

Innolight (300308 CH)

Overseas data center demand to remain resilient in 2H22

Innolight announced its 2Q22 results. 2Q22 revenue/NP to shareholders grew 17.3%/32.4% YoY and 2.6%/26.5% QoQ to RMB2.1bn/RMB275mn. GPM for 2Q22 was 27.3% (vs. 23.8% for 2Q21 and 26.3% in 1Q22), mainly due to favorable product mix and reduced opex. We continue to see strong demand from overseas cloud clients, while domestic Datacom demand seems soft. We remain positive on overseas clients' capex growth given their reaffirmed commitment to invest in technology infrastructure even in this tough macro environment. We maintain BUY rating and adjust TP to RMB42.0, reflecting softer-than-expected domestic demand for optical transceivers.

■ **Innolight's 2Q sales grew 2.6% QoQ, in line with expectations.** By geography, overseas sales contribution increased significantly from 75.1% in FY21 to 85.6% in 1H22. This is mainly due to strong demand from overseas cloud companies and relatively soft demand from domestic ICPs. Amazon/Google/Meta's total capex grew 34.9%/23.6% YoY in 1Q/2Q22. The surging demand for 200G/400G transceivers created favorable product mix. We see 2Q GPM grew to 27.3% vs. 26.3% in 1Q. As the market continues to embrace higher bandwidth (e.g., continuous migration to 200G/400G, deploy 800G optical modules starts from 4Q22), we believe Innolight can benefit from this trend.

■ **Looking forward, we remain positive on overseas clients' capex growth.** Although we see many companies are being disciplined or even cut on spending, large cloud leaders (AMZN/GOOG/FB/MSFT) all confirmed of continuous investments in technology infrastructure. However, the market seems to be less confident in Innolight's clients' demand, especially when Amazon and Meta guided lower-than-average sales growth for 3Q (-2% and -6%) and reduced hiring plans, suggesting weak consumer spending. Contrary to the consensus, we are more opportunistic than the market, considering resources should be allocated to key growth drivers, which will help boost performance when macro recovers.

■ **Maintain BUY and TP adjusted to RMB42.0.** Innolight is a major beneficiary of cloud capex growth. We maintained positive outlook for its overseas business but lowered forecasts for domestic sales. New TP of RMB42.0 is based on 26x 23E P/E. Potential risks include 1) reduced capex from global cloud companies, 2) slower deployment of 5G infrastructure and 3) faster-than-expected tech advancement.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Turnover (RMB mn)	7,050	7,695	9,398	10,770	12,139
YoY growth (%)	48.2%	9.2%	22.1%	14.6%	12.7%
Gross margin (%)	25.4%	25.6%	26.3%	26.6%	26.6%
Net profit (RMB mn)	865	877	1,076	1,296	1,460
EPS (RMB)	1.23	1.21	1.34	1.62	1.82
YoY growth (%)	68.5%	-1.6%	11.1%	20.5%	12.7%
PE (x)	24.5	24.9	22.4	18.6	16.5
Yield (%)	0.4%	0.7%	0.9%	1.1%	1.2%
Roe (%)	11.0%	7.6%	8.7%	9.6%	10.0%
Net gearing (%)	9.9%	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIGM estimates

BUY (Maintain)

Target Price **RMB42.00**
 (Previous TP **RMB45.60**)
 Up/Downside **+39.4%**
 Current Price **RMB30.13**

China Technology Sector

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Stock Data

Mkt. Cap. (RMB mn)	24,094
Avg. 3mths t/o (RMB mn)	450
52W High/Low (RMB)	43.96/28.45
Total Issued Shares (mn)	799.7

Source: Bloomberg

Shareholding Structure

Zhongji Investment	11.74%
HKSC	9.31%
Wang Weixiu	8.02%

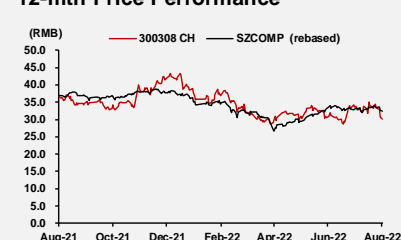
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-11.6%	-11.1%
3-mth	0.2%	-9.5%
6-mth	-18.2%	-12.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PWC Zhong Tian

Recent Reports:

1. Data center demand to remain resilient in 2H22g in 2022 – 12 Jul 2022 ([Link](#))
2. Corporate Day takeaways – 23 Jun 2022 ([Link](#))

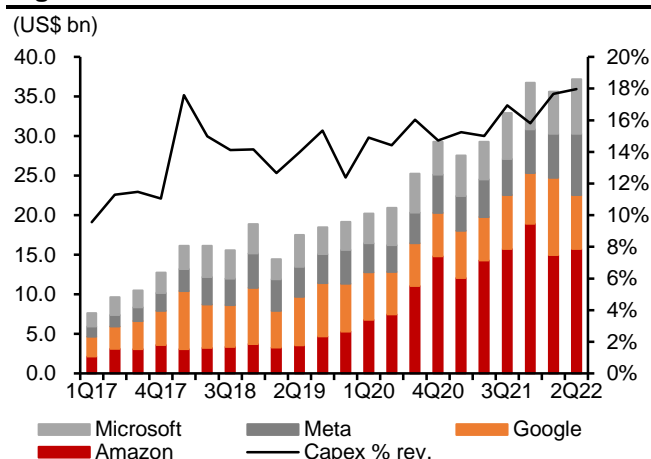
2Q22 Earnings Review

Figure 1: P&L forecasts

RMB mn	FY19A	FY20A	1H21A	2H21A	FY21A	1H22A	2H22E	FY22E	FY23E	FY24E
Revenue	4,758	7,050	3,298	4,398	7,695	4,231	5,166	9,398	10,770	12,139
...YoY	-7.7%	48.2%	1.6%	15.6%	9.2%	28.3%	17.5%	22.1%	14.6%	12.7%
Cost of sales	3,468	5,257	2,493	3,234	5,727	3,098	3,824	6,921	7,907	8,904
Gross profit	1,290	1,793	805	1,163	1,968	1,133	1,343	2,476	2,863	3,235
...YoY	(8.3%)	39.0%	-2.0%	19.7%	9.8%	40.8%	15.4%	25.8%	15.6%	13.0%
GPM (%)	27.1%	25.4%	24.4%	26.5%	25.6%	26.8%	26.0%	26.3%	26.6%	26.6%
SG&A	329	477	228	279	507	282	329	611	690	765
...% of rev	6.9%	6.8%	6.9%	6.3%	6.6%	6.7%	6.4%	6.5%	6.4%	6.3%
R&D	362	506	228	314	541	349	370	719	813	904
...% of rev	7.6%	7.2%	6.9%	7.1%	7.0%	8.2%	7.2%	7.6%	7.5%	7.4%
Operating profit	576	990	371	592	963	525	642	1,167	1,406	1,584
...YoY	-15.5%	71.7%	-13.7%	5.8%	-2.7%	41.3%	8.5%	21.2%	20.5%	12.7%
OPM (%)	12.1%	14.0%	11.3%	13.5%	12.5%	12.4%	12.4%	12.4%	13.1%	13.0%
Net profit	513	865	341	536	877	492	583	1,076	1,296	1,460
...YoY	-17.6%	68.6%	-6.7%	7.2%	1.3%	44.5%	8.8%	22.7%	20.5%	12.7%
NPM (%)	10.8%	12.3%	10.3%	12.2%	11.4%	11.6%	11.3%	11.4%	12.0%	12.0%

Source: Company data, CMBIGM estimates

Figure 2: Big four cloud companies' capex remain at high level



Source: Company filings, CMBIGM estimates

Figure 3: Top 10 transceiver suppliers (2010/2016/2018/2021)

2010	2016		2018	2021
Finisar	Finisar	1	Finisar	II-VI & Innolight (tie)
Opnext	Hisense	2	Innolight	
Sumitomo	Accelink	3	Hisense	Huawei (HiSilicon)
Avago	Acacia	4	Accelink	Cisco(Acacia)
Source Photonics	FOIT(Avago)	5	FOIT(Avago)	Hisense
Fujitsu	Oclaro	6	Lumentum/Oclaro	Broadcom (Avago)
JDSU	Innolight	7	Acacia	Eoptolink
Emcore	Sumitomo	8	Intel	Accelink
WTD	Lumentum	9	AOi	Molex
NeoPhotonics	Source Photonics	10	Sumitomo	Intel

Source: Lightcounting, CMBIGM estimates

Figure 4: Earnings revision

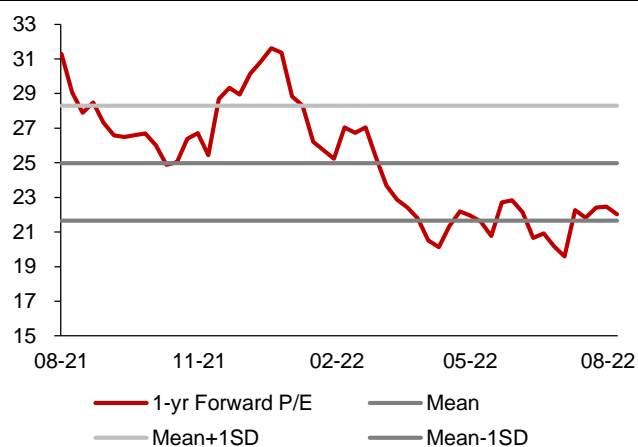
RMBmn	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	9,398	10,770	12,139	9,908	11,426	12,362	-5%	-6%	-2%
Gross Profit	2,476	2,863	3,235	2,645	3,078	3,352	-6%	-7%	-3%
Operating Profit	1,167	1,406	1,584	1,187	1,503	1,650	-2%	-6%	-4%
Net profit	1,076	1,296	1,460	1,108	1,399	1,538	-3%	-7%	-5%
EPS (US\$ cents)	1.34	1.62	1.82	1.38	1.75	1.92	-3%	-7%	-5%
Gross Margin	26.3%	26.6%	26.6%	26.7%	26.9%	27.1%	-0.3 ppt	-0.4 ppt	-0.5 ppt
Operating Margin	12.4%	13.1%	13.0%	12.0%	13.2%	13.4%	0.4 ppt	-0.1 ppt	-0.3 ppt
Net Margin	11.4%	12.0%	12.0%	11.2%	12.2%	12.4%	0.3 ppt	-0.2 ppt	-0.4 ppt

Source: Company data, CMBIGM estimates

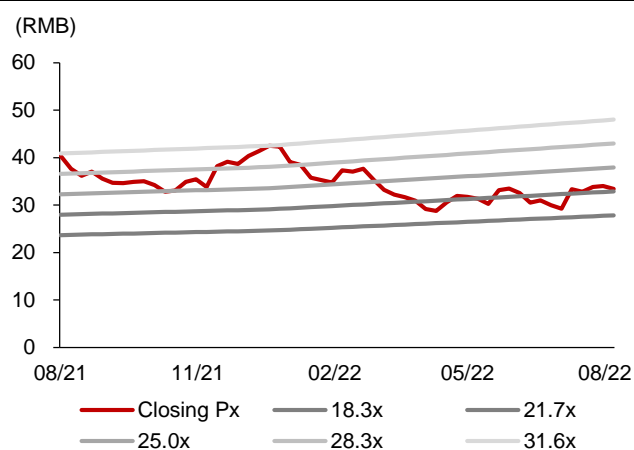
Figure 5: CMBIGM estimates vs consensus

US\$ mn	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	9,398	10,770	12,139	9,391	10,981	12,447	0%	-2%	-2%
Gross Profit	2,476	2,863	3,235	2,514	2,998	3,442	-2%	-5%	-6%
Operating Profit	1,167	1,406	1,584	1,183	1,481	1,673	-1%	-5%	-5%
Net profit	1,076	1,296	1,460	1,112	1,372	1,607	-3%	-6%	-9%
EPS (US\$ cents)	1.34	1.62	1.82	1.39	1.71	1.97	-3%	-5%	-7%
Gross Margin	26.3%	26.6%	26.6%	26.8%	27.3%	27.7%	-0.4 ppt	-0.7 ppt	-1 ppt
Operating Margin	12.4%	13.1%	13.0%	12.6%	13.5%	13.4%	-0.2 ppt	-0.4 ppt	-0.4 ppt
Net Margin	11.4%	12.0%	12.0%	11.8%	12.5%	12.9%	-0.4 ppt	-0.5 ppt	-0.9 ppt

Source: Company data, CMBIGM estimates

Figure 6: 12M forward P/E chart

Source: Company data, CMBIGM estimates

Figure 7: 12M forward P/E band

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	7,050	7,695	9,398	10,770	12,139
Cost of sales	(5,257)	(5,727)	(6,921)	(7,907)	(8,904)
Gross profit	1,793	1,968	2,476	2,863	3,235
Selling exp	(107)	(73)	(89)	(102)	(115)
Admin exp	(370)	(434)	(522)	(587)	(650)
R&D exp	(506)	(541)	(719)	(813)	(904)
Finance costs	(64)	(84)	(21)	(48)	(41)
Other operating exp.	1,850	2,137	2,660	3,008	3,362
Operating profit	990	963	1,167	1,406	1,584
Other non-oper exp.	(3)	(3)	(3)	(4)	(4)
Pre-tax profit	987	960	1,164	1,402	1,580
Income tax expense	(111)	(73)	(87)	(105)	(118)
Minority interests	11	10	1	2	2
Net profit to shareholders	865	877	1,076	1,296	1,460

Cash flow summary

YE 31 Dec (RMB mn)	FY20	FY21A	FY22E	FY23E	FY24E
Net profit	876	886	1,077	1,297	1,462
Depreciation/amortization	251	321	364	399	423
Change in working capital	(1,09)	(587)	(3)	342	(884)
Others	(10)	193	0	200	93
Net cash from operating	22	813	1,439	2,238	1,093
Capex	(956)	(840)	(698)	(762)	(818)
Other	83	(379)	(924)	160	145
Net cash from investing	(873)	(1,219)	(1,622)	(601)	(673)
Share issuance	0	2,665	7	0	0
Net borrowing	(121)	(168)	(262)	(297)	(341)
Other	1,421	(233)	(109)	21	160
Net cash from financing	1,300	2,264	(364)	(276)	(181)
Net change in cash	449	1,859	(547)	1,361	239
Cash at beginning of the year	1,236	1,648	3,489	2,925	4,268
Exchange difference	(37)	(17)	(17)	(17)	(17)
Cash at the end of year	1,648	3,489	2,925	4,268	4,490

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Current assets	7,982	10,022	11,053	11,855	13,369
Cash & equivalents	1,679	3,515	2,950	4,293	4,515
Account receivables	1,514	1,997	1,607	1,461	1,864
Inventory	3,774	3,799	4,734	4,365	5,149
Prepayment	40	72	66	77	86
Other current assets	973	638	1,696	1,659	1,754
Non-current assets	5,634	6,543	6,843	6,850	7,038
PPE	2,726	3,152	3,243	3,295	3,392
Deferred tax assets	38	46	59	57	65
Other non-current assets	2,870	3,345	3,541	3,498	3,581
Total assets	13,616	16,565	17,897	18,705	20,407
Current liabilities	3,772	3,166	3,463	2,786	3,122
ST borrowings	1,041	794	978	536	469
Account payables	1,367	1,205	1,763	1,487	1,831
Tax payable	35	68	49	64	63
Other current liabilities	1,329	1,098	673	699	759
Non-current liabilities	1,850	1,796	1,933	2,349	2,523
LT borrowings	1,430	1,262	1,398	1,767	1,901
Deferred tax liability	154	277	221	272	274
Other non-current liabilities	267	258	315	310	348
Total liabilities	5,622	4,962	5,397	5,135	5,645
Share capital	713	800	800	800	800
Reserve	5,147	7,799	7,799	7,799	7,799
Retained earnings	2,090	2,861	3,737	4,788	5,957
Other	(61)	29	48	66	87
Minority interest	104	114	115	117	119
Total equity	7,993	11,603	12,500	13,571	14,761
Total liabilities and equity	13,616	16,565	17,897	18,705	20,407

Key ratios

YE 31 Dec	FY20	FY21A	FY22E	FY23E	FY24E
Revenue mix					
High-end optical module	6,703	7,261	9,054	10,323	11,470
Access network module	161	327	343	446	670
High-end equipment	186	107	0	0	0
Growth (%)					
Revenue	48.2	9.2%	22.1%	14.6%	12.7%
Gross profit	39.0	9.8%	25.8%	15.6%	13.0%
Operating profit	71.7	-2.7%	21.2%	20.5%	12.7%
Adj. net profit	68.6	1.3%	22.7%	20.5%	12.7%
Profit & loss ratio (%)					
Gross margin	25.4	25.6%	26.3%	26.6%	26.6%
Operating margin	14.0	12.5%	12.4%	13.1%	13.0%
Net profit margin	12.3	11.4%	11.4%	12.0%	12.0%
Balance sheet ratio					
Gear ratio	9.9%	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	2.1	3.2	3.2	4.3	4.3
Receivable turnover days	69	83	70	52	50
Inventory turnover days	(218)	(241)	(225)	(210)	(195)
Payable turnover days	(91)	(82)	(78)	(75)	(68)
Profitability (%)					
ROE	11.0	7.6%	8.7%	9.6%	10.0%
ROA	6.4%	5.3%	6.0%	6.9%	7.2%
Per share data (RMB)					
EPS	1.23	1.21	1.34	1.62	1.82
DPS	0.12	0.22	0.27	0.32	0.37
BVPS	11.21	15.85	15.48	16.81	18.30

Source: Company data, CMBIGM estimates

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