

COMPANY NEWS

O-Net Technologies [0877.HK; HK\$5.63; Not Rated] -

Strong 2017 results. New technologies, new products and new applications to drive growth

Market Cap: US\$634m; Free Float: 48%; 3-month Average Daily Turnover: US\$2.6m

Analyst: Mark Po

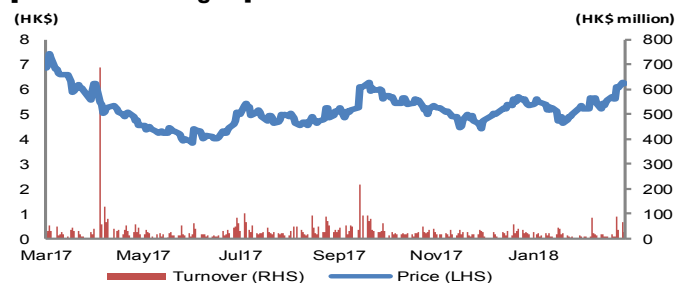
The Company. O-Net Technologies (O-Net), one of the leading high-tech enterprises in China, is engaged in optical networking, business related to electronic cigarettes, coating services, and machine vision solutions.

O-Net's 2017 net profit attributable to equity holders was up 60.0% YoY to HK\$208.9m, from HK\$103.6m in 2016, slightly higher than its previous profit alert in Feb 2018. The Company's turnover was up 27.3% YoY to HK\$2,035.1m in 2017, from HK\$1,598.3m in 2016, which was mainly due to the turnover growth in all business segments, including (a) optical networking for both the telecommunications and data-communications industry, (b) consumer business and others, such as its automation & sensing business and industrial lasers. The Company's gross profit was up 27.5% YoY to HK\$726.5m. O-Net reported a gross profit margin of 35.7% in 2017, up from 35.6% in 2016, the highest since 2013.

Optical network products recovered from inventory adjustments. Turnover in the optical networking products segment was up 14.7% YoY to HK\$1601.0m in 2017. The headline growth rate for optical network products may look unexciting, but it shows that the Company has recovered from the inventory adjustments in the industry in 1H 2017 (turnover in the optical networking products segment reported YoY growth of only 3.4% in 1H 2017). The recovery in performance was due to the launch of new products (especially Datacom products and secured orders from new customers). The telecommunications part of the optical networking business reported an 8.8% YoY increase in turnover to HK\$1,159.6m in 2017, which outperformed the market. The Company's Datacom products reported a 33.8% YoY increase in turnover to HK\$441.4m in 2017. Sales of 100G products took off in 2017, driven by the growth of web-scale data centres. Key products for the 100G telecom network, including EDFAs and linecards, ICR, and TNF, helped O-Net gain market share. In addition to enjoying strong demand for two kinds of products, passive components and transceiver modules, O-Net's 10 X 10 TOSA & ROSA products were qualified by customers and commenced mass shipments. According to management, O-Net continues to gain market share globally. Given the strong growth of the Datacom market, O-Net is well on its way to introducing new iterations of advanced products. It commenced shipments of the 100GbE AOC to major data centres and network equipment manufacturers in 2017, and launched the 100GbE QSFP28 CWDM4 at the end of 2017. According to management, the Company will launch its 400G products on time to capture the growth potential.

Optimistic outlook for consumer electronics segment. Turnover in the consumer electronics segment reported YoY growth of 214.4% to HK\$199.3m in 2017. This strong growth is a result of O-Net's application of cutting-edge coating technology for providing multi-coating solutions for smartphone casings. O-Net management highlighted that demand for coating solutions is strong and capacity is tight. Management is optimistic about the outlook for the consumer electronics segment. The industrial applications business recorded turnover of HK\$234.8m in 2017, up significantly from HK\$139.1m in 2016. The machine vision systems segment achieved YoY growth of 101.9% and contributed HK\$32.3.0m in 2017. O-Net's industrial laser business was contributed solely by ITF, which supplied optical components for industrial laser applications, such as fibre lasers. The industrial laser business reported turnover of HK\$123.5m in 2017, up 67.3% YoY. The LiDAR business reported turnover of HK\$15.4m

[O-Net Technologies]



Source: Bloomberg, CGIS Research,

Key Financials (in HKDm)	2015	2016	2017	2018E	2019E
Revenue	1,135.5	1,598.3	2,035.1	2,622.5	3,296.8
Change (YoY %)	36.6	40.8	27.3	28.9	62.0
Gross Profit	362.6	569.7	726.5	936.2	1,176.9
Gross Margin %	31.9	35.6	35.7	35.7	35.7
Net Profit	82.5	130.6	208.9	285.5	358.3
Net Margin %	7.3	8.2	10.3	10.9	10.9
EPS (Basic)	0.12	0.19	0.29	0.38	0.45
Change (YoY %)	105.4	58.3	54.5	29.4	52.7
DPS	\$0.000	\$0.000	\$0.000	\$0.072	\$0.090
ROE (%)	6.2	9.5	12.1	13.3	15.7
Dividend Yield (%)	-	-	-	1.15	1.44
PER (x)	51.8	32.7	21.2	16.4	13.9
PBR (x)	3.4	3.2	2.4	2.2	2.0
FCF Yield (%)	-0.17%	-3.66%	-5.96%	2.32%	1.33%
Capex (m)	(135.9)	(101.9)	(246.5)	(100.0)	(115.0)
Free cash flow per share	(0.0)	(0.2)	(0.4)	0.1	0.1
Net Gearing (%)	Net cash	Net cash	12.1	10.7	11.9

Source: Bloomberg, Company Data, CGIS Research

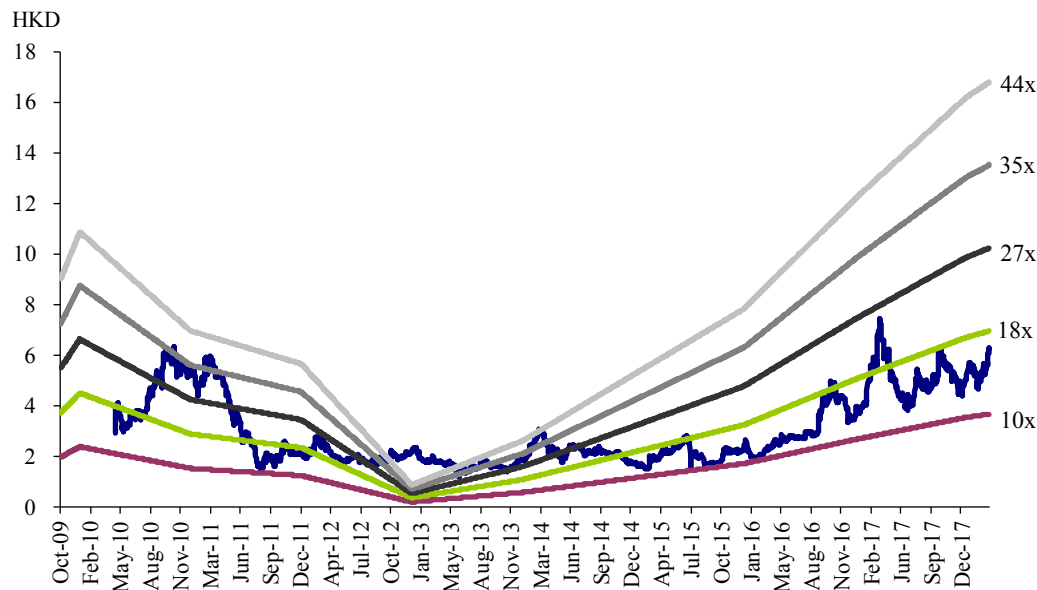
in 2017, up from HK\$2.4m in 2016. O-Net controlled costs well, as all operating expenses as a percentage of turnover decreased YoY in 2017. This was one of the reasons for the Company's strong net profit growth in 2016. O-Net remains committed to developing new products, as R&D expenses as a percentage of turnover remained at over 11% in 2017. The Company's operating cash flow was HK\$41.9m in 2016 vs. HK\$132.9m in 2015. O-Net's financial position is healthy, as its net gearing ratio was 12.1% in 2017.

Product roadmap and growth drivers. Management discussed O-Net's product roadmap and growth potential in 2018 and beyond during the results presentation. According to management, O-Net has already taken measures to strengthen its position in both the global telecommunications and data communications markets. O-Net launched 100GbE QSFP28 CWDM4 and 10GbE SFP at the end of 2017, which is expected to drive growth of the optical networking products segment. According to management, O-Net continues to develop and launch new solutions for high-power fibre laser products by leveraging ITF's technology platforms and manufacturing capabilities. O-Net has launched a best-in-class 2kWh laser engine and 6 kWh laser combiners and will release a multi-kilowatt fibre laser system in 2018 to drive growth of the industrial laser segment. According to O-Net management, the Company is one of the few suppliers of industrial lasers with a vertically integrated model. To expedite the growth of its LiDAR business, O-Net launched the first

generation cost-effective laser source module for LiDAR, called “PANDA”, in Sep 2017. O-Net is committed to continuing the development of next-generation laser source modules for LiDAR at a lower price point, thereby making ADAS a more cost-effective proposition for the automotive industry. O-Net acquired 3SP Technologies in the first half of 2017. The acquisition will enable the O-Net to leverage its expertise in indium phosphide and gallium arsenide-based laser chips to accelerate its penetration into the telecommunications and data-communication markets. O-Net is developing 25G+ VCSEL and EML chips internally.

Our view. O-Net is a HK-listed optical component play with a strong global presence. Its current valuation is somewhat justified considering its strong growth in operating performance and strong R&D capability. Its non-optical networking products are growing fast and the growth momentum should continue. In our view, the potential of the Company's existing business (especially the data-communications segment) and new business (coating and materials, LiDAR, sensing and VCSEL) has not been fully appreciated by the market. After a post-results earnings upward revision, O-Net is now trading at 16.4x 2018 PER, which is at a discount to its peers and lower than its historical mean. O-Net is one of the few HK-listed companies benefitting from increasing demand for equipment and components for high-speed communications. Despite the recent share price rally, O-Net's current valuation is still lower than its historical mean. Increasing attention to O-Net may boost its share price performance.

Catalysts. Accelerated qualification of new products from major customers; increased spending by Internet giants for data centres; increasing policy support for the industry; increasing IR activities; and news flow on LiDAR & VCSEL development .

Figure 1: O-Net PER BAND


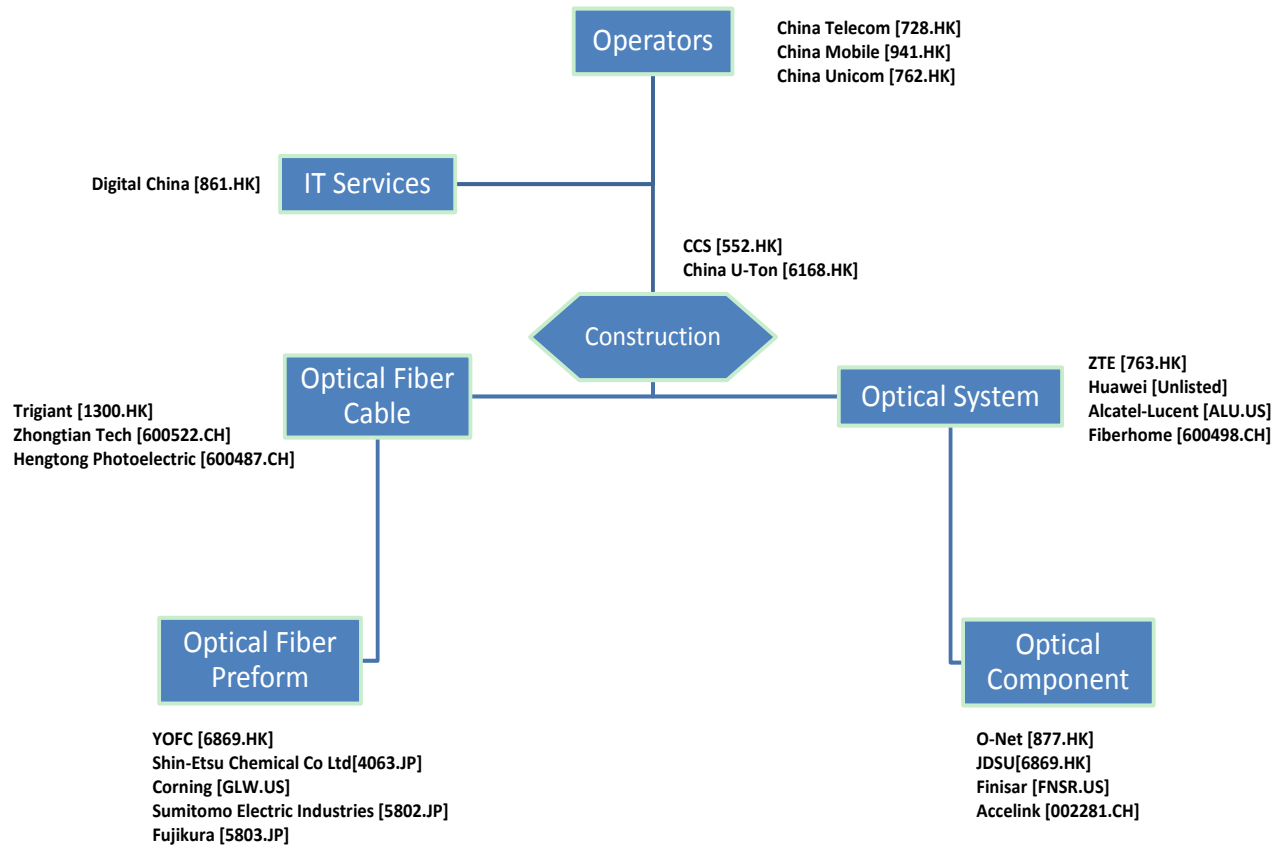
Sources: Bloomberg, Company, CGIS Research

Figure 2: Assumptions for O-Net

	2013	2014	2015	2016	2017	2018F	2019F
Turnover (HKDm)							
Optical Networking Business	654.0	781.4	974.7	1,395.7	1,601.0	1,826.2	2,069.8
Automation and Sensing Business	0	34.7	108.0	63.0	95.9	150.8	246.1
Others	7.5	15.2	52.8	139.6	338.2	645.5	980.9
Total	661.5	831.3	1,135.5	1,598.3	2,035.1	2,622.5	3,296.8
YoY Change (%)							
Optical Networking Business		19.5	24.7	43.2	14.7	14.1	13.3
Automation and Sensing Business		n.a.	211.2	(41.7)	52.2	57.3	63.2
Others				164.4	142.2	90.8	52.0
Total		25.7	36.6	40.8	27.3	28.9	25.7
Gross margin (%)							
Optical Networking Business	3.9	31.9	31.9	44.3	32.5	36.1	36.1
Automation and Sensing Business	8.0	6.5	35.0	35.0	30.0	32.9	32.9
Others	10.0	9.0	28.0	28.0	25.0	32.0	32.0
Net margin (%)	2.0	5.2	7.3	8.2	10.3	10.9	10.9
Cost (HKDm)							
S,G&A	(128.5)	(143.6)	(183.5)	(240.9)	(307.0)	(366.8)	(456.9)
Financial Expenses	(0.2)	(0.8)	0	0	(5.7)	(15.6)	(26.0)
YoY Change (%)							
S,G&A	n.a.	11.7	27.8	31.3	27.4	19.5	24.6
Financial Expenses	n.a.	369.3	n.a.	n.a.	n.a.	174.1	66.9
CAPEX (HKDm)	149.7	116.7	135.9	101.9	246.5	100.0	115.0
Net Gearing (%)				12.6	12.1	10.7	11.9

Sources: Company data, CGIS Research

Figure 3: Domestic optical network business supply chain



Sources: Bloomberg, CGIHK Research

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