Shennan Circuits (002916 CH)

Near-term cost pressure remains overhang; Maintain HOLD

We hosted a NDR call with Shennan mgmt. this week, and investors mainly focused on 5G telecom demand, laminate cost pressure, IDC/auto segments and capacity expansion. For FY20, Shennan reported revenue of RMB11.9bn (10% YoY) and net profit of RMB1.4bn (16% YoY), in-line with our/consensus estimates, mainly driven by 8%/33% YoY growth in PCB/IC substrate and 4% YoY decline in PCBA. Looking into 2021, we expect PCB/PCBA to grow 15%/5% thanks to telecom recovery and improving product mix, while IC substrate will grow at 19% YoY on strong demand and supply tightness. We revised down our FY21/22E EPS by 18/14% to reflect cost pressure and lower ASP, and adjusted our TP to RMB97.8 based on lower 30x FY21E P/E. Maintain HOLD.

- **Positive outlook for PCB demand on 5G rollout recovery and improved product mix.** With 60% telecom exposure, PCB/PCBA segment delivered weaker growth of +8%/-4% YoY in FY20, given slower 5G BTS build-out in 2H20 after a strong ramp in 1H20, while IDC/auto products grew 58%/50% YoY. Looking into 2021, we believe PCB segment will regain its strength as 1) China 5G deployment will reaccelerate in 1H21E (3rd batch 5G BTS tender in Mar-Apr) and overseas demand is recovering as COVID-19 is easing; 2) Nantong (2nd phase) is expected to reach its full capacity this year and 3) product mix will continue to improve as auto/server demand remains strong.
- **Capacity expansion on track for IC substrate segment.** Shennan's IC substrate clients mainly come from MEMS, fingerprint sensor, memory segments (30%/20%+/20%+ of substrate rev). As 2020 was a big year for semiconductor, IC substrate segment grew 33% YoY, and we expect strong momentum will continue into 2021 given solid demand and recent supply tightness. Mgmt. expect capacity of Wuxi plant will reach full utilization in 1H22E.
- **Maintain HOLD with new TP of RMB97.8.** We trimmed FY21-22E EPS by 14-18% for lower ASP/margin assumptions, and reduced our TP to RMB97.8 based on lower 30.0x FY21E P/E (vs prior 32.4x). We maintain HOLD and expect near-term pressure on the stock due to 1) price pressure on PCB de-spec for 700MHz 5G BTS and 2) rising laminate cost starting from late 1Q21E. Potential risks include lower 5G CAPEX from telco and raw material cost hike.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	10,524	11,600	13,316	15,131	17,352
YoY growth (%)	38.4	10.2	14.8	13.6	14.7
Gross margin	26.5	26.5	26.1	26.4	26.7
Net income (RMB mn)	1,233	1,430	1,595	1,874	2,193
EPS (RMB)	2.62	3.00	3.26	3.83	4.48
YoY growth (%)	5.2	14.5	8.7	17.5	17.0
Consensus EPS (RMB)	NA	NA	3.83	4.72	5.19
P/E (x)	35.3	30.8	28.4	24.1	20.6
P/B (x)	6.3	6.1	5.3	4.6	3.9
Dividend Yield (%)	1.2	1.0	1.1	1.3	1.6
ROE (%)	25	19	19	19	19
Gearing ratio (%)	34	24	26	31	28

Source: Company data, Bloomberg, CMBIS estimates

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HOLD (Maintain)

Target Price	**RMB97.8**
(Previous TP	RMB129.1)
Up/Downside	**+6%**
Current Price	**RMB92.46**

China Technology Sector

Lily Yang
(852) 3916 3716
lilyyang@cmbi.com.hk

Alex Ng
(852) 3900 0881
alexng@cmbi.com.hk

Stock Data

Mkt Cap (RMB mn)	45,052
Avg 3 mths t/o (RMB mn)	750
52w High/Low (RMB)	198.0/91.5
Total Issued Shares (mn)	489.3

Source: Bloomberg

Shareholding Structure

AVID International	67.05%
HKSCC	3.50%
China Asset Mgmt. Co.	1.03%

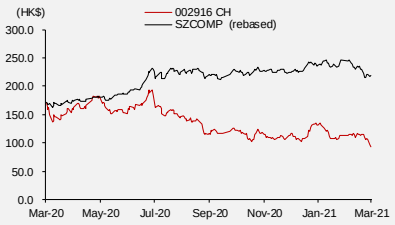
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-13.8%	-2.4%
3-mth	-14.0%	-10.7%
6-mth	-16.6%	-15.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Grant Thornton CPA

Recent Report:
China 5G Technology - Picking structural winners amid uncertainties; Initiate at Outperform – 18 Dec 2020

FY20 Results Review

Figure 1: FY20 results review

RMB mn	FY18	FY19	FY20	YoY	CMBIS estimates FY20E	Diff%	Consensus FY20E	Diff %
Revenue	7,602	10,524	11,600	10%	11,948	-3%	12,228	-5%
Gross Profit	1,758	2,792	3,071	10%	3,153	-3%	3,239	-5%
Operating Profit	784	1,417	1,625	15%	1,705	-5%	1,806	-10%
Net profit	697	1,233	1,430	16%	1,439	-1%	1,458	-2%
EPS (RMB)	2.49	3.66	3.00	15%	3.02	-1%	3.04	-1%
Gross Margin	23.1%	26.5%	26.5%	-0.2 ppt	26.4%	0.1 ppt	26.5%	0 ppt
Operating Margin	10.3%	13.5%	14.0%	4 ppt	14.3%	-0.3 ppt	14.8%	-0.8 ppt
Net Margin	9.2%	11.7%	12.3%	5.2 ppt	12.0%	0.3 ppt	11.9%	0.4 ppt

Source: Bloomberg, CMBIS estimates

Figure 2: FY20 results review (Quarterly)

RMB mn	4Q19	4Q19	1Q20	2Q20	3Q20	4Q20	QoQ	YoY
Revenue	2,867	2,866	2,498	3,418	3,067	2,618	-14.6%	-8.7%
Gross Profit	825	827	639	911	848	673	-20.7%	-18.7%
Operating Profit	468	403	336	514	442	332	-24.8%	-17.6%
Net profit	396	365	277	448	374	332	-11.2%	-9.1%
EPS (RMB)	1.17	1.08	0.82	0.94	0.76	0.68	-11.2%	-37.0%
Gross Margin	28.8%	28.9%	25.6%	26.7%	27.6%	25.7%	-1.9 ppt	-3.2 ppt
Operating Margin	16.3%	14.1%	13.5%	15.0%	14.4%	12.7%	-1.7 ppt	-1.4 ppt
Net Margin	13.8%	12.7%	11.1%	13.1%	12.2%	12.7%	0.5 ppt	-0.1 ppt

Source: Bloomberg, CMBIS estimates

Earnings Revision

Figure 3: CMBIS earnings revisions

RMB mn	New FY21E	New FY22E	New FY23E	Old FY21E	Old FY22E	Old FY23E	Change (%) FY21E	Change (%) FY22E	Change (%) FY23E
Revenue	13,316	15,131	17,352	15,521	17,045	NA	-14%	-11%	NA
Gross Profit	3,471	3,995	4,641	4,117	4,569	NA	-16%	-13%	NA
Operating Profit	1,830	2,149	2,514	2,247	2,526	NA	-19%	-15%	NA
Net profit	1,595	1,874	2,193	1,896	2,132	NA	-16%	-12%	NA
EPS (RMB)	3.26	3.83	4.48	3.97	4.47	NA	-18%	-14%	NA
Gross Margin	26.1%	26.4%	26.7%	26.5%	26.8%	NA	-0.5 ppt	-0.4 ppt	NA
Operating Margin	13.7%	14.2%	14.5%	14.5%	14.8%	NA	-0.7 ppt	-0.6 ppt	NA
Net Margin	12.0%	12.4%	12.6%	12.2%	12.5%	NA	-0.2 ppt	-0.1 ppt	NA

Source: Company data, CMBIS estimates

Figure 4: CMBIS estimates vs consensus

RMB mn	CMBIS FY21E	CMBIS FY22E	CMBIS FY23E	Consensus FY21E	Consensus FY22E	Consensus FY23E	Diff (%) FY21E	Diff (%) FY22E	Diff (%) FY23E
Revenue	13,316	15,131	17,352	15,197	17,961	18,723	-12%	-16%	-7%
Gross Profit	3,471	3,995	4,641	4,053	4,822	5,065	-14%	-17%	-8%
Operating Profit	1,830	2,149	2,514	2,294	2,757	3,025	-20%	-22%	-17%
Net profit	1,595	1,874	2,193	1,891	2,339	2,538	-16%	-20%	-14%
EPS (RMB)	3.26	3.83	4.48	3.87	4.75	5.19	-16%	-19%	-14%
Gross Margin	26.1%	26.4%	26.7%	26.7%	26.8%	27.1%	-0.6 ppt	-0.4 ppt	-0.3 ppt
Operating Margin	13.7%	14.2%	14.5%	15.1%	15.4%	16.2%	-1.4 ppt	-1.1 ppt	-1.7 ppt
Net Margin	12.0%	12.4%	12.6%	12.4%	13.0%	13.6%	-0.5 ppt	-0.6 ppt	-0.9 ppt

Source: Bloomberg, CMBIS estimates

Figure 5: P&L forecast

RMB mn	FY19	1Q20	2Q20	3Q20	4Q20	FY20	FY21E	FY22E	FY23E
Revenue	**10,524**	**2,498**	**3,418**	**3,067**	**2,618**	**11,600**	**13,316**	**15,131**	**17,352**
…YoY	*38%*	*15%*	*30%*	*7%*	*-9%*	*10%*	*15%*	*14%*	*15%*
Cost of sales	(7,732)	(1,858)	(2,507)	(2,219)	(1,945)	(8,530)	(9,845)	(11,136)	(12,710)
Gross profit	**2,792**	**639**	**911**	**848**	**673**	**3,071**	**3,471**	**3,995**	**4,641**
GPM (%)	27%	26%	27%	28%	26%	26%	26%	26%	27%
…YoY	*59%*	*26%*	*44%*	*3%*	*-19%*	*10%*	*13%*	*15%*	*16%*
SG&A	(719)	(166)	(178)	(173)	(130)	(647)	(759)	(862)	(989)
…% of rev	*-7%*	*-7%*	*-5%*	*-6%*	*-5%*	*-6%*	*-6%*	*-6%*	*-6%*
R&D	(537)	(120)	(164)	(183)	(178)	(645)	(732)	(832)	(954)
…% of rev	*-5%*	*-5%*	*-5%*	*-6%*	*-7%*	*-6%*	*-6%*	*-6%*	*-6%*
Operating profit	**1,417**	**336**	**514**	**442**	**332**	**1,625**	**1,830**	**2,149**	**2,514**
OPM (%)	*13%*	*13%*	*15%*	*14%*	*13%*	*14%*	*14%*	*14%*	*14%*
…YoY	*81%*	*55%*	*56%*	*-5%*	*-18%*	*15%*	*13%*	*17%*	*17%*
Net profit	**1,233**	**277**	**448**	**374**	**332**	**1,430**	**1,595**	**1,874**	**2,193**
NPM (%)	*12%*	*11%*	*13%*	*12%*	*13%*	*12%*	*12%*	*12%*	*13%*
…YoY	*77%*	*48%*	*57%*	*-6%*	*-9%*	*16%*	*12%*	*18%*	*17%*

Source: Company data, CMBIS estimates

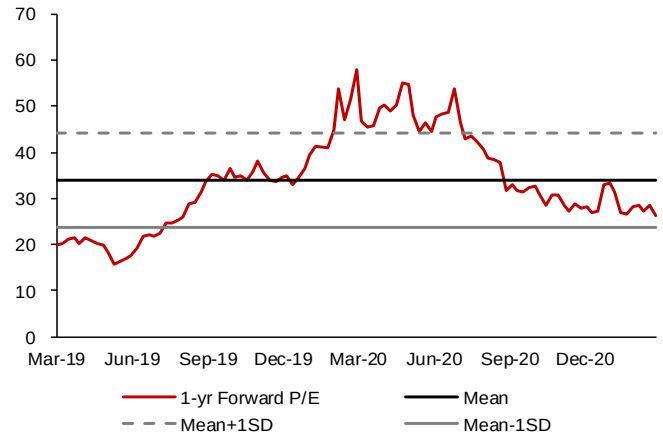
Valuation

Maintain HOLD and trim TP to RMB97.8

We maintain HOLD and adjust TP to RMB97.8 based on lower 30.0x FY21E P/E (vs prior 32x). Upcoming catalysts include 1) upcoming catalysts include 3rd phase of 5G BTS tenders and 2) operators' 2021 capex budget.

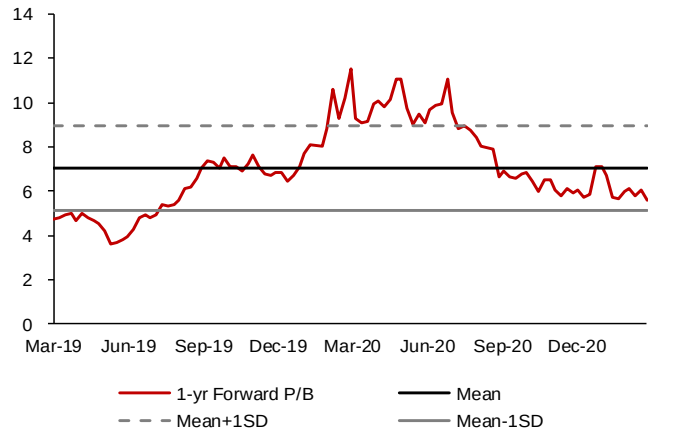
Risks include 1) continued price increase in upstream materials, 2) de-spec of 5G BTS and 3) less-than-expected demand from Telecom and Datacom operators.

Figure 6: 12M forward P/E band



Source: Company data, CMBIS estimates

Figure 7: 12M forward P/B band



Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	**10,524**	**11,600**	**13,316**	**15,131**	**17,352**
Cost of sales	7,732	8,530	9,845	11,136	12,710
Gross profit	**2,792**	**3,071**	**3,471**	**3,995**	**4,641**
Selling exp	218	167	186	212	243
Admin exp	501	480	573	651	746
R&D exp	537	645	732	832	954
Finance costs	73	152	153	154	186
Other operating exp.	47	2	(3)	(2)	(2)
Operating profit	**1,417**	**1,625**	**1,830**	**2,149**	**2,514**
Other non-oper exp.	(14)	(19)	(16)	(18)	(21)
Pre-tax profit	**1,403**	**1,606**	**1,814**	**2,131**	**2,493**
Income tax expense	170	175	218	256	299
Minority interests	1	1	1	1	1
Net profit to shareholders	**1,233**	**1,430**	**1,595**	**1,874**	**2,193**

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net profit	1,234	1,431	1,596	1,875	2,194
Dep. /amort.	467	644	721	881	1,057
Change in working capital	(650)	(557)	379	(1,094)	217
Others	212	282	147	150	185
Net cash from operating	**1,263**	**1,800**	**2,842**	**1,812**	**3,653**
Capex	(2,183)	(2,486)	(2,884)	(2,504)	(2,857)
Other	186	(149)	0	0	0
Net cash from investing	**(1,997)**	**(2,635)**	**(2,884)**	**(2,504)**	**(2,857)**
Share issuance	130	0	0	0	0
Dividend paid	(278)	(453)	(465)	(519)	(609)
Debt issuance/(paydown)	1,746	87	803	1,085	292
Other	(82)	295	(153)	(154)	(186)
Net cash from financing	**1,516**	**(71)**	**186**	**412**	**(503)**
Net change in cash	**791**	**(937)**	**144**	**(279)**	**293**
Cash at beginning of year	650	1,441	504	648	369
Exchange difference	9	(31)	0	0	0
Cash at the end of year	**1,441**	**504**	**648**	**369**	**662**

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Current assets	**5,977**	**5,941**	**6,256**	**6,990**	**7,718**
Cash & equivalents	1,444	507	651	371	664
Account receivables	2,092	2,053	2,539	2,679	3,304
Inventory	1,504	2,206	1,891	2,764	2,575
Prepayment	3	6	6	6	6
Other current assets	934	1,169	1,169	1,169	1,169
Non-current assets	**6,242**	**8,067**	**10,236**	**11,863**	**13,665**
PPE	4,310	6,485	7,913	9,456	11,026
Construction in process	1,147	885	1,615	1,685	1,899
Intangibles	297	322	334	348	366
Other non-current assets	488	374	374	374	374
Total assets	**12,219**	**14,008**	**16,492**	**18,853**	**21,383**
Current liabilities	**4,670**	**4,932**	**5,763**	**6,095**	**6,859**
ST borrowings	713	688	969	1,382	1,493
Notes payables	765	858	858	858	858
Account payables	1,555	1,515	2,065	1,984	2,638
Other payables	1,119	1,399	1,399	1,399	1,399
Other current liabilities	517	472	472	472	472
Non-current liabilities	**2,547**	**1,631**	**2,153**	**2,826**	**3,007**
LT borrowings	2,250	1,059	1,581	2,254	2,435
LT Deferred income	294	266	266	266	266
Other non-current liabilities	3	306	306	306	306
Total liabilities	**7,216**	**6,563**	**7,916**	**8,921**	**9,866**
Share capital	339	489	489	489	489
Reserve	2,231	3,660	3,660	3,660	3,660
Retained earnings	2,170	3,135	4,185	5,447	6,922
Other equity items	260	158	237	331	441
Minority interest	2	3	4	5	6
Total equity	**5,003**	**7,444**	**8,575**	**9,932**	**11,517**
Total liabilities and equity	**12,219**	**14,008**	**16,492**	**18,853**	**21,383**

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue mix					
PCB	73	72	72	72	75
PCBA	12	10	9	8	8
IC substrate	11	13	14	14	12
Growth (%)					
Revenue	38.4	10.2	14.8	13.6	14.7
Gross profit	58.8	10.0	13.0	15.1	16.2
Operating profit	80.8	14.7	12.6	17.5	17.0
Net profit	5.2	14.5	8.7	17.5	17.0
Profit & loss ratio (%)					
Gross margin	26.5	26.5	26.1	26.4	26.7
Operating margin	13.5	14.0	13.7	14.2	14.5
Net profit margin	11.7	12.3	12.0	12.4	12.6
Balance sheet ratio					
Net debt/total equity (%)	34.0	24.1	26.1	30.6	27.6
Current ratio (x)	1.3	1.2	1.1	1.1	1.1
Receivable turnover days	64	65	63	63	63
Inventory turnover days	49	58	56	56	56
Payable turnover days	67	66	66	66	66
Cash conversion cycle	46	58	53	53	53
Profitability (%)					
ROE	24.6	19.2	18.6	18.9	19.0
ROA	10.1	10.2	9.7	9.9	10.3
Per share data (RMB)					
EPS	2.62	3.00	3.26	3.83	4.48
DPS	1.15	0.95	1.06	1.25	1.46

Source: Company data, CMBIS estimates

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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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