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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%

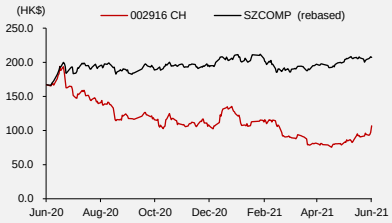
Source: Bloomberg

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

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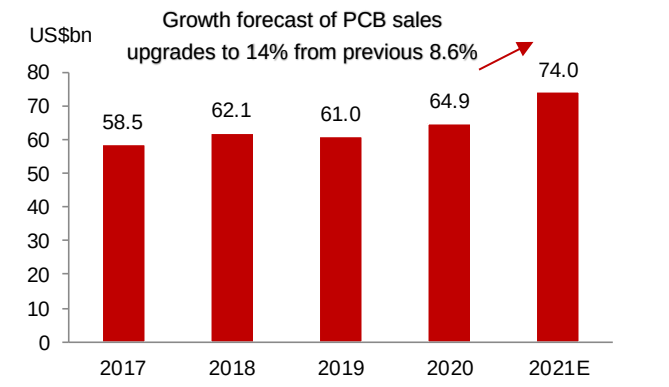
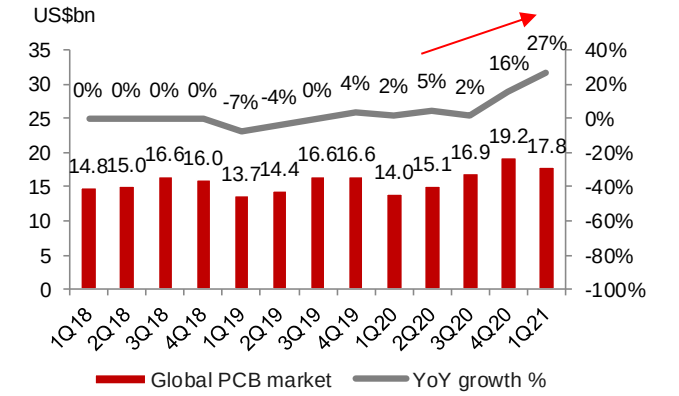
Focus Charts

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



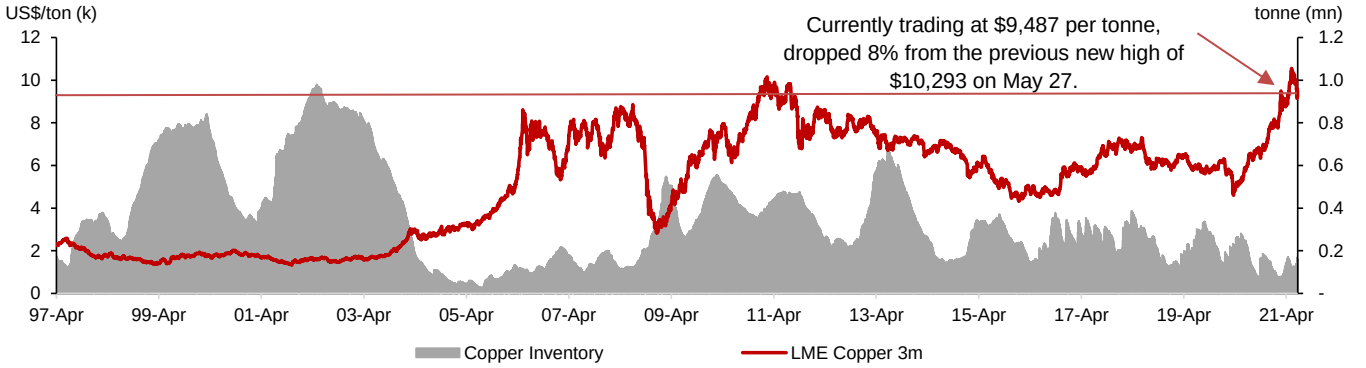
Source: SCI99, CMBIS estimates

Figure 2: Global PCB market rebounded since 2Q20



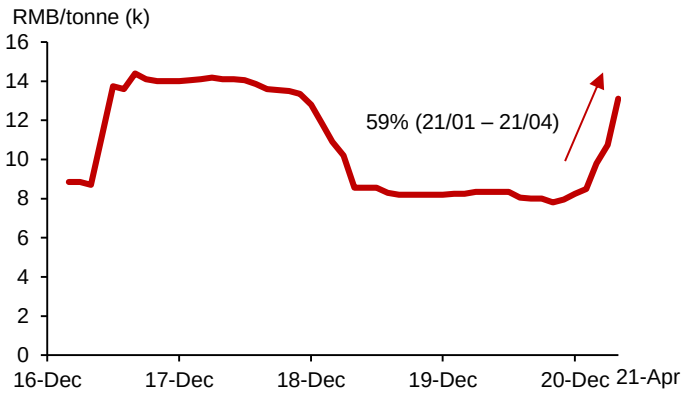
Source: Wind, CMBIS estimates

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



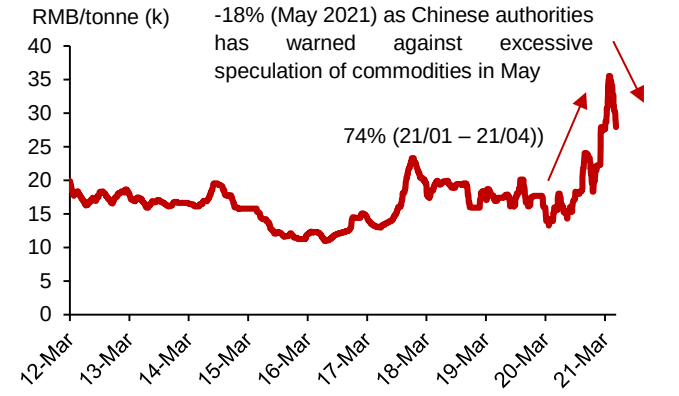
Source: Wind, CMBIS estimates

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

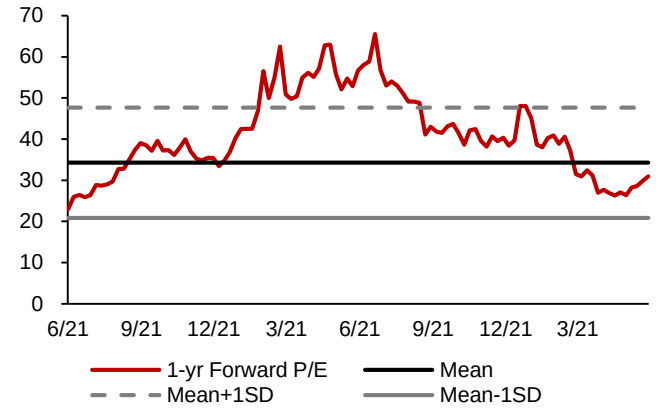
Valuation

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.

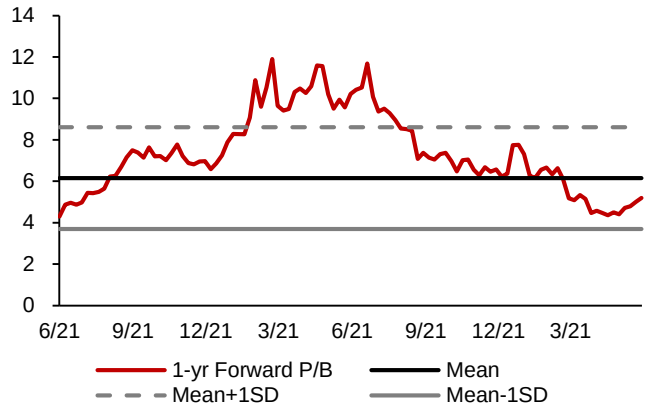
Risks include 1) continued price increase in upstream materials, 2) de-spec of 5G BTS and ASP pressure and 3) slower than expected 5G deployment.

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) FY21E	P/E (x) FY22E	P/B (x) FY21E	P/B (x) FY22E	ROE (%) FY21E	ROE (%) 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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