

Shennan Circuits (002916 CH)

Positive on capacity expansion plan; Maintain HOLD on fair valuation

Shennan announced to expand substrate capacity (200mn FC-BGA, 3mn panel RF/FC-CSP) in Guangzhou. Total investment is ~RMB6bn, of which fixed asset investment will be over RMB5.8bn (1st/2nd phase: RMB 3.8bn/2bn). We believe revenue will start to contribute in FY23/24E. Meanwhile, we are positive on PCB demand pick-up in 3Q21E as China 3rd batch of 5G BTS deployment has kicked off recently. We raised our TP to RMB101.92 as we rollover to 30x 2022E P/E. Maintain HOLD given fair valuation and overhang on margin pressure.

- New capacity to capture upcycle of substrate market.** Shennan announced to expand substrate capacity in Guangzhou production base, which will add 200mn FC-BGA and 3mn panel RF/FC-CSP substrate capacity. We expect the new project to contribute revenue in 2023/24E. Shennan's existing substrate capacity has been in full production since last year, driven by strong semiconductor demand. We believe strong substrate revenue will continue into 2H21E, driving 22% YoY growth in FY21E.
- Demand for PCB to pick up in 2H21E.** Based on our recent checks, despite delay of bidding announcement of China 3rd batch of 5G BTS tenders in 1H21, China 5G BTS deployment has already kicked off (120k 2.6GHz by CM, 320k 3.5GHz/2.1GHz by CU/CT). CM/CBN will also resume its 700MHz 5G BTS deployment (400k+ in 2 years). This week, CBN has announced the tender to transfer its 700MHz frequency band, suggesting that CBN officially started the cleanup work for 700MHz BTS deployment. We believe PCB demand from telecom equipment providers will pick up in 3Q21E, which will drive Shennan's PCB business to recover in 2H21E.
- Near-term cost pressure to continue.** 3M LME copper price is currently at \$9,488/tonne, slightly down 8% from its previous new high. Although material cost pressure has hindered willingness in production (especially for low-margin consumer products), we expect material cost pressure to continue in near term. In the long run, we believe top PCB players will enjoy scale benefits and Shennan will gain share with accelerated industry consolidation.
- Maintain HOLD with new TP of RMB101.92.** We raised our TP to RMB101.92 as we rollover to 30.0x FY22E P/E (vs 30x FY21E prior). We maintain HOLD given rich valuation and margin overhang.

Earnings Summary

| (YE 31 Dec) | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------|--------|--------|--------|--------|--------|
| Revenue (RMB mn) | 10,524 | 11,600 | 13,320 | 15,141 | 17,338 |
| YoY growth (%) | 38.4 | 10.2 | 14.8 | 13.7 | 14.5 |
| Gross margin | 26.5 | 26.5 | 24.6 | 25.5 | 26.0 |
| Net income (RMB mn) | 1,233 | 1,430 | 1,348 | 1,662 | 1,970 |
| EPS (RMB) | 2.62 | 3.00 | 2.76 | 3.40 | 4.03 |
| YoY growth (%) | 5.2 | 14.5 | (8.2) | 23.3 | 18.5 |
| Consensus EPS (RMB) | NA | NA | 3.57 | 4.39 | 4.90 |
| P/E (x) | 40.8 | 35.6 | 39.0 | 31.5 | 26.6 |
| P/B (x) | 7.3 | 7.0 | 6.3 | 5.5 | 4.8 |
| Dividend Yield (%) | 1.4 | 1.2 | 1.1 | 1.4 | 1.6 |
| ROE (%) | 25 | 19 | 16 | 17 | 18 |
| Gearing ratio (%) | 34 | 24 | 28 | 33 | 31 |

Source: Company data, Bloomberg, CMBIS estimates

HOLD (Maintain)

| | |
|---------------|-----------|
| Target Price | RMB101.92 |
| (Previous TP) | RMB82.7) |
| Up/Downside | -4.7% |
| Current Price | RMB106.9 |

China Technology Sector

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Stock Data

| | |
|--------------------------|--------------|
| Mkt Cap (RMB mn) | 52,308 |
| Avg 3 mths t/o (RMB mn) | 361 |
| 52w High/Low (RMB) | 198.00/74.88 |
| Total Issued Shares (mn) | 489.3 |

Source: Bloomberg

Shareholding Structure

| | |
|-----------------------|--------|
| AVID International | 67.05% |
| HKSCC | 2.60% |
| China Asset Mgmt. Co. | 0.99% |

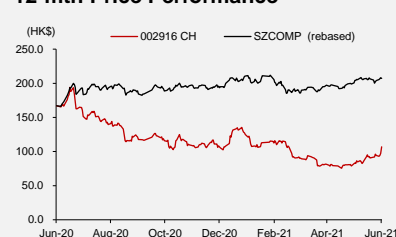
Source: Bloomberg

Share Performance

| | Absolute | Relative |
|-------|----------|----------|
| 1-mth | 23.2% | 17.7% |
| 3-mth | 5.6% | -4.4% |
| 6-mth | -10.4% | -15.7% |

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Grant Thornton CPA

Recent Report:

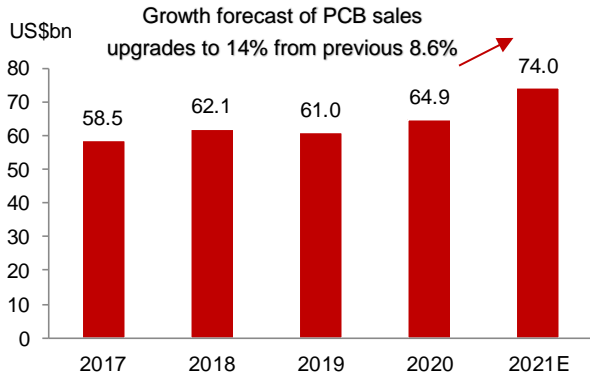
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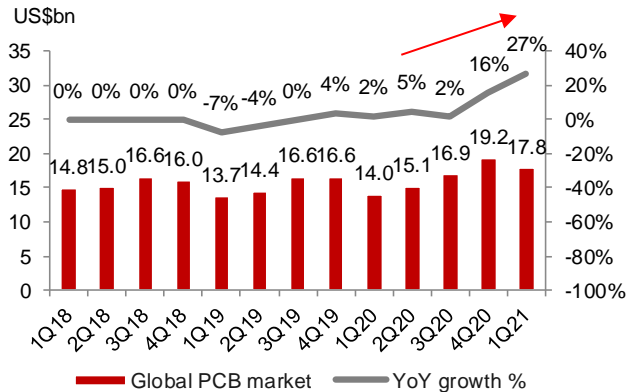
Focus Charts

Figure 1: Global PCB market to grow at 14% YoY



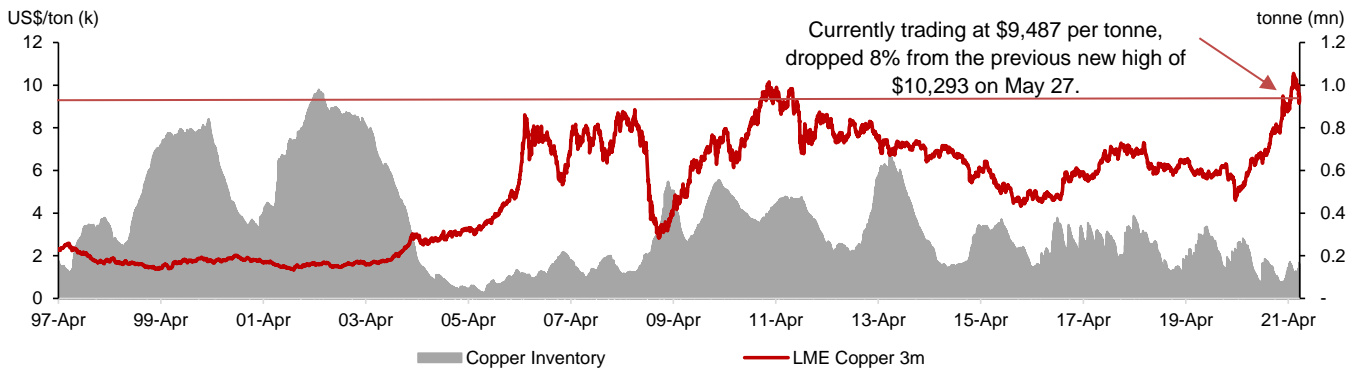
Source: SCI99, CMBIS estimates

Figure 2: Global PCB market rebounded since 2Q20



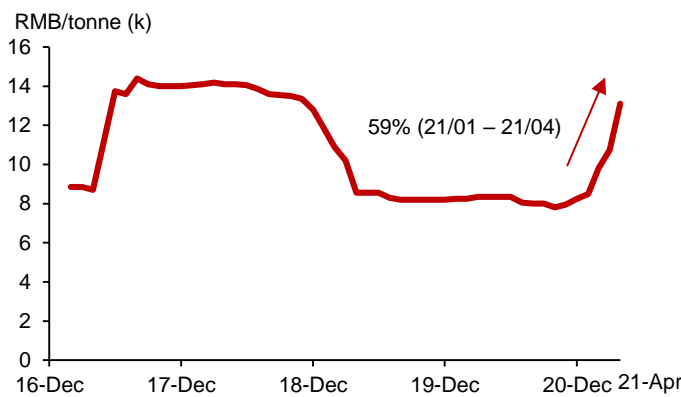
Source: Wind, CMBIS estimates

Figure 3: Copper price topped US\$10k in May 2021, reaching new high since 2011



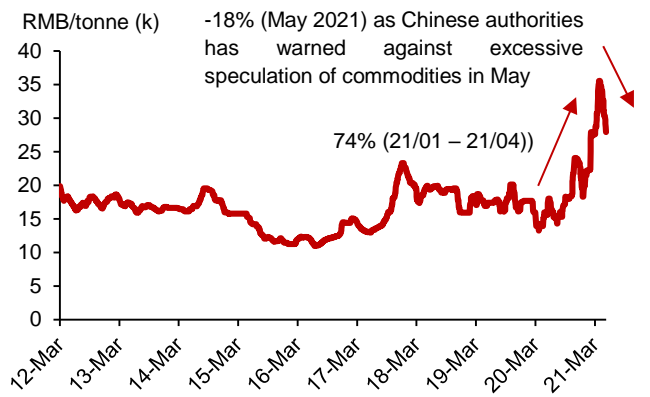
Source: Wind, CMBIS estimates

Figure 4: Glass fibre ASP surged 59% YTD (Apr 2021)



Source: SCI99, CMBIS estimates

Figure 5: Resin ASP dropped since May 2021



Source: Wind, CMBIS estimates

Financial analysis

Figure 6: Major assumptions

| RMB mn | FY19 | FY20 | FY21E | FY22E | FY23E |
|---------------------|---------------|---------------|---------------|---------------|---------------|
| PCB | 7,726 | 8,311 | 9,515 | 10,813 | 12,873 |
| ...YoY | 44% | 8% | 14% | 14% | 19% |
| PCBA | 1,211 | 1,160 | 1,218 | 1,279 | 1,343 |
| ...YoY | 31% | -4% | 5% | 5% | 5% |
| IC substrate | 1,164 | 1,544 | 1,880 | 2,224 | 2,157 |
| ...YoY | 23% | 33% | 22% | 18% | -3% |
| Other products | 288 | 219 | 230 | 253 | 278 |
| ...YoY | 14% | -24% | 5% | 10% | 10% |
| Other business | 135 | 367 | 477 | 572 | 687 |
| ...YoY | 38% | 173% | 30% | 20% | 20% |
| Total | 10,524 | 11,600 | 13,320 | 15,141 | 17,338 |
| ...YoY | 38% | 10% | 15% | 14% | 15% |
| Gross Margin | | | | | |
| PCB | 28.0% | 28.4% | 26.0% | 27.0% | 27.5% |
| PCBA | 19.5% | 14.6% | 13.0% | 14.0% | 14.5% |
| IC substrate | 26.2% | 28.1% | 28.0% | 28.3% | 28.5% |
| Other products | 19.7% | 26.0% | 25.0% | 25.0% | 25.0% |
| Other business | 23.6% | 13.5% | 13.5% | 13.5% | 13.5% |
| Total | 26.5% | 26.5% | 24.6% | 25.5% | 26.0% |

Source: Company data, CMBIS estimates

Figure 7: P&L forecast

| RMB mn | FY19 | FY20 | FY21E | FY22E | FY23E |
|-------------------------|---------------|---------------|---------------|---------------|---------------|
| Revenue | 10,524 | 11,600 | 13,320 | 15,141 | 17,338 |
| ...YoY | 38.4% | 10.2% | 14.8% | 13.7% | 14.5% |
| Gross profit | 2,792 | 3,071 | 3,280 | 3,867 | 4,512 |
| GPM (%) | 26.5% | 26.5% | 24.6% | 25.5% | 26.0% |
| SG&A | (719) | (647) | (773) | (878) | (1,006) |
| ...% of rev | (6.8%) | (5.6%) | (5.8%) | (5.8%) | (5.8%) |
| R&D | (537) | (645) | (799) | (908) | (1,040) |
| ...% of rev | (5.1%) | (5.6%) | (6.0%) | (6.0%) | (6.0%) |
| Operating profit | 1,417 | 1,625 | 1,549 | 1,908 | 2,260 |
| OPM (%) | 13.5% | 14.0% | 11.6% | 12.6% | 13.0% |
| ...YoY | 80.8% | 14.7% | (4.7%) | 23.2% | 18.5% |
| Net profit | 1,233 | 1,430 | 1,348 | 1,662 | 1,970 |
| NPM (%) | 11.7% | 12.3% | 10.1% | 11.0% | 11.4% |
| ...YoY | 76.8% | 16.0% | (5.7%) | 23.3% | 18.5% |

Source: Company data, CMBIS estimates

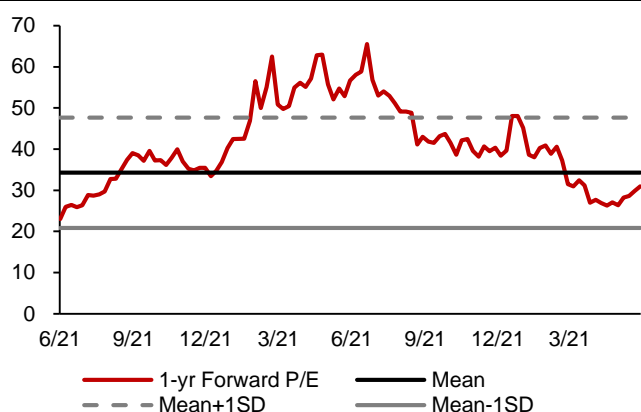
Valuation

Maintain HOLD with new TP of RMB101.9

We maintain HOLD and raised TP to RMB101.9 as we rollover to 30.0x FY22E P/E (vs 30x FY21E P/E prior). Upcoming catalysts include further details of 3rd phase of 5G BTS tenders.

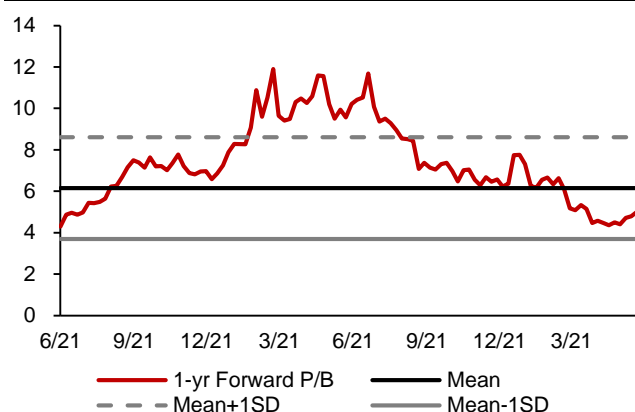
Risks include 1) continued price increase in upstream materials, 2) de-spec of 5G BTS and ASP pressure and 3) slower than expected 5G deployment.

Figure 8: 12M forward P/E band



Source: Company data, CMBIS estimates

Figure 9: 12M forward P/B band



Source: Company data, CMBIS estimates

Figure 10: Peers' valuation

| Company | Ticker | Rating | Mkt Cap US\$(mn) | Price (LC) | TP (LC) | Up/Down -side | P/E (x) | | P/B (x) | | ROE (%) | | |
|----------------|-----------|--------|---------------------|---------------|------------|------------------|---------|-------------|-------------|------------|------------|-------------|-------------|
| | | | | | | | FY21E | FY22E | FY21E | FY22E | FY21E | FY22E | |
| SCC | 002916 CH | HOLD | 8,089 | 106.90 | 101.9 | -5% | 39.0 | 31.5 | 6.3 | 5.5 | 16.2 | 17.4 | |
| SY Tech | 600183 CH | BUY | 8,224 | 23.21 | 29.5 | 31% | 22.8 | 18.8 | 4.7 | 4.1 | 20.6 | 22.0 | |
| WUS | 002463 CH | NR | 4,229 | 15.86 | NA | NA | 18.7 | 15.3 | 3.7 | 3.1 | 21.3 | 21.3 | |
| DSBJ | 002384 CH | NR | 5,632 | 21.30 | NA | NA | 19.4 | 15.4 | 2.6 | 2.3 | 13.1 | 14.7 | |
| Zhen Ding | 4958 TT | NR | 3,417 | 106.00 | NA | NA | 10.9 | 9.4 | 1.2 | 1.1 | 9.9 | 10.9 | |
| TTM | TTMI US | NR | 1,539 | 14.36 | NA | NA | 11.6 | 9.8 | 1.0 | 0.9 | 8.7 | 9.0 | |
| UMTC | 3037 TT | NR | 7,044 | 131.00 | NA | NA | 21.7 | 18.4 | 3.6 | 3.2 | 16.4 | 17.1 | |
| Tripod | 3044 TT | NR | 2,488 | 132.50 | NA | NA | 10.8 | 9.7 | 1.8 | 1.6 | 17.0 | 17.3 | |
| Comped | 2313 TT | NR | 1,799 | 42.25 | NA | NA | 10.3 | 9.1 | 1.6 | 1.4 | 16.1 | 16.1 | |
| SEMCO | 009150 KS | NR | 11,582 | 175500.00 | NA | NA | 14.6 | 13.1 | 2.1 | 1.8 | 14.8 | 14.5 | |
| Average | | | | | | | | 18.0 | 15.0 | 2.8 | 2.5 | 15.4 | 16.0 |

Source: Bloomberg, CMBIS estimates

Financial Summary

Income statement

| YE 31 Dec (RMB mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|-----------------------------------|---------------|---------------|---------------|---------------|---------------|
| Revenue | 10,524 | 11,600 | 13,320 | 15,141 | 17,338 |
| Cost of sales | 7,732 | 8,530 | 10,039 | 11,274 | 12,826 |
| Gross profit | 2,792 | 3,071 | 3,280 | 3,867 | 4,512 |
| Selling exp | 218 | 167 | 240 | 273 | 312 |
| Admin exp | 501 | 480 | 533 | 606 | 694 |
| R&D exp | 537 | 645 | 799 | 908 | 1,040 |
| Finance costs | 73 | 152 | 163 | 175 | 208 |
| Other operating exp. | 47 | 2 | (3) | (2) | (2) |
| Operating profit | 1,417 | 1,625 | 1,549 | 1,908 | 2,260 |
| Other non-oper exp. | (14) | (19) | (16) | (18) | (21) |
| Pre-tax profit | 1,403 | 1,606 | 1,533 | 1,890 | 2,239 |
| Income tax expense | 170 | 175 | 184 | 227 | 269 |
| Minority interests | 1 | 1 | 1 | 1 | 1 |
| Net profit to shareholders | 1,233 | 1,430 | 1,348 | 1,662 | 1,970 |

Cash flow summary

| YE 31 Dec (RMB mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|--------------------------------|----------------|----------------|----------------|----------------|----------------|
| Net profit | 1,234 | 1,431 | 1,349 | 1,663 | 1,971 |
| Dep. /amort. | 467 | 644 | 721 | 881 | 1,057 |
| Change in working capital | (650) | (557) | 447 | (1,187) | 318 |
| Others | 212 | 282 | 157 | 172 | 207 |
| Net cash from operating | 1,263 | 1,800 | 2,674 | 1,528 | 3,552 |
| Capex | (2,183) | (2,486) | (2,885) | (2,506) | (2,855) |
| Other | 186 | (149) | 0 | 0 | 0 |
| Net cash from investing | (1,997) | (2,635) | (2,885) | (2,506) | (2,855) |
| Share issuance | 130 | 0 | 0 | 0 | 0 |
| Dividend paid | (278) | (453) | (465) | (438) | (540) |
| Debt issuance/(paydown) | 1,746 | 87 | 1,316 | 1,119 | 295 |
| Other | (82) | 295 | (163) | (175) | (208) |
| Net cash from financing | 1,516 | (71) | 689 | 505 | (453) |
| Net change in cash | 791 | (937) | 479 | (472) | 244 |
| Cash at beginning of year | 650 | 1,441 | 504 | 983 | 511 |
| Exchange difference | 9 | (31) | 2 | 0 | 0 |
| Cash at the end of year | 1,441 | 504 | 983 | 511 | 755 |

Balance sheet

| YE 31 Dec (RMB mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------------------|---------------|---------------|---------------|---------------|---------------|
| Current assets | 5,977 | 5,941 | 6,593 | 7,136 | 7,799 |
| Cash & equivalents | 1,444 | 507 | 986 | 514 | 758 |
| Account receivables | 2,092 | 2,053 | 2,540 | 2,681 | 3,297 |
| Inventory | 1,504 | 2,206 | 1,892 | 2,766 | 2,568 |
| 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 | 10,237 | 11,866 | 13,665 |
| PPE | 4,310 | 6,485 | 7,913 | 9,458 | 11,027 |
| Construction in process | 1,147 | 885 | 1,616 | 1,686 | 1,898 |
| Intangibles | 297 | 322 | 334 | 348 | 366 |
| Other non-current assets | 488 | 374 | 374 | 374 | 374 |
| Total assets | 12,219 | 14,008 | 16,830 | 19,002 | 21,464 |
| Current liabilities | 4,670 | 4,932 | 6,029 | 6,282 | 7,130 |
| ST borrowings | 713 | 688 | 1,164 | 1,589 | 1,702 |
| Notes payables | 765 | 858 | 858 | 858 | 858 |
| Account payables | 1,555 | 1,515 | 2,135 | 1,964 | 2,700 |
| 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 | 2,472 | 3,165 | 3,348 |
| LT borrowings | 2,250 | 1,059 | 1,900 | 2,593 | 2,776 |
| LT Deferred income | 294 | 266 | 266 | 266 | 266 |
| Other non-current liabilities | 3 | 306 | 306 | 306 | 306 |
| Total liabilities | 7,216 | 6,563 | 8,500 | 9,447 | 10,479 |
| Share capital | 339 | 489 | 489 | 489 | 489 |
| Reserve | 2,231 | 3,660 | 3,660 | 3,660 | 3,660 |
| Retained earnings | 2,170 | 3,135 | 3,950 | 5,091 | 6,422 |
| Other equity items | 260 | 158 | 227 | 310 | 408 |
| Minority interest | 2 | 3 | 4 | 4 | 5 |
| Total equity | 5,003 | 7,444 | 8,330 | 9,555 | 10,985 |
| Total liabilities and equity | 12,219 | 14,008 | 16,830 | 19,002 | 21,464 |

Key ratios

| YE 31 Dec | FY19A | FY20A | FY21E | FY22E | FY23E |
|------------------------------------|-------|-------|-------|-------|-------|
| Revenue mix | | | | | |
| PCB | 73 | 72 | 71 | 71 | 74 |
| PCBA | 12 | 10 | 9 | 8 | 8 |
| IC substrate | 11 | 13 | 14 | 15 | 12 |
| Growth (%) | | | | | |
| Revenue | 38.4 | 10.2 | 14.8 | 13.7 | 14.5 |
| Gross profit | 58.8 | 10.0 | 6.8 | 17.9 | 16.7 |
| Operating profit | 80.8 | 14.7 | (4.7) | 23.2 | 18.5 |
| Net profit | 5.2 | 14.5 | (8.2) | 23.3 | 18.5 |
| Profit & loss ratio (%) | | | | | |
| Gross margin | 26.5 | 26.5 | 24.6 | 25.5 | 26.0 |
| Operating margin | 13.5 | 14.0 | 11.6 | 12.6 | 13.0 |
| Net profit margin | 11.7 | 12.3 | 10.1 | 11.0 | 11.4 |
| Balance sheet ratio | | | | | |
| Net debt/total equity (%) | 34.0 | 24.1 | 27.8 | 33.4 | 30.6 |
| 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 | 16.2 | 17.4 | 17.9 |
| ROA | 10.1 | 10.2 | 8.0 | 8.7 | 9.2 |
| Per share data (RMB) | | | | | |
| EPS | 2.62 | 3.00 | 2.76 | 3.40 | 4.03 |
| DPS | 1.15 | 0.95 | 0.90 | 1.10 | 1.31 |

Source: Company data, CMBIS estimates

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