

China / Hong Kong Company Update

Q Technology

Bloomberg: 1478 HK Equity | Reuters: 1478.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

9 Aug 2022

BUY

Last Traded Price (8 Aug 2022): HK\$4.40 (HSI : 20,046)
Price Target 12-mth: HK\$5.20 (18% upside) (Prev HK\$8.90)

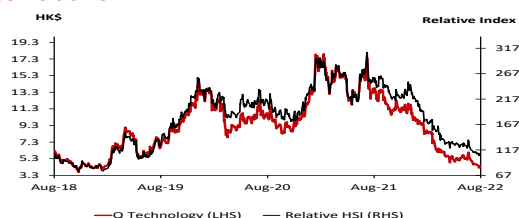
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What's New

- 1H22 profit decreased 71% y-o-y, in line with the profit warning in July
- Reduce FY22/23F CCM shipment growth from 5%/32% to -3%/12%, while that of FY24F increased from 10% to 19%
- FY22/23/24F revenue and net profit lowered by 24%/32%/27% and 58%/56%/34%, as expected incremental shipments face market reposition delay
- Maintain BUY on undemanding valuation and margin improvement from premiumisation strategy, TP lowered to HK\$5.2

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2021A	2022F	2023F	2024F
Turnover	18,663	15,665	18,494	22,895
EBITDA	1,469	919	1,267	1,978
Pre-tax Profit	957	475	783	1,450
Net Profit	863	428	695	1,262
Net Pft (Pre Ex) (core profit)	863	428	695	1,262
Net Profit Gth (Pre-ex) (%)	2.7	(50.4)	62.4	81.5
EPS (RMB)	0.73	0.36	0.58	1.04
EPS (HK\$)	0.85	0.42	0.67	1.21
EPS Gth (%)	1.2	(50.7)	61.2	80.2
Diluted EPS (HK\$)	0.85	0.42	0.67	1.21
DPS (HK\$)	0.05	0.02	0.04	0.07
BV Per Share (HK\$)	4.65	5.08	5.76	6.95
PE (X)	5.2	10.6	6.6	3.6
P/Cash Flow (X)	2.8	3.0	4.8	3.3
P/Free CF (X)	6.5	5.0	17.4	8.5
EV/EBITDA (X)	3.0	3.7	2.4	1.2
Net Div Yield (%)	1.1	0.5	0.9	1.6
P/Book Value (X)	0.9	0.9	0.8	0.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE (%)	20.3	8.7	12.5	19.2
Earnings Rev (%)		(58)	(56)	(34)
Consensus EPS (RMB)		0.54	0.76	0.97
Other Broker Recs:		B:17	S:1	H:6

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

Incremental shipments from market reposition delay

Investment Thesis

The incremental shipment growth from market reposition was lower and delayed due to the expected weak android smartphone sales in China. FY21-24F CCM shipment CAGR has been lower to 9%. However, we expected a slight improvement in y-o-y shipments in 2H22 due to 1) increased penetration in shipments for high-potential customers and 2) the resolution of the logistics and supply chain constraints.

Premiumisation of CCM boosts margin. Shipments of advanced CCMs are expected to increase from 34.0% in FY21 to 39% in FY24, restoring the overall gross margin to 10.5% in FY24 from 9.4% in FY21.

Potential A-share listing narrows R&D spread with peers. Over 50% of capital raised will be allocated to R&D investment, with support for research expenditure to double in three years.

Valuation:

Q Tech is trading at a 10.0 FY22F PE, well below its forward PE historical average of 11.8x. Our TP of HK\$5.2 is based on an 11.8x FY22F PE, reversion to the historical average, on promising share gains.

Where we differ:

Our FY24F CCM gross margin estimation is 2.6% higher than the market's, resulting in 4.5% higher FY24F earnings.

Key Risks to Our View:

Slowing smartphone shipment growth due to prolonged weak consumer sentiment.

At A Glance

Issued Capital (m shrs)	1,182
Mkt Cap (HKm/US\$m)	5,201 / 663
Major Shareholders (%)	
He (Ningning)	63.6
Free Float (%)	36.4
3m Avg. Daily Val. (US\$m)	1.3
GICS Industry: Information Technology / Technology Hardware & Equipment	



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WHAT'S NEW

Weak 1H performance in line with profit warning; expect mild improvement in 2H

2Q22 results highlights

2Q22 results in line. 2Q22 revenue decreased 24.0% y-o-y to Rmb7.1bn, reaching the lower limit of the profit warning in July. Camera module (CCM) and fingerprint recognition module (FRM) revenue decreased 22.6%/40.0% y-o-y, respectively, due to weak smartphone shipments, caused by 1) inflation concerns, 2) weak consumer sentiment as a result of the geopolitical conflict and lockdowns, and 3) the lower CCM ASP caused by the worse-than-expected high-end android smartphone sales.

Gross margin narrowed 6.3ppt y-o-y to 5.3%. The contraction was largely attributable to margin contractions in both segments. The FRM segment saw a significant margin contraction of 9.5ppt, to -1.5%, while CCM's gross margin decreased to 5.7%, down 6.2ppt, caused by 1) a 4.4ppt decrease in the share of shipments of high-end camera modules due to bad consumer sentiment, 2) higher component costs, and 3) higher logistics costs due to logistics and supply chain constraints.

Net profit decreased 71.0% y-o-y, to Rmb165.5m, owing to weak shipments and the contraction of the margin, in line with the profit warning of a 50%-70% decline. EPS was Rmb0.14.

Our View

We expect the weak smartphone demand to remain, at least for 2H22, due to prolonged weak consumer sentiment. However, we also expected a slight improvement in y-o-y CCM shipments in 2H22 due to 1) increased penetration in shipments for high-potential customers like Lenovo, Samsung, DJI, and BYD; and 2) the resolution of the logistics and supply chain constraints.

Therefore, we lower and delay the incremental shipment growth in terms of shipment gains by Oppo and Vivo due to the expected weak android smartphone sales in China. We decreased our CCM shipment growth forecasts from 5.3% to -2.5% in FY22F and 32.4% to 10.6% in FY23F but increased it from 9.5% to 19.3% for FY24F.

We also lower our gross margin forecast for the CCM segment by 3.0ppt/2.5ppt in FY22/23 due to lower a utilisation rate on the back of weakened shipments and the component cost hike. We expect FY24 gross margin to rebound to 10.5% in the CCM segments, attributable to a better product mix as a result of increased shipment penetration pertaining to the premium products of some exciting clients like Samsung, BYD, and DJI in the long run.

FY22/23/24F revenue and net profit were lowered by and 23.9%/32.3%/26.9% and 58.2%/56.2%/33.9%, respectively, after factoring in the above forecast. We expect FY23/24F net profit growth to be boosted to 62.2%/81.6%, on the back of 1) the expected resumption of global smartphone shipments and resolution of supply chain woes from 2023 onwards, 2) and the continuation of market share gains through Oppo's and Vivo's shipment gains, and 3) the resumption of increased penetration in the more high-end module space.

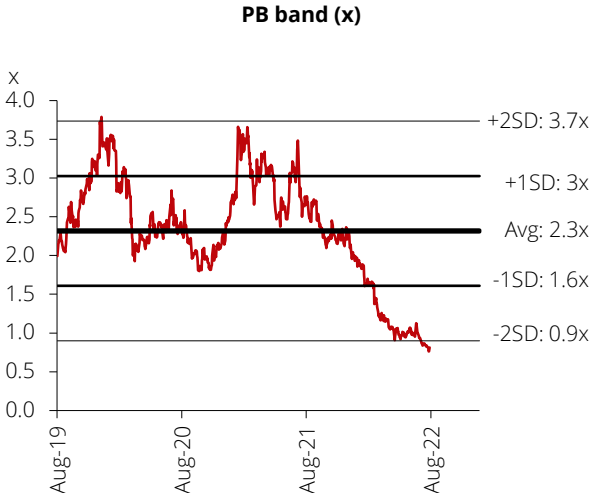
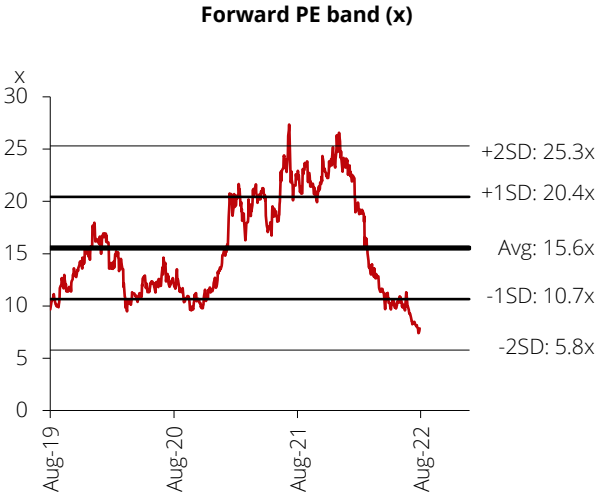
Q Tech is trading at 10x FY22F PE, below its forward PE historical average of 11.8x. We lower our TP to HK\$5.2 on a lower FY22F EPS. We maintain BUY based on an undemanding valuation and its strategic premiumisation to alleviate the negative impact of weak smartphone shipments.

Company Background

Established in 2007, Q Tech is China's third-largest camera module (CCM) supplier in terms of revenue, after Sunny Optical (2382 HK) and OFilm (002456 CH). Its major customers are among the top five smartphone vendors in China, namely Vivo, Oppo, Lenovo, Xiaomi, and Huaqin (Huawei's ODM supplier). The company entered the fingerprint module (FPM) business in 2H15. CCM and FPM accounted for 87% and 11% of its FY20 revenue, respectively.

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Historical PE and PB band



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2020A	2021A	2022F	2023F	2024F
Camera Modules Shipment ('000 unit)	392.6	479.1	467.4	517.0	616.9
Gross Margin (%)	10.0	9.7	7.2	8.5	10.5
Fingerprint recognition modules Shipment ('000 unit)	81.5	114.6	108.9	118.4	122.7
Gross Margin (%)	10.7	5.2	3.0	5.2	8.0

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenues (RMB m)					
Camera Modules	15,202	16,875	13,900	16,544	20,727
Fingerprint recognition modules	2,101	1,675	1,592	1,775	1,964
Others	97	112	173	175	204
Total	17,400	18,663	15,665	18,494	22,895

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Revenue	17,400	18,663	15,665	18,494	22,895
Cost of Goods Sold	(15,630)	(16,901)	(14,556)	(16,943)	(20,500)
Gross Profit	1,771	1,762	1,109	1,551	2,394
Other Opng (Exp)/Inc	(768)	(827)	(693)	(814)	(1,004)
Operating Profit	1,002	935	417	738	1,391
Other Non Opg (Exp)/Inc	27	86	74	50	62
Associates & JV Inc	(23)	(52)	(3)	(3)	(3)
Net Interest (Exp)/Inc	(37)	(12)	(12)	(1)	1
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	970	957	475	783	1,450
Tax	(130)	(94)	(47)	(88)	(188)
Minority Interest	0	0	1	1	1
Preference Dividend	0	0	0	0	0
Net Profit	840	863	428	695	1,262
Net Profit before Except.	840	863	428	695	1,262
EBITDA	1,391	1,469	919	1,267	1,978
Growth					
Revenue Gth (%)	32.1	7.3	(16.1)	18.1	23.8
EBITDA Gth (%)	48.5	5.6	(37.4)	37.8	56.1
Opg Profit Gth (%)	56.5	(6.7)	(55.5)	77.1	88.6
Net Profit Gth (%)	54.9	2.7	(50.4)	62.4	81.5
Margins & Ratio					
Gross Margins (%)	10.2	9.4	7.1	8.4	10.5
Opg Profit Margin (%)	5.8	5.0	2.7	4.0	6.1
Net Profit Margin (%)	4.8	4.6	2.7	3.8	5.5
ROAE (%)	25.3	20.3	8.7	12.5	19.2
ROA (%)	7.6	7.1	3.3	5.1	8.0
ROCE (%)	18.1	14.2	5.4	8.6	14.0
Div Payout Ratio (%)	12.8	5.6	5.6	5.6	5.6
Net Interest Cover (x)	27.4	77.9	34.3	543.6	NM

Source: Company, DBS HK

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Balance Sheet (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Net Fixed Assets	2,960	3,144	3,286	3,491	3,825
Invts in Associates & JVs	416	344	341	338	334
Other LT Assets	145	244	270	303	341
Cash & ST Invts	2,084	1,800	2,858	3,252	3,938
Inventory	1,943	2,258	1,895	2,238	2,770
Debtors	3,589	4,446	3,732	4,406	5,454
Other Current Assets	267	811	384	437	529
Total Assets	11,403	13,048	12,768	14,465	17,192
ST Debt	1,104	1,708	1,708	1,708	1,708
Creditors	6,021	6,283	5,515	6,420	7,769
Other Current Liab	151	89	64	80	114
LT Debt	159	50	50	50	50
Other LT Liabilities	182	214	249	277	311
Shareholder's Equity	3,786	4,699	5,176	5,926	7,237
Minority Interests	0	6	5	5	4
Total Cap. & Liab.	11,403	13,048	12,768	14,465	17,192
Non-Cash Wkg. Capital	(374)	1,144	432	581	871
Net Cash/(Debt)	820	42	1,101	1,494	2,180
Debtors Turn (avg days)	89.2	78.6	95.3	80.3	78.6
Creditors Turn (avg days)	146.2	136.9	152.5	132.3	129.7
Inventory Turn (avg days)	46.2	46.7	53.7	45.8	45.8
Asset Turnover (x)	1.6	1.5	1.2	1.4	1.4
Current Ratio (x)	1.1	1.2	1.2	1.3	1.3
Quick Ratio (x)	0.8	0.8	0.9	0.9	1.0
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	41.4	51.6	32.6	39.0	49.0
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Dec	2020A	2021A	2022F	2023F	2024F
Pre-Tax Profit	970	957	475	783	1,450
Dep. & Amort.	385	500	433	483	529
Tax Paid	(121)	(176)	(47)	(88)	(188)
Assoc. & JV Inc/(loss)	23	74	3	3	3
(Pft)/ Loss on disposal of FAS	58	46	0	0	0
Chg in Wkg.Cap.	2,177	173	712	(149)	(290)
Other Operating CF	113	22	(89)	(83)	(101)
Net Operating CF	3,604	1,596	1,487	949	1,403
Capital Exp.(net)	(523)	(907)	(573)	(686)	(862)
Other Invts.(net)	(169)	26	57	0	0
Invts in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(4)	0	74	50	62
Net Investing CF	(696)	(880)	(443)	(636)	(800)
Div Paid	(107)	(49)	(24)	(39)	(71)
Chg in Gross Debt	(1,015)	(351)	0	0	0
Capital Issues	60	59	73	94	120
Other Financing CF	(252)	(602)	23	26	35
Net Financing CF	(1,315)	(942)	72	81	84
Currency Adjustments	(21)	(14)	0	0	0
Chg in Cash	1,572	(240)	1,115	394	686
Opg CFPS (RMB)	1.22	1.20	0.65	0.91	1.40
Free CFPS (RMB)	2.64	0.58	0.76	0.22	0.45

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	Target Price	Rating
1	17-Feb-22	HK\$8.59	HK\$16.60	BUY
2	22-Mar-22	HK\$6.38	HK\$8.90	BUY

Source: DBS HK

Analyst: Jim Au

Tsz Wang Tam

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STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

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FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

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*Share price appreciation + dividends

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