

## Greater China smartphone sector

### Eyeing spec upgrade trends

- New iPhones should arrive in September; dual camera should be the key selling point
- iPhone weakness in 1H16 looks priced in; we expect 36% HoH volume growth in 2H16 (vs. 10% HoH in 2H15)
- Prefer components with spec upgrades vs. volume players; focus on market leaders – top picks: Largan, AAC, and Sunny Optical

Negative

Neutral

Positive



**Positive**  
(unchanged)

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**What's new:** We outline our expectations for Apple mobile-device releases in 2H16, emerging trends in the smartphone space, and implications for the Greater China supply chain based on our market research findings.

**What's the impact: iPhones.** We expect Apple to introduce a new flagship smartphone model this September: a 4.7" version (iPhone 7) and two 5.5" versions (iPhone 7 Plus and 7 Plus Premium). Our research indicates all versions are likely to have similar spec upgrades relative to the 6S/6S Plus: a thinner design and water-proofing, a similar but more streamlined metal casing with a new color (piano black) and a re-designed antenna, faster CPU, and no headphone jack.

The major upgrade will likely be a better camera: we expect the iPhone 7 Plus Premium to have a dual camera (12MP+12MP) while the iPhone 7 and 7 Plus should have a single camera with an OIS and 6P lens. We see the dual camera as the key selling point and expect the iPhone 7 Plus Premium model to account for 25% of total new iPhones, higher than the street estimate of 15%. In addition, we think Apple may adopt dual cameras for all 5.5 models, which could boost the dual camera adoption to 30-40% if the decision is finalized. We look for a strong volume pick-up for iPhones in 2H16 of 36% HoH (vs. 10% HoH in 2H15) on the new release. However, on weak iPhones 6S sales in 1H16E, we forecast total production volume of 212m in 2016, a 9% YoY decline.

**iPads and Apple Watch.** We expect Apple to release an updated iPad (7.9" and 12.9") and Apple Watch in 4Q16. We do not expect too many "wow" factors and look for iPad volume to fall to 43.5m (vs. 50m in 2015) and Apple Watch volume to fall to 7-8m in 2016 (vs. 11m in 2015).

**What we recommend: Focus on market leaders amidst favorable industry trends.** In the smartphone space, we prefer components with spec upgrades over OEM/EMS due to expected muted volume growth this year. Apple supply-chain names have corrected by 20% in the past 6 months on weak iPhone 6S demand and a light seasonal effect. While we view 2016 as a tough year for iPhone names, we believe that the negatives have been mostly priced in and that it is a good time to accumulate high-quality names on favorable industry trends. Our top picks in smartphone space are **Largan:** lens spec upgrades and dual-camera trend; **AAC:** acoustics spec upgrades (water-proofing) and market-share gains in non-acoustics; and **Sunny Optical:** beneficiary of rising of smart cars and dual-camera trend. We also like GIS for its long-term potential from emerging opportunities in OLED adoption. We suggest investors to stay away from tier-2 brands – HTC and TCLC – as well as volume players – FIH Mobile and Hon Hai – due to the stiff competition in the space.

**How we differ:** We are more optimistic than the street on the benefits from spec upgrades to our preferred names.

### Greater China smartphone sector: top picks

Company	Ticker	Daiwa rating	Mkt cap (USDbn)
Largan	3008 TT	Buy	10.4
AAC	2018 HK	Buy	8.6
Sunny	2382 HK	Outperform	3.4

Source: Daiwa; based on 10 May 2016 closing prices

## Valuation summary

Company	Ticker	Price (local curr.) 05/10/16	Daiwa Rating	Mkt cap (USDbn)	EPS (rpt)			PER (x)			EPS growth (%)			ROE (%)			PBR (x)		
					2015	2016E	2017E	2015	2016E	2017E	2015	2016E	2017E	2015	2016E	2017E	2015	2016E	2017E
Hon Hai	2317 TT	74.8	Hold	36.0	9.5	9.1	9.8	7.9	8.2	7.7	8.0	-3.9	6.8	15.0	13.6	13.4	1.2	1.2	1.1
Largan	3008 TT	2530.0	Buy	10.4	180.1	175.2	215.9	14.0	14.4	11.7	24.3	-2.7	23.2	44.1	33.1	32.6	7.3	5.4	4.3
AAC	2018 HK	54.6	Buy	8.6	2.5	3.0	3.6	17.3	14.4	12.1	34.0	19.9	18.9	30.1	29.6	29.0	5.8	4.7	3.9
Sunny Optical	2382 HK	24.0	Outperform	3.4	0.7	1.0	1.2	27.1	20.1	16.2	34.0	35.0	23.7	21.5	24.2	24.8	6.3	5.4	4.4
FIH	2038 HK	2.57	Hold	2.6	0.029	0.012	0.017	11.2	28.0	19.8	31.6	-59.9	41.7	5.9	2.5	3.5	0.6	0.7	0.7
HTC	2498 TT	69.0	Sell	1.8	-18.7	-8.0	-10.0	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0.7	0.9	1.0
GIS	6456 TT	80.6	Buy	0.8	7.4	8.7	10.5	17.3	10.9	9.3	58.1	17.7	21.1	23.4	21.7	22.7	3.1	2.2	1.9
TCLC	2618 HK	5.13	Underperform	0.8	0.8	0.6	0.7	6.1	9.3	7.2	-7.4	-34.7	28.7	25.8	16.8	19.5	1.5	1.6	1.5
TPK	3673 TT	61.4	Outperform	0.7	-56.9	5.6	8.2	n.a.	10.9	7.5	n.a.	n.a.	45.9	n.a.	6.2	8.5	0.4	0.7	0.7
TXC	3042 TT	43.1	Outperform	0.4	3.0	3.4	3.8	14.2	12.6	11.4	-5.7	13.0	10.9	9.6	9.7	10.5	1.5	1.2	1.2

Source: Bloomberg, Daiwa; based on 10 May 2016 closing prices

## iPhone: production volume by model

(m units)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16E	3Q16E	4Q16E	2014	2015	2016E
iPhone 4 & 4S	7.5	7.5	5.0	2.0	2.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	22.0	2.5	0.0
iPhone 5C	6.5	5.0	4.0	3.0	2.5	1.0	0.5	0.0	0.0	0.0	0.0	0.0	18.5	4.0	0.0
iPhone 5S/6 SE	26.5	24.0	13.0	6.0	8.0	4.5	4.0	2.5	4.0	6.0	6.0	6.5	69.5	19.0	22.5
iPhone 6 & 6 Plus	0.0	0.0	17.0	63.0	45.5	47.0	19.5	13.5	7.5	5.0	4.0	4.5	80.0	125.5	21.0
iPhone 6S & 6S Plus	0.0	0.0	0.0	0.0	0.0	0.0	22.0	60.0	35.5	32.0	14.0	8.0	0.0	82.0	89.5
iPhone 7 series	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	23.5	55.5	0.0	0.0	79.0
<b>Total</b>	<b>40.5</b>	<b>36.5</b>	<b>39.0</b>	<b>74.0</b>	<b>58.0</b>	<b>53.0</b>	<b>46.0</b>	<b>76.0</b>	<b>47.0</b>	<b>43.0</b>	<b>47.5</b>	<b>74.5</b>	<b>190.0</b>	<b>233.0</b>	<b>212.0</b>

Source: Daiwa forecasts

## iPad: production volume by model

(m units)	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16E	3Q16E	4Q16E	2014	2015	2016E
iPad 2	0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8	0.0	0.0
iPad 4	0.8	1.0	1.0	0.5	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	3.3	0.0	0.0
iPad Air/ Pro (9.7)	7.0	7.0	7.0	12.5	7.5	6.0	7.0	9.0	4.5	6.0	5.7	6.5	33.5	29.5	22.7
iPad mini	3.5	2.5	2.5	1.5	0.5	0.5	0.0	0.0	0.0	0.0	0.0	0.0	10.0	1.0	0.0
iPad mini Retina	3.0	4.0	4.5	4.9	4.0	3.5	4.0	5.5	4.0	2.5	3.5	5.3	16.4	17.0	15.3
iPad Pro (12.9)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	2.5	2.0	1.0	1.0	1.5	0.0	2.5	5.5
<b>Total</b>	<b>15.1</b>	<b>14.5</b>	<b>15.0</b>	<b>19.4</b>	<b>12.0</b>	<b>10.0</b>	<b>11.0</b>	<b>17.0</b>	<b>10.5</b>	<b>9.5</b>	<b>10.2</b>	<b>13.3</b>	<b>64.0</b>	<b>50.0</b>	<b>43.5</b>

Source: Daiwa forecasts

## Global smartphone shipments: 2012-2018E



Source: Daiwa forecasts

## Greater China smartphone sector: Apple supply chain share prices



Source: Daiwa forecasts

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