prop Mgmt	-	Clear vision of promising secular growth	BUY	Dallas Cai/Yuji Fung
11/09/2019	Q Tech	1478	August saw product mix improving on track	BUY	Yuji Fung/Dallas Cai
10/09/2019	Sunny Optical	2382	Upgrade on HLS market share gain	BUY	Yuji Fung/Dallas Cai
05/09/2019	Sinosoft Tech	1297	1H19 saw softened growth	BUY	Yuji Fung/Dallas Cai
05/09/2019	Truly Int'l	732	1H19 saw loss from associate narrowing on track	BUY	Yuji Fung/Dallas Cai
02/09/2019	TCL Electronics	1070	1H19 earnings beat our expectations	BUY	Yuji Fung/Dallas Cai
27/08/2019	Anta Sports	2020	Positive surprise from OPM and Descente breakeven	BUY	Dallas Cai/Megan Jin
23/08/2019	Tian Lun Gas	1600	1H19 saw growth on track	BUY	Yuji Fung/Dallas Cai
23/08/2019	Ju Teng Intl	3336	1H19 results in line with expectations	BUY	Yuji Fung/Dallas Cai
22/08/2019	Xtep Intl	1368	1H19 earnings beat on non-core items	BUY	Dallas Cai/Megan Jin
22/08/2019	Tongda	698	1H19 saw GPM recovery as expected	BUY	Yuji Fung/Dallas Cai
21/08/2019	Chinasoft Intl	354	1H19 results in line with expectations	BUY	Yuji Fung/Dallas Cai
21/08/2019	361 Degrees Intl	1361	1H19 results in line	BUY	Megan Jin
21/08/2019	Edvantage Group	382	Pathway to the World	NR	Yuji Fung
20/08/2019	Regal Intl Airport	357	Franchise revenue retreated on competition	BUY	Yuji Fung/Dallas Cai
19/08/2019	Ausnutria Dairy	1717	Response to short-sell allegations	BUY	Dallas Cai/Megan Jin
16/08/2019	CH Display OPT	334	Downgrade on robust shipment growth at the cost of squeezed dollar margin	HOLD	Yuji Fung/Dallas Cai
16/08/2019	Kingdee Intl	268	1H19 results in line with previous profit warnings	SELL	Yuji Fung/Dallas Cai
16/08/2019	Sunny Optical	2382	Positive surprise on handset lens sets margin	BUY	Yuji Fung/Dallas Cai
15/08/2019	Ausnutria Dairy	1717	Inventory surge on one-off events	BUY	Dallas Cai/Megan Jin
15/08/2019	Li Ning	2331	Higher visibility for wholesale channel optimization	BUY	Dallas Cai/Megan Jin
13/08/2019	Q Tech	1478	Comeback with upbeat margin	BUY	Yuji Fung/Dallas Cai

Historical recommendations and target price: Q Tech (1478 HK)

(as of 18/10/2019)

	Date	Rating	TP (HK$)	CLOSE (HK$)		Date	Rating	TP (HK$)	CLOSE (HK$)
1	20 Feb 2019	BUY	7.00	5.66	6	21 Jun 2019	SELL	5.00	6.07
2	26 Mar 2019	SELL	5.70	6.61	7	01 Jul 2019	BUY	7.40	5.95
3	10 Apr 2019	SELL	5.70	9.09	8	13 Aug 2019	BUY	9.20	7.35
4	09 May 2019	SELL	5.70	7.43	9	10 Sep 2019	BUY	9.20	8.67
5	11 Jun 2019	SELL	5.00	6.28	10	11 Oct 2019	BUY	10.00	9.15

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CONTACT

27/F, Two Exchange Square,
8 Connaught Place, Central, Hong Kong

www.oriental-patron.com.hk
yuji.fung@oriental-patron.com.hk

Tel: (852) 2135 0236
Fax:(852) 2135 0295