



Ambarella's Investors Shouldn't Be Surprised by Its Latest Crisis in China

Description

Ambarella's ([NASDAQ: AMBA](#)) stock recently plunged after the Trump Administration added two of the chipmaker's top Chinese customers, Hikvision and Dahua, to its trade blacklist. Secretary of Commerce Wilbur Ross claims that the two security camera makers — along with companies like facial recognition firms SenseTime and Megvii — helped China engage “in the brutal suppression of ethnic minorities within China.”

The Commerce Department claims that the blacklisted companies and bureaus provided technologies used for the “repression, mass arbitrary detention, and high-technology surveillance” of Muslim minority groups across China following the Urumqi riots a decade ago. China told the U.S. to stop interfering in its affairs, while Hikvision stated that it “strongly opposes” the decision.

Ambarella doesn't disclose its revenue by individual customer, but plenty of red flags appeared earlier this year. In late May, Morgan Stanley analyst Joseph Moore warned that Ambarella generated a “high-teens” percentage of its revenue from Hikvision. In June, Needham analyst N. Quinn Bolton warned that losing Hikvision and Dahua would reduce Ambarella's annual revenue by 25%-30%.

Yet the bulls didn't seem to pay attention. Instead, the stock hit a 52-week high in mid-September on optimism about its stabilizing revenue, the launch of its new computer vision chips, and a fresh buyback plan. Unfortunately, none of those improvements will offset the losses of Hikvision and Dahua.

Investors shouldn't be surprised...

I've [repeatedly warned](#) that Ambarella's dependence on China's top security camera makers exposes it to the escalating U.S.-China trade war. The U.S. already banned Hikvision and Dahua's cameras from government contracts and facilities last year, so it wasn't surprising that they were formally blacklisted.

Losing Hikvision and Dahua will likely reverse Ambarella's recovery in the first half of fiscal 2020. Ambarella's revenue fell 10% annually last quarter, but it still rose 19% from the first quarter.

Metric	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020
Revenue (in millions)	\$62.5	\$57.3	\$51.1	\$47.2	\$56.1
YOY growth	(13%)	(36%)	(28%)	(17%)	(10%)

YOY = Year-over-year. Source: Ambarella quarterly reports.

Ambarella [attributed that recovery](#) to strong sales of its security camera System On a Chip (SoCs) sets in China, which offset the sequentially flat growth of its automotive business and its declines in other consumer-oriented devices. At the time, Ambarella estimated that its third-quarter revenue would rise 12%-19% sequentially and 10%-17% annually, which would end its two-year streak of revenue declines.

Ambarella previously expected two tailwinds to revive its top-line growth: the expansion of its automotive business with new SoCs for dash cams and computer vision chips for connected and driverless cars, and higher sales of SoCs for Chinese security camera makers. Unfortunately, the Trump Administration’s latest move will torpedo Ambarella’s security business and cripple its recovery in the second half of the year.



Image source: Getty Images.

A lesson in customer concentration

During last quarter's [conference call](#), Ambarella CEO Fermi Wang warned that there was a risk that the U.S. would "limit or restrict" its shipments to top Chinese customers. However, Wang also noted that demand at its "largest security camera customer in China" (likely Hikvision) improved during the quarter.

Wang stated that Ambarella was reducing its dependence [on Chinese companies](#) by growing its security camera market share in other markets. However, Needham believes that Hikvision and Dahua's orders still account for about half of Ambarella's professional security camera revenue. Based on that percentage, Needham estimates that Hikvision and Dahua contribute about \$50 million to Ambarella's annual sales — which equals more than a fifth of its projected revenue this year.

Ambarella isn't the only American chipmaker with heavy exposure to Hikvision, which controls roughly a fifth of the global security camera market. Its other suppliers include **Intel** ([NASDAQ: INTC](#)), which provides its cameras with CPUs and Movidius' computer vision chips; **NVIDIA** ([NASDAQ: NVDA](#)), which supplies it with deep learning GPUs; and hard drive makers **Western Digital** ([NASDAQ: WDC](#)) and **Seagate** ([NASDAQ: STX](#)), which provide its surveillance systems with high-capacity drives.

Simply put, the Trump Administration's moves against Hikvision, Dahua, and other Chinese companies will likely also hurt U.S. companies. It will also exacerbate the trade war and push China to aggressively [reduce its dependence](#) on U.S. chips, which sounds like a lose-lose situation for all parties involved.

Is it time to sell Ambarella?

There's no real reason to keep holding Ambarella in your portfolio. The trade blacklist derails its recovery, its gross margins are slipping, and its stock looks pricey at 80 times forward earnings. Its core growth engine is sputtering out, so investors should avoid Ambarella and stick with its safer peers like Intel, NVIDIA, or **AMD** instead.

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1. Investing
2. Tech Stocks

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TICKERS GLOBAL

1. NASDAQ:AMBA (Ambarella, Inc.)
2. NASDAQ:INTC (Intel Corporation)
3. NASDAQ:NVDA (NVIDIA Corporation)

4. NASDAQ:STX (Seagate Technology plc)
5. NASDAQ:WDC (Western Digital Corporation)

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