

Innolight (300308 CH)

Weak 1Q21; Expect demand to pick up in 2Q

Innolight preannounced a weak 1Q21 net profit of RMB118-145mn, implying 6-23% YoY decline, and mid-point accounted for 13%/12% of our/consensus estimates. Excluding RMB27mn equity incentive fees, net profit would be RMB150-195mn, implying growth of -2% to 27% YoY. Despite a weak 1Q, we believe client demand will recover QoQ in 2Q/3Q20, as 200G products will start shipment in 2Q21 and domestic 5G deployment will kick off in the near term. We trimmed FY21-22E EPS by 16-17%, and revised our TP to RMB49.27 based on lower 34x FY21E P/E (vs prior 42x). Innolight now trades at trough valuation of 24.1x FY21E P/E, well below 34x P/E for 1-sd below historical average. Maintain BUY.

- **1Q21 net profit miss; expect demand recovery in Q2/Q3.** Innolight's 1Q21 net profit weakness is mainly due to 1) weaker demand on seasonality similar to last year; 2) delayed procurement of major clients and 2) one-time charge of RMB27mn of equity incentive fee. We believe the demand will pick up in 2Q, mainly driven by global capex from major cloud clients. Based on latest guidance from overseas cloud companies, we are positive on their FY21E capex: 1) Google expects server continues to be the largest driver of tech infrastructure and 2) Facebook expects FY21E capex to reach \$21-23bn (vs. \$16bn in FY20), driven by data centers and servers.
- **Mgmt. increased stake as positive sign of future growth.** On 25 Feb, senior mgmt. announced termination of their share reduction plan and some core employees will increase their shareholdings in the next 6 months, with total amount of RMB114-181mn. We think it is a positive sign to regain market confidence as the stock is now trading at a trough valuation of 24x 1-year forward P/E, the lowest level in past 3 years.
- **Maintain BUY; Trim TP to RMB49.27.** We maintain BUY and adjusted our target price to RMB49.27 based on lower 34x FY21E P/E (vs prior 42x given recent sector de-rating). Trading at 24.1x FY21E P/E (lower than 1-sd below 2-year avg.), we think the stock is attractive, backed by 20%/25% revenue/ NP FY20-22E CAGR. Potential risks include weaker capex from global cloud companies, slower deployment of 5G infrastructure and ASP pressure.

Earnings Summary

(YE 31 Dec)	FY19A	FY20E	FY21E	FY22E	FY23E
Revenue (RMB mn)	4,758	7,053	8,640	10,321	12,371
YoY growth (%)	(7.7)	48.2	22.5	19.5	19.9
Net profit (RMB mn)	513	849	1,034	1,315	1,627
EPS (RMB)	0.73	1.19	1.45	1.84	2.28
YoY growth (%)	-46%	63%	22%	27%	24%
PE (x)	50.5	30.9	25.4	20.0	16.1
PB (x)	3.8	3.3	3.0	2.6	2.3
Yield (%)	0.2	0.3	0.4	0.5	0.6
ROE (%)	6.2	9.5	11.7	13.1	14.1
Net gearing (%)	2.3	17.2	3.1	14.6	4.4

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	RMB 49.27
(Previous TP)	RMB 72.66)
Up/Downside	+33.7%
Current Price	RMB 36.84

China Technology Sector

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Stock Data

Mkt. Cap. (RMB mn)	24,927
Avg. 3mths t/o (RMB mn)	365
52W High/Low (RMB)	72.81/32.99
Total Issued Shares (mn)	713

Source: Bloomberg

Shareholding Structure

Zhongji Investment	18.17%
HKSC	8.48%
SZ Yixingfu Ent Mgmt	7.04%

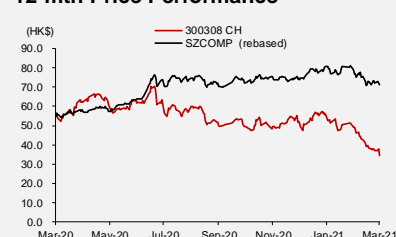
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-29.7%	-23.9%
3-mth	-32.9%	-30.1%
6-mth	-31.5%	-32.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers
Zhong Tian

Recent Reports:

1. Innolight - 4Q20 in-line; 400G upgrade and hyperscale capex recovery to drive growth in 2021 – 1 Feb 2020
2. China 5G Technology - Picking structural winners amid uncertainties; Initiate at Outperform – 18 Dec 2020

Forecasts revision

Figure 1: CMBIS estimate revisions

RMB mn	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	8,640	10,321	12,371	9,561	11,784	NA	-10%	-12%	NA
Gross Profit	2,183	2,670	3,267	2,421	3,055	NA	-10%	-13%	NA
Operating Profit	1,220	1,518	1,878	1,424	1,830	NA	-14%	-17%	NA
Net profit	1,034	1,315	1,627	1,235	1,588	NA	-16%	-17%	NA
EPS (RMB)	1.45	1.84	2.28	1.73	2.23	NA	-16%	-17%	NA
Gross Margin	25.3%	25.9%	26.4%	25.3%	25.9%	NA	-0.1 ppt	-0.1 ppt	NA
Operating Margin	14.1%	14.7%	15.2%	14.9%	15.5%	NA	-0.8 ppt	-0.8 ppt	NA
Net Margin	12.0%	12.7%	13.2%	12.9%	13.5%	NA	-1 ppt	-0.7 ppt	NA

Source: Company data, CMBIS estimates

Figure 2: CMBIS estimates vs consensus

RMB mn	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	8,640	10,321	12,371	8,985	11,008	NA	-4%	-6%	NA
Gross Profit	2,183	2,670	3,267	2,389	2,926	NA	-9%	-9%	NA
Operating Profit	1,220	1,518	1,878	1,327	1,705	NA	-8%	-11%	NA
Net profit	1,034	1,315	1,627	1,147	1,457	NA	-10%	-10%	NA
EPS (RMB)	1.45	1.84	2.28	1.60	2.06	NA	-9%	-10%	NA
Gross Margin	25.3%	25.9%	26.4%	26.6%	26.6%	NA	-1.3 ppt	-0.7 ppt	NA
Operating Margin	14.1%	14.7%	15.2%	14.8%	15.5%	NA	-0.6 ppt	-0.8 ppt	NA
Net Margin	12.0%	12.7%	13.2%	12.8%	13.2%	NA	-0.8 ppt	-0.5 ppt	NA

Source: Company data, CMBIS estimates

Figure 3: P&L forecasts

RMB mn	FY19A	1Q20	2Q20	3Q20	4Q20	FY20	FY21E	FY22E	FY23E
Revenue	4,758	1,326	1,919	1,960	1,848	7,053	8,640	10,321	12,371
...YoY	-8%	51%	65%	57%	25%	48%	22%	19%	20%
Cost of sales	(3,468)	(995)	(1,429)	(1,483)	(1,390)	(5,297)	(6,457)	(7,652)	(9,104)
Gross profit	1,290	331	490	477	458	1,757	2,183	2,670	3,267
GPM (%)	27.1%	24.9%	25.5%	24.4%	24.8%	24.9%	25.3%	25.9%	26.4%
...YoY	-8%	34%	47%	36%	27%	36%	24%	22%	22%
SG&A	(329)	(87)	(98)	(141)	(165)	(490)	(596)	(712)	(854)
...% of rev	-6.9%	-6.5%	-5.1%	-7.2%	-8.9%	-7.0%	-6.9%	-6.9%	-6.9%
R&D	(362)	(88)	(88)	(117)	(110)	(402)	(475)	(568)	(680)
...% of rev	-7.6%	-6.6%	-4.6%	-5.9%	-5.9%	-5.7%	-5.5%	-5.5%	-5.5%
Operating profit	576	173	257	269	294	994	1,220	1,518	1,878
OPM (%)	12.1%	13.1%	13.4%	13.7%	15.9%	14.1%	14.1%	14.7%	15.2%
...YoY	-15%	48%	123%	72%	57%	72%	23%	24%	24%
Net profit	513	154	211	235	249	849	1,034	1,315	1,627
NPM (%)	10.8%	11.6%	11.0%	12.0%	13.5%	12.0%	12.0%	12.7%	13.2%
...YoY	-18%	54%	96%	56%	60%	241%	22%	27%	24%

Source: Company data, CMBIS estimates

Valuation

Maintain BUY with TP RMB49.27 (33.7% upside)

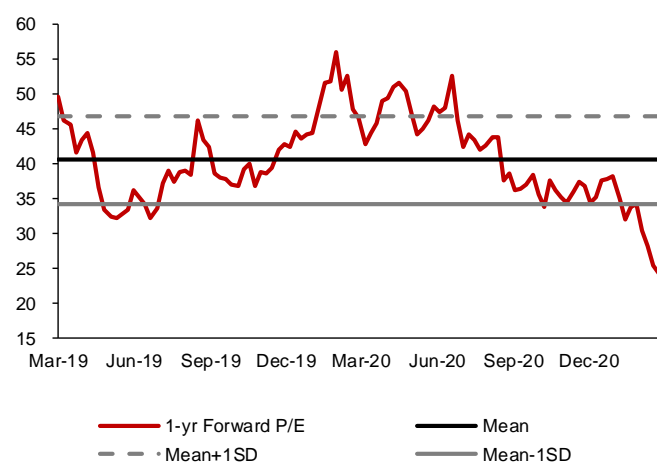
We adjust our 12m TP to RMB49.27 based on lower 34x FY20E P/E, vs prior 42x given recent sector de-rating. We believe this is justified as Innolight is the industry leader in the fast growing optical module market. Upcoming catalysts include increasing demand of 200G/400G/800G and share gain in China telecom market. Potential risks include weaker capex from cloud giants, slower deployment of 5G infrastructure and ASP pressure.

Figure 4: Peers' valuation

Company	Ticker	Rating	Mkt Cap	Price	TP	Up/Down	P/E (x)		P/B (x)		ROE (%)	
			US\$(mn)	(LC)	(LC)	-side	FY21E	FY22E	FY21E	FY22E	FY21E	FY22E
Innolight	300308 CH	Buy	3,809	36.84	49.27	34%	25.4	20.0	3.0	2.6	11.7	13.1
Accelink Tech	002281 CH	NR	2,332	21.87	NA	NA	25.1	21.1	2.7	2.4	10.8	11.7
Eoptolink Tech	300502 CH	NR	2,166	39.14	NA	NA	20.6	15.9	4.6	3.8	25.3	25.9
HG Genuine	000988 CH	NR	3,303	21.50	NA	NA	27.6	23.4	2.9	2.6	11.1	12.0
FIT Hon Teng	6088 HK	NR	2,333	2.63	NA	NA	11.7	10.0	1.0	0.9	8.8	8.8
Lumentum	LITE US	NR	6,469	85.45	NA	NA	13.3	12.3	3.3	2.7	26.2	20.9
Finisar	IIVI US	NR	6,873	65.61	NA	NA	17.6	15.2	2.4	2.2	17.3	15.4
Sumitomo	8053 JT	NR	18,459	1609.50	NA	NA	-	9.2	0.8	0.8	-4.7	8.9
NeoPhotonics	NPTN US	NR	583	11.48	NA	NA	-	41.3	3.6	3.4	-5.7	12.6
Csico	CSCO US	NR	215,564	51.06	NA	NA	16.0	15.0	5.2	4.6	33.8	31.6
Average							19.5	18.2	2.9	2.6	13.5	16.1

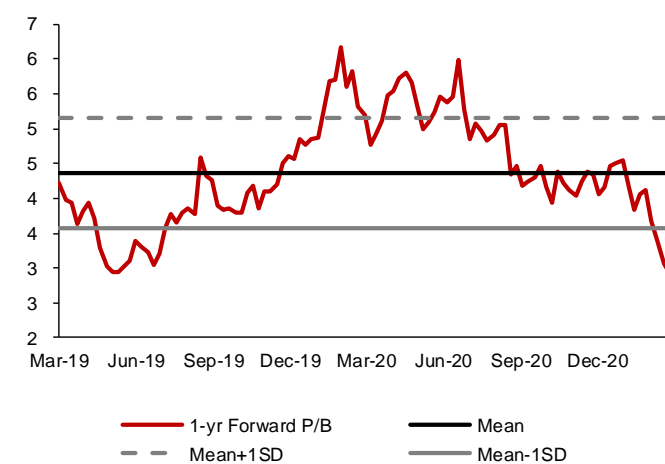
Source: Bloomberg, CMBIS estimates

Figure 5: 12M forward P/E band



Source: Company data, CMBIS estimates

Figure 6: 12M forward P/B band



Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20E	FY21E	FY22E	FY23E
Revenue	4,758	7,053	8,640	10,321	12,371
Cost of sales	3,468	5,297	6,457	7,652	9,104
Gross profit	1,290	1,757	2,183	2,670	3,267
Tax and surcharges	17	18	17	21	25
Selling exp	55	109	121	144	173
Admin exp (excl. R&D)	275	381	475	568	680
R&D exp	362	402	475	568	680
Finance costs	17	50	55	54	73
Other operating exp.	5	(180)	(163)	(182)	(218)
Operating profit	576	994	1,220	1,518	1,878
Other non-oper exp.	0	(2)	(27)	0	0
Pre-tax profit	577	992	1,193	1,518	1,878
Income tax expense	63	134	149	190	235
Minority interests		8	10	13	16
Net profit	513	849	1,034	1,315	1,627
Adj. net profit	430	745	1,034	1,315	1,627

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20E	FY21E	FY22E	FY23E
Net profit	513	858	1,044	1,328	1,644
Depreciation/amortization	241	386	516	662	808
Change in working capital	(360)	(1,929)	963	(2,224)	64
Others	175	119	126	153	187
Net cash from operating	569	(566)	2,649	(80)	2,702
Capex	(759)	(1,128)	(1,116)	(1,070)	(1,203)
Other	(1,180)	197	(29)	(96)	(54)
Net cash from investing	(1,939)	(931)	(1,145)	(1,165)	(1,258)
Share issuance	1,524	(0)	0	0	0
Net borrowing	159	1,341	(272)	1,604	(85)
Other	(126)	45	(153)	(201)	(252)
Net cash from financing	1,557	1,386	(424)	1,403	(338)
Net change in cash	195	(129)	1,079	158	1,107
Cash at beginning of the	1,041	1,236	1,108	2,187	2,345
Exchange difference	8	(17)	0	0	0
Cash at the end of year	1,236	1,140	2,220	2,377	3,484

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20E	FY21E	FY22E	FY23E
Current assets	5,991	8,303	8,653	11,434	12,851
Cash & equivalents	1,236	1,140	2,220	2,377	3,484
Account receivables	1,133	2,081	1,712	2,708	2,579
Inventory	2,504	3,966	3,569	5,004	5,255
Prepayment	65	31	31	31	31
Other current assets	1,054	1,084	1,121	1,314	1,502
Non-current assets	4,500	5,409	6,009	6,417	6,812
PPE	1,950	2,794	3,414	3,926	4,465
Goodwill	1,717	1,915	1,915	1,915	1,915
Intangible assets	311	396	545	710	897
Other non-current assets	522	304	136	-134	-464
Total assets	10,491	13,711	14,662	17,851	19,663
Current liabilities	2,826	4,417	4,508	5,830	6,164
ST borrowings	933	1,677	1,514	2,476	2,425
Account payables	1,259	1,529	1,782	2,141	2,527
Other current liabilities	634	1,212	1,212	1,212	1,212
Non-current liabilities	739	1,420	1,312	1,953	1,919
LT borrowings	466	1,096	987	1,629	1,595
Deferred tax liability	109	100	100	100	100
Other non-current liabilities	164	224	224	224	225
Total liabilities	3,565	5,838	5,820	7,783	8,083
Share capital	713	713	713	713	713
Reserve	6,213	7,054	8,013	9,225	10,721
Minority interest	0	106	116	129	145
Total equity	6,926	7,874	8,843	10,068	11,580
Total liabilities and equity	10,491	13,711	14,662	17,851	19,663

Key ratios

YE 31 Dec	FY19A	FY20E	FY21E	FY22E	FY23E
Revenue mix					
10G/40G modules	22	13	9	6	7
25G/100G/400G modules	78	84	82	85	87
High-end equipment	3	2	2	2	2
Growth (%)					
Revenue	(7.7)	48.2	22.5	19.5	19.9
Gross profit	(8.3)	36.2	24.3	22.3	22.4
Operating profit	(15.5)	72.4	22.7	24.5	23.7
Adj. net profit	(27.2)	73.5	38.7	27.3	23.7
Profit & loss ratio (%)					
Gross margin	27.1	24.9	25.3	25.9	26.4
Operating margin	12.1	14.1	14.1	14.7	15.2
Net profit margin	10.8	12.0	12.0	12.7	13.2
Balance sheet ratio					
Gear ratio	2.3	17.2	3.1	14.6	4.4
Current ratio (x)	2.1	1.9	1.9	2.0	2.1
Receivable turnover days	76	84	81	79	79
Inventory turnover days	185	174	166	159	159
Payable turnover days	108	96	94	94	94
Profitability (%)					
ROE	6.2	9.5	11.7	13.1	14.1
ROA	4.1	5.4	7.0	7.4	8.3
Per share data (RMB)					
EPS	0.73	1.19	1.45	1.84	2.28
DPS	0.08	0.10	0.14	0.18	0.23
BVPS	9.70	10.89	12.24	13.94	16.03

Source: Company data, CMBIS estimates

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