

# Shennan Circuits (002916 CH)

## Margin pressure to persist on rising material cost; Maintain HOLD

Shennan announced 1Q21 results with revenue of RMB2,725mn (+9.1% YoY) and net profit of RMB244mn (-12% YoY), which accounted for 20%/18% and 19%/14% of our/consensus FY21E forecasts. We think the miss was a result of 1) weak PCB demand due to delayed 3rd batch 5G BTS tender, 2) strong IC substrate business given surging demand and 3) lower gross margin due to rising cost pressure. We revised down our FY21/22E EPS by 15/11% to reflect cost pressure and lower ASP, and adjusted our TP to RMB82.7 based on same 30x FY21E P/E. Maintain HOLD as margin pressure remains a major overhang.

- PCB demand to improve sequentially and IC substrate to remain strong.**  
 We believe 1Q21 PCB weakness was mainly due to delay of China 3rd batch of 5G BTS tender. We expect this business to improve sequentially in 2Q/3Q when the tender is released and global economy continues to recover. In addition, we expect IC substrate business to maintain robust growth with 22% YoY in FY21E driven by strong demand for package substrate.
- Near-term cost pressure to accelerate consolidation in the long run.**  
 1Q21 GPM came in lower at 23.4% (vs. 25.6%/26.5% in 1Q20/FY20), mainly due to rising laminate cost on higher copper price since 2H20. Looking ahead, we think cost hike cannot be fully transferred to downstream clients in 1H21E, and copper price will rise further in near term given global economy rebound and tight supply in Chile and Peru due to new wave of COVID-19 and labor issues. We expect 1H20 growth will be at a lower gear and gross margin pressure will continue in short term. In the long run, we believe top PCB players can enjoy scale benefits and Shennan will gain share with accelerated industry consolidation.
- Maintain HOLD with new TP of RMB82.7.** We trimmed FY21-22E EPS by 11-15% for lower ASP/margin assumptions, and reduced our TP to RMB82.8 based on same 30.0x FY21E P/E. 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) continued surge in material costs. 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	13,320	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)	30.4	26.6	28.9	23.5	19.8
P/B (x)	5.4	5.2	4.7	4.1	3.6
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	RMB82.7
(Previous TP)	RMB97.8)
Up/Downside	+3.7%
Current Price	RMB79.7

### China Technology Sector

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### Stock Data

Mkt Cap (RMB mn)	38,994
Avg 3 mths t/o (RMB mn)	586
52w High/Low (RMB)	198.0/78.31
Total Issued Shares (mn)	489.3

Source: Bloomberg

### Shareholding Structure

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

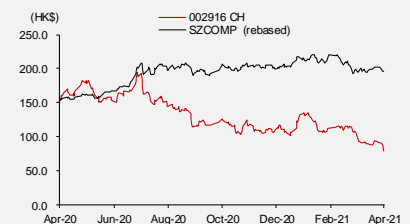
Source: Bloomberg

### Share Performance

	Absolute	Relative
1-mth	-25.7%	-24.6%
3-mth	-41.4%	-35.9%
6-mth	-37.6%	-34.2%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: Grant Thornton CPA

### Recent Report:

- Near-term cost pressure remains overhang; Maintain HOLD – 18 Mar 2021
- China 5G Technology - Picking structural winners amid uncertainties; Initiate at Outperform – 18 Dec 2020

## 1Q21 Results Review

Figure 1: Quarterly results review

RMB mn	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	QoQ	YoY
Revenue	2,866	2,498	3,418	3,067	2,618	2,725	4.1%	9.1%
Gross Profit	827	639	911	848	673	639	-5.0%	-0.1%
Operating Profit	403	336	514	442	332	277	-16.7%	-17.6%
Net profit	365	277	448	374	332	244	-26.6%	-12.0%
EPS (RMB)	1.08	0.82	0.94	0.76	0.68	0.50	-26.6%	-39.0%
Gross Margin	28.9%	25.6%	26.7%	27.6%	25.7%	23.4%	-1.9 ppt	-3.2 ppt
Operating Margin	14.1%	13.5%	15.0%	14.4%	12.7%	10.2%	-1.7 ppt	-1.4 ppt
Net Margin	12.7%	11.1%	13.1%	12.2%	12.7%	8.9%	0.5 ppt	-0.1 ppt

Source: Bloomberg, CMBIS estimates

## Earnings Revision

Figure 2: CMBIS earnings revisions

RMB mn	New			Old			Change (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	13,320	15,141	17,338	13,316	15,131	17,352	0%	0%	0%
Gross Profit	3,280	3,867	4,512	3,471	3,995	4,641	-5%	-3%	-3%
Operating Profit	1,549	1,908	2,260	1,830	2,149	2,514	-15%	-11%	-10%
Net profit	1,348	1,662	1,970	1,595	1,874	2,193	-15%	-11%	-10%
EPS (RMB)	2.76	3.40	4.03	3.26	3.83	4.48	-15%	-11%	-10%
Gross Margin	24.6%	25.5%	26.0%	26.1%	26.4%	26.7%	-1.4 ppt	-0.9 ppt	-0.7 ppt
Operating Margin	11.6%	12.6%	13.0%	13.7%	14.2%	14.5%	-2.1 ppt	-1.6 ppt	-1.5 ppt
Net Margin	10.1%	11.0%	11.4%	12.0%	12.4%	12.6%	-1.9 ppt	-1.4 ppt	-1.3 ppt

Source: Company data, CMBIS estimates

Figure 3: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	13,320	15,141	17,338	14,211	16,836	18,610	-6%	-10%	-7%
Gross Profit	3,280	3,867	4,512	3,772	4,503	4,988	-13%	-14%	-10%
Operating Profit	1,549	1,908	2,260	2,054	2,510	2,754	-25%	-24%	-18%
Net profit	1,348	1,662	1,970	1,750	2,162	2,435	-23%	-23%	-19%
EPS (RMB)	2.76	3.40	4.03	3.57	4.39	4.90	-23%	-23%	-18%
Gross Margin	24.6%	25.5%	26.0%	26.5%	26.7%	26.8%	-1.9 ppt	-1.2 ppt	-0.8 ppt
Operating Margin	11.6%	12.6%	13.0%	14.5%	14.9%	14.8%	-2.8 ppt	-2.3 ppt	-1.8 ppt
Net Margin	10.1%	11.0%	11.4%	12.3%	12.8%	13.1%	-2.2 ppt	-1.9 ppt	-1.7 ppt

Source: Bloomberg, CMBIS estimates

**Figure 4: 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%
<b>Total</b>	<b>10,524</b>	<b>11,600</b>	<b>13,320</b>	<b>15,141</b>	<b>17,338</b>
<b>...YoY</b>	<b>38%</b>	<b>10%</b>	<b>15%</b>	<b>14%</b>	<b>15%</b>
<b>Gross Margin</b>					
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%
<b>Total</b>	<b>26.5%</b>	<b>26.5%</b>	<b>24.6%</b>	<b>25.5%</b>	<b>26.0%</b>

Source: Company data, CMBIS estimates

**Figure 5: P&L forecast**

RMB mn	FY19	FY20	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>10,524</b>	<b>11,600</b>	<b>13,320</b>	<b>15,141</b>	<b>17,338</b>
...YoY	38.4%	10.2%	14.8%	13.7%	14.5%
<b>Gross profit</b>	<b>2,792</b>	<b>3,071</b>	<b>3,280</b>	<b>3,867</b>	<b>4,512</b>
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%)
<b>Operating profit</b>	<b>1,417</b>	<b>1,625</b>	<b>1,549</b>	<b>1,908</b>	<b>2,260</b>
OPM (%)	13.5%	14.0%	11.6%	12.6%	13.0%
...YoY	80.8%	14.7%	(4.7%)	23.2%	18.5%
<b>Net profit</b>	<b>1,233</b>	<b>1,430</b>	<b>1,348</b>	<b>1,662</b>	<b>1,970</b>
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

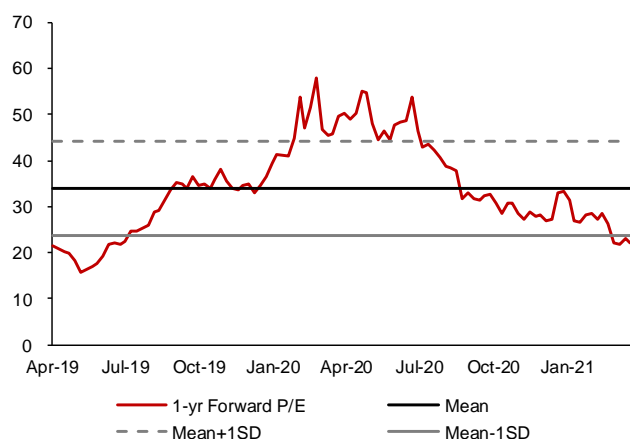
## Valuation

### Maintain HOLD and trim TP to RMB82.7

We maintain HOLD and adjusted TP to RMB82.7 based on same 30.0x FY21E P/E. Upcoming catalysts include 1) upcoming catalysts include 3rd phase of 5G BTS tenders and 2) overseas demand from global economy recovery.

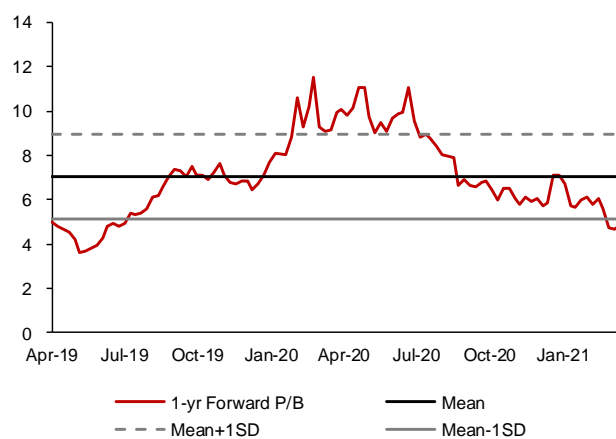
Risks include 1) continued price increase in upstream materials, 2) de-spec of 5G BTS and 3) less-than-expected demand from Telecom and Datacom operators.

**Figure 6: 12M forward P/E band**



Source: Company data, CMBIS estimates

**Figure 7: 12M forward P/B band**



Source: Company data, CMBIS estimates

**Figure 8: Peers' valuation**

Company	Ticker	Rating	Mkt Cap US\$(mn)	Price (LC)	TP (LC)	Up/Down -side	P/E (x)		P/B (x)		ROE (%)		
							FY20E	FY21E	FY20E	FY21E	FY20E	FY21E	
SCC	002916 CH	HOLD	5,970	79.69	82.7	4%	28.9	23.5	4.7	4.1	16.2	17.4	
SY Tech	600183 CH	BUY	8,304	23.67	29.5	24%	24.1	19.0	4.9	4.3	20.2	22.6	
WUS	002463 CH	NR	4,237	16.05	NA	NA	17.2	14.6	3.7	3.1	21.9	21.5	
DSBJ	002384 CH	NR	4,783	18.27	NA	NA	15.7	12.9	2.4	2.0	15.9	16.5	
Zhen Ding	4958 TT	NR	3,441	108.50	NA	NA	9.6	8.4	1.3	1.2	12.7	13.8	
TTM	TTMI US	NR	1,596	14.93	NA	NA	12.0	10.4	1.1	1.1	8.8	9.1	
UMTC	3037 TT	NR	4,628	87.50	NA	NA	20.0	13.5	2.6	2.2	12.0	16.2	
Tripod	3044 TT	NR	2,531	137.00	NA	NA	10.8	9.7	1.9	1.7	17.5	18.0	
Comped	2313 TT	NR	1,764	42.10	NA	NA	9.6	8.6	1.6	1.4	17.3	17.2	
SEMCO	009150 KS	NR	12,765	190500	NA	NA	16.4	14.5	2.2	2.0	14.2	14.2	
<b>Average</b>								<b>16.4</b>	<b>13.5</b>	<b>2.6</b>	<b>2.3</b>	<b>15.7</b>	<b>16.7</b>

Source: Bloomberg, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>10,524</b>	<b>11,600</b>	<b>13,320</b>	<b>15,141</b>	<b>17,338</b>
Cost of sales	7,732	8,530	10,039	11,274	12,826
<b>Gross profit</b>	<b>2,792</b>	<b>3,071</b>	<b>3,280</b>	<b>3,867</b>	<b>4,512</b>
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)
<b>Operating profit</b>	<b>1,417</b>	<b>1,625</b>	<b>1,549</b>	<b>1,908</b>	<b>2,260</b>
Other non-oper exp.	(14)	(19)	(16)	(18)	(21)
<b>Pre-tax profit</b>	<b>1,403</b>	<b>1,606</b>	<b>1,533</b>	<b>1,890</b>	<b>2,239</b>
Income tax expense	170	175	184	227	269
Minority interests	1	1	1	1	1
<b>Net profit to shareholders</b>	<b>1,233</b>	<b>1,430</b>	<b>1,348</b>	<b>1,662</b>	<b>1,970</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Net profit</b>	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
<b>Net cash from operating</b>	<b>1,263</b>	<b>1,800</b>	<b>2,674</b>	<b>1,528</b>	<b>3,552</b>
Capex	(2,183)	(2,486)	(2,885)	(2,506)	(2,855)
Other	186	(149)	0	0	0
<b>Net cash from investing</b>	<b>(1,997)</b>	<b>(2,635)</b>	<b>(2,885)</b>	<b>(2,506)</b>	<b>(2,855)</b>
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)
<b>Net cash from financing</b>	<b>1,516</b>	<b>(71)</b>	<b>689</b>	<b>505</b>	<b>(453)</b>
<b>Net change in cash</b>	<b>791</b>	<b>(937)</b>	<b>479</b>	<b>(472)</b>	<b>244</b>
Cash at beginning of year	650	1,441	504	983	511
Exchange difference	9	(31)	2	0	0
<b>Cash at the end of year</b>	<b>1,441</b>	<b>504</b>	<b>983</b>	<b>511</b>	<b>755</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Current assets</b>	<b>5,977</b>	<b>5,941</b>	<b>6,593</b>	<b>7,136</b>	<b>7,799</b>
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
<b>Non-current assets</b>	<b>6,242</b>	<b>8,067</b>	<b>10,237</b>	<b>11,866</b>	<b>13,665</b>
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
<b>Total assets</b>	<b>12,219</b>	<b>14,008</b>	<b>16,830</b>	<b>19,002</b>	<b>21,464</b>
<b>Current liabilities</b>	<b>4,670</b>	<b>4,932</b>	<b>6,029</b>	<b>6,282</b>	<b>7,130</b>
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
<b>Non-current liabilities</b>	<b>2,547</b>	<b>1,631</b>	<b>2,472</b>	<b>3,165</b>	<b>3,348</b>
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
<b>Total liabilities</b>	<b>7,216</b>	<b>6,563</b>	<b>8,500</b>	<b>9,447</b>	<b>10,479</b>
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
<b>Total equity</b>	<b>5,003</b>	<b>7,444</b>	<b>8,330</b>	<b>9,555</b>	<b>10,985</b>
<b>Total liabilities and equity</b>	<b>12,219</b>	<b>14,008</b>	<b>16,830</b>	<b>19,002</b>	<b>21,464</b>

### Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue mix</b>					
PCB	73	72	71	71	74
PCBA	12	10	9	8	8
IC substrate	11	13	14	15	12
<b>Growth (%)</b>					
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
<b>Profit &amp; loss ratio (%)</b>					
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
<b>Balance sheet ratio</b>					
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
<b>Profitability (%)</b>					
ROE	24.6	19.2	16.2	17.4	17.9
ROA	10.1	10.2	8.0	8.7	9.2
<b>Per share data (RMB)</b>					
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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**HOLD** : Stock with potential return of +15% to -10% over next 12 months  
**SELL** : Stock with potential loss of over 10% over next 12 months  
**NOT RATED** : Stock is not rated by CMBIS

**OUTPERFORM** : Industry expected to outperform the relevant broad market benchmark over next 12 months  
**MARKET-PERFORM** : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months  
**UNDERPERFORM** : Industry expected to underperform the relevant broad market benchmark over next 12 months

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