Innolight (300308 CH)

4Q20 in-line; 400G upgrade and hyperscale capex recovery to drive growth in 2021

Innolight announced FY20E preliminary net profit of RMB780mn-905mn, up 52%-76% YoY, with mid-point of RMB843mn (+64% YoY) largely in-line with our/consensus estimates of RMB870/863mn. By 4Q20, we estimate revenue/net profit of RMB1,909mn/252mn, up 30%/62% YoY. The strong result was driven by robust data traffic and increasing capex from global/china hyperscalers. We slightly adjusted our estimates for 4Q20 results, and revised our TP to RMB 72.66 is based on same 42x FY21E P/E (2-year historical average). Innolight now trades at lower end of its historical valuation band, and we believe concerns over hyperscale capex slowdown in 2021 is overdone. Reiterate BUY. Upcoming catalysts include stronger cloud capex and 5G deployment.

- **FY20 NP largely in-line; Solid growth in Q4.** Innolight reported FY20 preliminary net profit of RMB780-905mn (+52%-76% YoY), largely in-line with our/consensus estimates, mainly driven by global hyperscale capex from major cloud companies (e.g. Google, Amazon, Facebook, Microsoft) and rapid 400G upgrade. For 4Q20, we estimate revenue/net profit grew 25%/62% YoY (vs +57%/56% YoY in 3Q20), given slower China 5G deployment but improving margins due to better product mix and yield of 400G products.
- **Expect strong demand pick-up in 2Q/3Q21E.** Looking into FY21E, we expect weaker 1Q21E on seasonality and sequential demand pick-up into 2Q/3Q21E, driven by datacom demand ramp from overseas clients. As the global largest supplier of 100G/200G/400G optical modules and increasing presence in telecom market, we expect Innolight to become the major beneficiary of secular data growth and 400G datacom upgrade cycle. We expect Innolight to deliver 29%/37% revenue/NP CAGR during FY20-22E.
- **Maintain BUY with new TP of RMB72.66.** We reiterate BUY and adjusted our target price to RMB72.66 based on same 41.9x FY21E P/E, after slight revision of our forecasts. Trading at 29.7x FY21E P/E (1-sd below 2-year avg.), we think the stock is attractive, compared to 39% EPS FY20-22E CAGR. Potential risks include weaker capex from global cloud companies, slower deployment of 5G infrastructure and higher ASP pressure.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	5,156	4,758	7,114	9,561	11,784
YoY growth (%)	118.8	(7.7)	49.5	34.4	23.2
Net profit (RMB mn)	623	513	851	1,235	1,588
EPS (RMB)	1.36	0.73	1.19	1.73	2.23
YoY growth (%)	172%	-46%	64%	45%	29%
PE (x)	37.8	70.4	43.0	29.7	23.1
PB (x)	5.1	5.3	4.6	4.0	3.5
Yield (%)	0.2	0.2	0.2	0.3	0.4
ROE (%)	12.4	6.2	9.4	13.6	15.0
Net gearing (%)	Net cash	2.3	15.1	7.9	14.3

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	**RMB 72.66**
(Previous TP	RMB 73.45)
Up/Downside	**+41.5%**
Current Price	**RMB 51.37**

China Technology Sector

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Stock Data

Mkt. Cap. (RMB mn)	36,635
Avg. 3mths t/o (RMB mn)	362
52W High/Low (RMB)	73.45/46.66
Total Issued Shares (mn)	713.2

Source: Bloomberg

Shareholding Structure

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

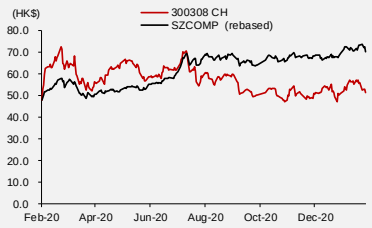
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	6.9%	0.4%
3-mth	8.1%	-0.7%
6-mth	-3.3%	-14.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PricewaterhouseCoopers Zhong Tian

Recent Reports:
China 5G Technology - Picking structural winners amid uncertainties; Initiate at Outperform – 18 Dec 2020

4Q20 Review

Figure 1: 4Q20 results review

RMB mn	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20E	QoQ	YoY
Revenue	1,249	1,474	1,326	1,919	1,960	1,909	-2.6%	29.5%
Gross Profit	350	361	331	490	477	474	-0.7%	31.5%
Operating Profit	157	188	173	257	269	298	11.0%	59.1%
Net profit	151	156	154	211	235	251	7.1%	61.6%
EPS (RMB)	0.23	0.23	0.22	0.30	0.33	0.35	7.1%	54.3%
Gross Margin	28.1%	24.5%	24.9%	25.5%	24.4%	24.8%	0.5 ppt	0.4 ppt
Operating Margin	12.6%	12.7%	13.1%	13.4%	13.7%	15.6%	1.9 ppt	2.9 ppt
Net Margin	12.1%	10.6%	11.6%	11.0%	12.0%	13.2%	1.2 ppt	2.6 ppt

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: P&L forecasts

RMB mn	FY18A	FY19A	1Q20	2Q20	3Q20	4Q20E	FY20E	FY21E	FY22E
Revenue	**5,156**	**4,758**	**1,326**	**1,919**	**1,960**	**1,909**	**7,114**	**9,561**	**11,784**
…YoY	*119%*	*-8%*	*51%*	*65%*	*57%*	*30%*	*50%*	*34%*	*23%*
Cost of sales	(3,750)	(3,468)	(995)	(1,429)	(1,483)	(1,435)	(5,341)	(7,140)	(8,729)
Gross profit	**1,406**	**1,290**	**331**	**490**	**477**	**474**	**1,772**	**2,421**	**3,055**
GPM (%)	27.3%	27.1%	24.9%	25.5%	24.4%	24.8%	24.9%	25.3%	25.9%
…YoY	*123%*	*-8%*	*34%*	*47%*	*36%*	*31%*	*37%*	*37%*	*26%*
SG&A	(314)	(329)	(87)	(98)	(141)	(173)	(498)	(593)	(731)
…% of rev	*-6.1%*	*-6.9%*	*-6.5%*	*-5.1%*	*-7.2%*	*-9.1%*	*-7.0%*	*-6.2%*	*-6.2%*
R&D	(309)	(362)	(88)	(88)	(117)	(113)	(405)	(545)	(672)
…% of rev	*-6.0%*	*-7.6%*	*-6.6%*	*-4.6%*	*-5.9%*	*-5.9%*	*-5.7%*	*-5.7%*	*-5.7%*
Operating profit	**682**	**576**	**173**	**257**	**269**	**298**	**998**	**1,424**	**1,830**
OPM (%)	*13.2%*	*12.1%*	*13.1%*	*13.4%*	*13.7%*	*15.6%*	*14.0%*	*14.9%*	*15.5%*
…YoY	*231%*	*-15%*	*48%*	*123%*	*72%*	*59%*	*73%*	*43%*	*29%*
Net profit	**623**	**513**	**154**	**211**	**235**	**251**	**851**	**1,235**	**1,588**
NPM (%)	*12.1%*	*10.8%*	*11.6%*	*11.0%*	*12.0%*	*13.2%*	*12.0%*	*12.9%*	*13.5%*
…YoY	*286%*	*-18%*	*54%*	*96%*	*56%*	*62%*	*239%*	*45%*	*29%*

Source: Company data, CMBIS estimates

Forecasts revision

Figure 3: CMBIS estimate revisions

	New			Old			Diff (%)		
RMB mn	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	7,114	9,561	11,784	7,246	9,746	11,998	-2%	-2%	-2%
Gross Profit	1,772	2,421	3,055	1,866	2,559	3,265	-5%	-5%	-6%
Operating Profit	998	1,424	1,830	999	1,432	1,855	0%	-1%	-1%
Net profit	851	1,235	1,588	870	1,249	1,619	-2%	-1%	-2%
EPS (RMB)	1.19	1.73	2.23	1.22	1.75	2.27	-2%	-1%	-2%
Gross Margin	24.9%	25.3%	25.9%	25.8%	26.3%	27.2%	-0.8 ppt	-0.9 ppt	-1.3 ppt
Operating Margin	14.0%	14.9%	15.5%	13.8%	14.7%	15.5%	0.2 ppt	0.2 ppt	0.1 ppt
Net Margin	12.0%	12.9%	13.5%	12.0%	12.8%	13.5%	0 ppt	0.1 ppt	0 ppt

Source: Company data, CMBIS estimates

Figure 4: CMBIS estimates vs consensus

	CMBIS			Consensus			Diff (%)		
RMB mn	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	7,114	9,561	11,784	7,060	9,052	11,068	1%	6%	6%
Gross Profit	1,772	2,421	3,055	1,833	2,373	2,926	-3%	2%	4%
Operating Profit	998	1,424	1,830	960	1,341	1,715	4%	6%	7%
Net profit	851	1,235	1,588	835	1,133	1,446	2%	9%	10%
EPS (RMB)	1.19	1.73	2.23	1.18	1.60	2.06	1%	8%	8%
Gross Margin	24.9%	25.3%	25.9%	26.0%	26.2%	26.4%	-1 ppt	-0.9 ppt	-0.5 ppt
Operating Margin	14.0%	14.9%	15.5%	13.6%	14.8%	15.5%	0.4 ppt	0.1 ppt	0 ppt
Net Margin	12.0%	12.9%	13.5%	11.8%	12.5%	13.1%	0.1 ppt	0.4 ppt	0.4 ppt

Source: Company data, CMBIS estimates

Figure 5: Revenue breakdown

RMB mn	FY18A	FY19A	FY20E	FY21E	FY22E
10G/40G modules	**1,249**	**1,030**	**1,121**	**1,643**	**1,563**
…YoY	*36%*	*-18%*	*-15%*	*-2%*	*-12%*
25G/100G/400G modules	**3,749**	**3,601**	**5,828**	**7,713**	**9,974**
…YoY	*190%*	*-4%*	*62%*	*32%*	*29%*
High-end equipment	**159**	**127**	**165**	**206**	**247**
…YoY	*6%*	*-20%*	*30%*	*25%*	*20%*
Total	**5,156**	**4,758**	**7,114**	**9,561**	**11,784**
…YoY	*119%*	*-8%*	*50%*	*34%*	*23%*
Gross Margin					
10G/40G modules	24.4%	29.2%	23.9%	22.8%	23.2%
25G/100G/400G modules	28.2%	26.7%	25.3%	26.0%	26.5%
High-end equipment	29.4%	20.5%	20.0%	20.0%	20.0%
Total	**27.3%**	**27.1%**	**24.9%**	**25.3%**	**25.9%**

Source: Company data, CMBIS estimates

Valuation

Maintain BUY with new TP RMB72.66 (41.5% upside)

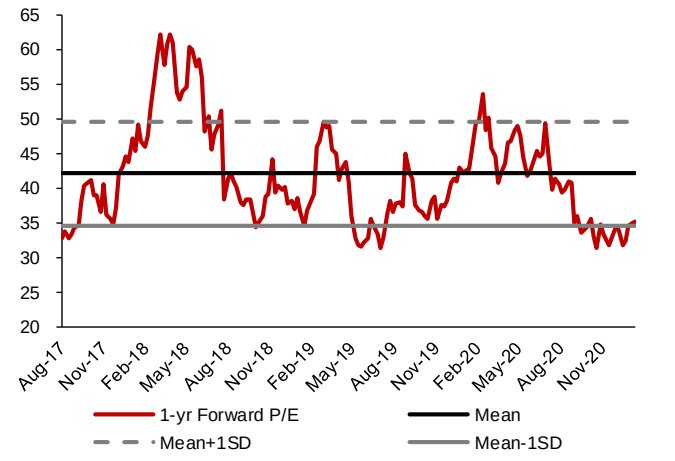
We derived our new 12m TP of RMB72.66 based on same 41.9x FY20E P/E, in line with its 2-year historical average. We believe this is justified as Innolight is the industry leader in the fast growing optical module market. Upcoming catalysts include increasing demand of 200G/400G/800G and share gain in China telecom market. Potential risks include weaker capex from cloud giants, slower deployment of 5G infrastructure and ASP pressure.

Figure 6: Peers' valuation

			Mkt Cap	Price	TP	Up/Down	P/E (x)		P/B (x)		ROE (%)	
Company	Ticker	Rating	US$(mn)	(LC)	(LC)	-side	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Innolight	300308 CH	Buy	5,747	51.80	72.66	42%	43.0	29.7	4.6	4.0	9.4	13.6
Accelink Tech	002281 CH	NR	2,810	25.88	NA	NA	35.6	29.7	3.6	3.2	10.1	10.8
Eoptolink Tech	300502 CH	NR	3,082	54.69	NA	NA	39.2	28.8	8.6	6.9	25.4	26.4
HG Genuine	000988 CH	NR	3,565	22.79	NA	NA	36.9	32.9	3.4	3.0	10.1	10.9
FIT Hon Teng	6088 HK	NR	2,943	3.31	NA	NA	18.6	13.8	1.3	1.2	7.4	9.2
Lumentum	LITE US	NR	7,102	93.80	NA	NA	18.5	15.0	4.1	3.6	24.0	25.3
Finisar	IIVI US	NR	8,720	84.07	NA	NA	38.5	24.8	3.8	3.0	11.8	15.3
Sumitomo	8053 JT	NR	16,576	1387.00	NA	NA	8.8	-	0.6	0.7	8.7	(4.1)
NeoPhotonics	NPTN US	NR	559	11.14	NA	NA	40.5	-	3.2	3.3	8.9	(4.3)
Csico	CSCO US	NR	188,172	44.58	NA	NA	14.2	14.1	5.2	4.6	37.8	33.2
	Average						**29.3**	**23.5**	**3.8**	**3.4**	**15.5**	**13.7**

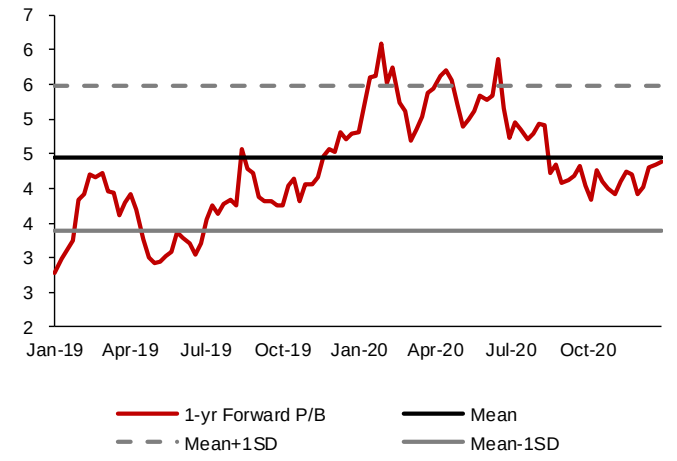
Source: Bloomberg, CMBIS estimates

Figure 7: 12M forward P/E band



Source: Company data, CMBIS estimates

Figure 8: 12M forward P/B band



Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	**5,156**	**4,758**	**7,114**	**9,561**	**11,784**
Cost of sales	3,750	3,468	5,341	7,140	8,729
Gross profit	**1,406**	**1,290**	**1,772**	**2,421**	**3,055**
Tax and surcharges	10	17	18	19	24
Selling exp	60	55	114	143	177
Admin exp (excl. R&D)	253	275	384	449	554
R&D exp	309	362	405	545	672
Finance costs	79	17	49	74	89
Other operating exp.	22	5	(178)	(214)	(267)
Operating profit	**682**	**576**	**998**	**1,424**	**1,830**
Other non-oper exp.	13	0	(5)		
Pre-tax profit	**695**	**577**	**993**	**1,424**	**1,830**
Income tax expense	72	63	134	178	229
Minority interests			8	11	14
Net profit	**623**	**513**	**851**	**1,235**	**1,588**
Adj. net profit	**590**	**430**	**745**	**1,235**	**1,588**

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net profit	623	513	859	1,246	1,602
Depreciation/amortization	201	241	386	518	668
Change in working capital	(441)	(360)	(1,841)	134	(1,944)
Others	277	175	120	141	176
Net cash from operating	**660**	**569**	**(477)**	**2,039**	**502**
Capex	(608)	(759)	(1,132)	(1,177)	(1,167)
Other	(65)	(1,180)	269	(62)	(93)
Net cash from investing	**(673)**	**(1,939)**	**(862)**	**(1,238)**	**(1,260)**
Share issuance	52	1,524	(0)	0	0
Net borrowing	151	159	1,353	322	1,347
Other	(66)	(126)	104	(162)	(236)
Net cash from financing	**137**	**1,557**	**1,458**	**160**	**1,111**
Net change in cash	**139**	**195**	**101**	**961**	**353**
Cash at beginning of the year	902	1,041	1,236	1,337	2,298
Exchange difference	15	8	(17)	0	0
Cash at the end of year	**1,041**	**1,236**	**1,370**	**2,331**	**2,684**

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Current assets	**4,158**	**5,991**	**8,632**	**10,025**	**12,609**
Cash & equivalents	1,041	1,236	1,370	2,331	2,684
Account receivables	840	1,133	2,109	2,092	2,960
Inventory	2,119	2,504	4,023	4,344	5,485
Prepayment	55	65	31	31	31
Other current assets	103	1,054	1,099	1,226	1,449
Non-current assets	**3,922**	**4,500**	**5,425**	**6,084**	**6,583**
PPE	1,497	1,950	2,794	3,415	3,928
Goodwill	1,717	1,717	1,915	1,915	1,915
Intangible assets	384	311	398	573	776
Other non-current assets	325	522	319	182	-35
Total assets	**8,080**	**10,491**	**14,058**	**16,109**	**19,192**
Current liabilities	**2,868**	**2,826**	**4,630**	**5,380**	**6,446**
ST borrowings	390	933	1,684	1,877	2,686
Account payables	802	1,259	1,552	2,109	2,367
Other current liabilities	1,676	634	1,393	1,393	1,393
Non-current liabilities	**436**	**739**	**1,494**	**1,623**	**2,162**
LT borrowings	270	466	1,101	1,230	1,769
Deferred tax liability	69	109	164	164	164
Other non-current liabilities	98	164	229	229	229
Total liabilities	**3,304**	**3,565**	**6,124**	**7,003**	**8,608**
Share capital	475	713	713	713	713
Reserve	4,301	6,213	7,116	8,276	9,741
Minority interest	0	0	105	116	130
Total equity	**4,776**	**6,926**	**7,934**	**9,106**	**10,584**
Total liabilities and equity	**8,080**	**10,491**	**14,058**	**16,109**	**19,192**

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue mix					
10G/40G modules	25	22	13	9	7
25G/100G/400G modules	75	78	84	82	86
High-end equipment	3	3	2	2	2
Growth (%)					
Revenue	118.8	(7.7)	49.5	34.4	23.2
Gross profit	122.7	(8.3)	37.4	36.6	26.2
Operating profit	231.2	(15.5)	73.1	42.7	28.5
Adj. net profit	122.9	(27.2)	73.5	65.8	28.5
Profit & loss ratio (%)					
Gross margin	27.3	27.1	24.9	25.3	25.9
Operating margin	13.2	12.1	14.0	14.9	15.5
Net profit margin	12.1	10.8	12.0	12.9	13.5
Balance sheet ratio					
Gear ratio	Net cash	2.3	15.1	7.9	14.3
Current ratio (x)	1.5	2.1	1.9	1.9	2.0
Receivable turnover days	66	76	84	81	79
Inventory turnover days	151	185	174	166	159
Payable turnover days	120	108	96	94	94
Profitability (%)					
ROE	12.4	6.2	9.4	13.6	15.0
ROA	7.3	4.1	5.3	7.7	8.3
Per share data (RMB)					
EPS	1.36	0.73	1.19	1.73	2.23
DPS	0.12	0.08	0.10	0.17	0.22
BVPS	10.05	9.70	10.98	12.61	14.66

Source: Company data, CMBIS estimates

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