# Hardware – Optical transceivers

## Implications from Coherent 2Q23 results and guidance

**MARKET PERFORM (Maintain)**

Coherent's (COHR US, not rated) stock plunged after releasing 2Q23 earnings on Wednesday. The Company gave a bullish outlook on demand within the Datacom AI/ML sector, combined with their perspective that the present AI demand, constitutes a transformative shift rather than a short-lived cycle, which has likely influenced market sentiment. However, Coherent's exclusion of US$200mn AI-related sales might suggest a slower-than-expected pace in its capacity ramp-up. Challenges in production to meet surging demand is not company specific. Due to supply chain disruptions in the past years, industry was stocking components. As macroeconomics weakens, the industry has entered into inventory correction stage. It takes time to optimize supply chain to catch up with the surging AI demand. The current supply chain constraints are in line with our previous prediction (link).

- **In our view, Coherent's earnings call did not provide additional clarity to the market dynamics, divided views still exist.** Nevertheless, there are still several crucial takeaways that deserve investors' attentions. 1) Demand for 800G optical transceivers remains robust in the near-term as Coherent explicitly stated, "The surge in Datacom orders drove almost 100% upside to our outlook largely from AI/ML-related 800G transceivers." 2) Supply chain bottlenecks persist, bringing constraints to manufacturing lines at Coherent. We anticipate a swifter capacity ramp-up by Innolight (300308CH, HOLD, TP RMB104) given their effective execution management, but investors should not be overly optimistic. 3) Hyperscales' CapEx is relatively fixed in the short term and is leaning heavily towards AI. This translates into weaker sales of non-AI transceivers. Coherent has corroborated with this trend as it stated "The legacy products demand is declining."

- **We remain unchanged on our view of optical transceivers sector**, as we expect robust short-term demand while maintaining a cautious standpoint regarding the sustainability of high demand in mid-to-long term. We expect AI investments will likely cannibalize certain traditional server expenditures, potentially leading to a negative impact on sales of non-AI high speed transceivers. Moreover, current huge buildouts in generative AI infrastructure appear to be for major hyperscalers and for industry participants building and training LLMs. Considering the massive cost of continuous training to get better enhanced results and potential enormous cost of maintaining operation in inference phase, companies (SaaS/IaaS providers) in fact are making a big bet that they can obtain material AI revenues. Should the expectation of AI revenue generation hit any roadblocks (e.g., pushback from regulatory authorities), we suspect if the current AI infrastructure investment frenzy will continue without any interruption. As a result, we give a more conservative outlook to optical transceiver sector than the current consensus.

- **Coherent FY23 results recap: Rev grew 55.6% YoY to US$5.2bn but net earnings turned negative to US$260mn (vs. US$235mn for FY22).** The Company gave an unsatisfactory outlook: 1) FY24 revenue forecasts fall within the range of US$4.5-4.7bn, suggesting 9.6%-13.5% YoY decline. The Company clarified on CC that they have included a meaningful amount of 800G sales, particularly in 2Q. 2) A potential upside of US$200mn sales, driven by Datacom transceivers for AI, were NOT included in the guidance, as the Company cited the need to address multiple aspects of the supply chain. 3) While the Company expressed confidence in the enduring nature of Datacom AI/ML demand, it also acknowledged "anticipated declines in demand from the traditional data centers and hyperscale customers in data communications in FY24."

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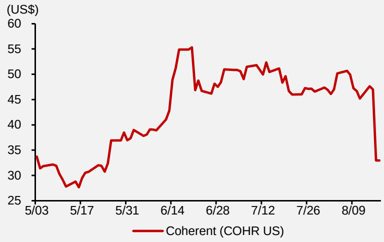


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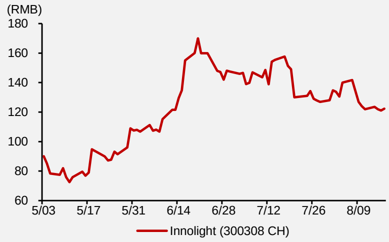


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