

Equity Research | China | Technology

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Multi-cylinder growth

- O-Net reported a stellar set of FY17 results, with revenue and net profit soaring 27.3%/59.9% YoY.
- With strong in-house R&D and upstream chip-level capacity, O-Net appears to have emerged from a technology 'dark horse' to a pioneer, in particular in several promising new fields like machine vision, LiDAR and industrial laser etc.
- We have raised our FY18/19E earnings estimates by 13.0%/16.6% respectively and our DCF-based price target to HKD7.60 (from HKD6.80). Looking ahead, we believe O-Net deserves a decent re-rating in the mid-term in view of its strong growth momentum and growth prospects over the coming 3-5 years. Maintain Buy.

Across-the-board strong growth. O-Net reported a strong stellar set of FY17 results, with 27.3% YoY revenue growth and 59.9% YoY net profit growth. While revenue growth was across-the-board, new businesses demonstrated remarkable momentum (+33.8% in Datacom, +67.3% in industrial laser, +101.9% in machine vision, +214.4% in coating, and five-fold growth in LiDAR). In telecoms networking (optical components), O-Net continued to enrich its 100GB products (well poised for upcoming 5G investment cycle). Meanwhile, O-Net has increasingly become a front-runner in several rapidly emerging new markets, including machine vision, LiDAR and industrial laser, with huge long-term growth potential in each of these markets. Besides strong growth potential, O-Net's new businesses are of higher gross margin (than optical components), ranging from 35%-60%.

Multi-cylinder engine growth. With 20 years of commitment in the optical industry as well as several milestone-style acquisitions, O-Net appears to have emerged from a technology 'dark horse' to a pioneer. While continuing to build its core capability in telecoms networking (100GB as mainstream, 200GB/400GB in pipeline), O-Net's diversified product portfolio (from coating, machine-vision, to laser and LiDAR) would secure its long-term growth, given the huge market potential, in our view.

Valuation still least reflective of its growth prospects. While leaving our revenue forecasts little changed, we have raised our FY18/19E earnings estimates by 13.0%/16.6% on the back of higher gross margin and economies of scale. By rolling over to end-2019, we have raised our DCF-based price target to HKD7.6 (from HKD6.80). O-Net currently trades at FY18E 16.7x PER and 2.2x PBR, which looks attractive with a mid-term re-rating justified in view of its strong growth potential over the coming 3-5 years.

O-Net (877 HK)

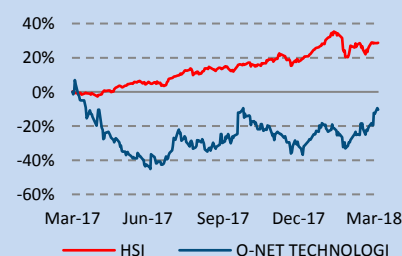
Buy

(unchanged)

Price Target	HK\$7.60
(Revision)	(+11.8%)
(upside)	(22.2%)
EPS	2018E 2019E
revision	(+13.0%) (+16.6%)
Close price	HKD6.22
Market cap.	HKD4,975mn
Free float	48.2%
52-week range	HKD3.79–HKD7.55
3-mth ave. T/O	HKD21.6mn

Price as of 20 Mar 2018

Stock rel HSI performance (%)



LIU Taisheng, Steven, CFA, PhD
 (CE No.: AMO971)

stevenliu@csci.hk +852 3465 5652

SHEN Xiangfei, Thomas
 (CE No.: BHV664)

thomasshen@csci.hk +852 3465 8689

Figure 1: O-Net y FY17 results summary

FY Dec (HKD mn)	2016	2017	YoY
Revenue by regions			
China	742.0	965.0	30.1%
Europe	433.8	429.1	-1.1%
North America	242.6	326.3	34.5%
Others	179.9	314.6	74.9%
Revenue by products			
Optical component	1,065.8	1,159.6	8.8%
Datacom	330.0	441.4	33.8%
Industrial laser (Avensys)	73.8	123.5	67.3%
Machine vision	16.0	32.3	101.9%
Automation & sensing (e-Cigarette)	46.9	63.6	35.6%
Coating	63.4	199.3	214.4%
LiDAR	2.4	15.4	541.7%
Revenue	1,598.3	2,035.1	27.3%
COGS	(1,028.6)	(1,308.6)	27.2%
Gross profit	569.7	726.5	27.5%
Gross margin	35.6%	35.7%	0.2%
Other income	21.2	30.4	43.2%
Selling & marketing costs	(63.4)	(76.2)	20.1%
R&D expenses	(187.8)	(230.8)	22.9%
Administrative expenses	(177.5)	(177.1)	-0.2%
Operating expenses	(428.7)	(484.1)	12.9%
Operating profit	162.2	272.8	68.2%
Finance income	9.2	2.1	-76.9%
Share of result of a JV	(1.5)	(0.0)	-99.8%
EBT	154.4	248.9	61.3%
Taxation	(25.6)	(43.1)	68.7%
Net profit	128.8	205.8	59.8%
Non-controlling interests	1.8	3.0	68.8%
Owners of the company	130.6	208.9	59.9%
Adjustments for non-GAAP			
Share options	17.1	22.7	33.0%
Amortisation of intangible	5.5	5.4	-1.8%
Other gains, net	(2.9)	28.2	-1063.6%
Non-GAAP net profit	162.0	265.3	63.7%
EPS, basic (HKD)	0.184	0.278	51.3%
EPS, diluted (HKD)	0.177	0.266	50.3%
Non-GAAP EPS, diluted (HKD)	0.220	0.338	53.9%

Source: Company

Income statement (HKDm)

Year end: Dec	2016	2017	2018E	2019E	2019E
Revenue	1598	2,035	2,554	3,079	3,653
COGS	(1,029)	(1,309)	(1,640)	(1,958)	(2,319)
Gross profit	570	726	915	1,121	1,334
Selling and marketing	(63)	(76)	(92)	(109)	(127)
R&D	(188)	(231)	(284)	(346)	(409)
Admin	(178)	(177)	(197)	(218)	(244)
Operating profit	141	242	342	448	555
Other income	21	30	62	67	73
EBIT	162	273	404	515	627
Net interest	(6)	(24)	(25)	(22)	(24)
Associates and JVs	(1)	(0)	(2)	-	-
Exceptional items	-	-	-	-	-
Pretax profit	154	249	377	492	604
Taxation	(26)	(43)	(80)	(109)	(138)
Minority	2	3	3	3	4
Net profit	131	209	301	387	469
Net profit (adjusted)	131	209	301	387	469
Basic EPS (HKD)	0.16	0.28	0.38	0.49	0.59
EPS (adjusted) (HKD)	0.16	0.27	0.37	0.48	0.58
DPS (RMB)	-	-	-	-	-

Balance sheet (HKDm)

Year end: Dec	2016	2017	2018E	2019E	2019E
Cash	169	321	688	893	1,177
Short term investments	10	2	3	3	3
Accounts receivables	647	975	808	903	1,010
Inventory	270	377	338	379	425
Other current assets	391	105	109	112	116
Total current assets	1,487	1,781	1,946	2,290	2,731
PP&E	702	916	839	932	1,023
Intangible Assets and goodwill	88	83	78	74	69
Associates and JVs	-	2	2	2	2
Other long term assets	210	322	289	303	319
Total long term assets	999	1,323	1,209	1,312	1,413
TOTAL ASSETS	2,487	3,104	3,155	3,602	4,143
Short term debt	684	654	500	500	501
Accounts payables	290	367	392	455	529
Other current liabilities	21	33	33	33	33
Total current liabilities	995	1,053	924	988	1,063
Long term debt	29	-	-	-	-
Deferred tax	3	2	3	3	3
Other long term liabilities	30	15	15	15	15
Total long term liabilities	63	18	18	18	18
TOTAL LIABILITIES	1,058	1,071	942	1,006	1,081
Shareholders' funds	1,421	2,032	2,193	2,580	3,050
Minority Interests	8	2	2	(2)	(5)
TOTAL LIAB AND EQUITY	2,487	3,104	3,137	3,584	4,125
Net cash / (debt)	(544)	(333)	188	393	676

Cash flow statement (HKDm)

Year end: Dec	2016	2017	2018E	2019E	2019E
EBIT	162	273	404	515	627
Depreciation & amortisation	62	65	68	72	76
Net interest	6	24	25	22	24
Taxes paid	(5)	(21)	(80)	(109)	(138)
Changes in working capital	(304)	(195)	258	(90)	(98)
Others	19	(44)	(44)	(29)	(27)
Cash flow from operations	(60)	102	632	382	465
Capex	(115)	(110)	(150)	(160)	(161)
Acquisitions	(124)	-	-	-	-
Disposals	1	-	-	-	-
Others	(317)	3	(8)	(16)	(21)
Cash flow from investing	(555)	(107)	(158)	(176)	(182)
Dividends	-	-	-	-	-
Issue of shares	18	263	-	-	-
Change in debt	639	(60)	(154)	-	1
Others	-	-	-	-	-
Cash flow from financing	657	203	(154)	-	1
Change in cash	42	198	320	205	284
Free cash flow	86	181	236	303	384

Key ratios

Year end: Dec	2016	2017	2018E	2019E	2019E
Operating ratios					
EBIT margin (%)	10.1	13.4	15.8	16.7	17.2
EBITDA margin (%)	14.0	16.6	18.5	19.1	19.3
Effective tax rate (%)	16.6	17.3	21.1	22.0	22.8
Revenue growth (%)	40.8	27.3	25.5	20.5	18.7
Net income growth (%)	62.5	59.8	44.6	28.9	21.4
EPS growth adj (%)	62.5	59.8	44.6	28.9	21.4
DPS growth (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Efficiency ratios					
ROE (%)	9.2	10.3	13.7	15.0	15.4
ROCE (%)	16.2	20.6	33.4	39.2	44.4
Asset turnover (x)	0.6	0.7	0.8	0.9	0.9
Op cash / EBIT (x)	(0.4)	0.4	16	0.7	0.7
Depreciation / CAPEX (x)	0.5	0.6	0.5	0.5	0.5
Accounts receivable days	132.0	145.5	127.4	101.4	95.6
Accounts payable days	12.0	91.6	84.4	78.9	77.4
Leverage ratios					
Net gearing (%)	38.3	16.4	(8.6)	(15.2)	(22.2)
Net debt / EBITDA (x)	2.4	1.0	(0.4)	(0.7)	(1.0)
Interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.
Current ratio (x)	15	17	2.1	2.3	2.6
Valuation					
PER (x)	35.1	23.3	16.7	13.0	-
EV/EBITDA (x)	19.0	12.9	9.0	6.9	-
PBR (x)	3.1	2.3	2.2	1.9	-

Source: Company, Bloomberg, CSCI Research estimates

Research

LIU Taisheng, Steven
TMT
(852) 3465 5652
stevenliu@csci.hk

CHAN Ka Yeung, Duncan
Commodity
(852) 3465 5654
duncanchan@csci.hk

TIAN Yang
Automotive
(852) 3465 5775
tianyang@csci.hk

SUN Lingxiao, Roger
Industrials
(852) 3465 5785
rogersun@csci.hk

YAO Xue, Snowy
Power & coal
snowyyao@csci.hk
+852 3465 5675

SHEN Xiangfei, Thomas
(852) 3465 8689
thomasshen@csci.hk

XU Qiwen
(852) 3465 8690
xuqiwen@csci.hk

Institutional Sales & Trading

XIANG Xinrong, Ron
(852) 3465 5633
ronxiang@csci.hk

HO Wen Hao, Jack
(852) 3465 5685
jackho@csci.hk

WANG Zhuo, Gary
(852) 3465 8655
wangzhuo@csci.hk

LEE Ying Ju, Rose
(852) 3465 5707
roselee@csci.hk

LI Jiageng, Mike
(852) 3465 5636
mikeli@csci.hk

XIA Tian
(852) 3465 5670
xiatian@csci.hk

XU Xiaowei, Vincent
(852) 3465 5795
vincentxu@csci.hk

Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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China Securities (International) Research

18/F, Two Exchange Square, Central, Hong Kong

Tel: (852) 34655600 Fax: (852) 21809495

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