

Equity Research | China | Semiconductor

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Solid growth prospects intact

- In spite of the escalating China-U.S. trade disputes, we see limited impacts on O-Net given its insignificant exposure to the U.S. market.
- O-Net's investment in and partnership with InLC Technology would substantially bolster its product portfolio and help better capture the immense opportunities brought about by 5G investments.
- We trimmed our FY18E/19E revenue estimates by 7.2%/6.9% and earnings by 14.7%/18.8% respectively and lowered our DCF-based PT to HKD6.50 (from HKD7.60). Maintain Buy.

Limited impacts of China-U.S. trade war. The escalating China-U.S. trade disputes have led to deep share price corrections in most Chinese technology names, with O-Net not being spared. Nonetheless, O-Net is far from being an outright victim, in our view. In 1H18, North America accounted for only 14.7% of O-Net's revenue, and a much smaller percentage by product destinations. On sourcing, O-Net derives over 70% of its revenue from passive optical products that are well supplied by domestic suppliers. In datacom and active optical products, O-Net has strong in-house capacities ranging from design and foundry to manufacturing (ITF Technologies, ArtIC, 3SPTechnologies, ViS).

Strategic partnership with InLC Technology. O-Net announced that it has invested in and formed a strategic partnership with InLC Technology, a Korea-based technology company focused on liquid crystal (LC) and liquid-crystal-on-silicon (LCoS) WSS (wavelength selective switch) and DGE (dynamic gain equalizer). The partnership would substantially bolster O-Net's downstream capabilities (more modules), in our view.

An early beneficiary of 5G. With commercial trials scheduled to be conducted in 2019, commercial 5G will likely be initially launched by telcos in China and major developed markets in 2020. 5G will substantially increase wireless and wireline data traffic, which requires much higher bandwidth of optical networks. Having started shipments of 100GB/200GB products, O-Net is well poised to capture the immense opportunities brought about by the global wide 5G investments over the coming 3-5 years, in our view.

Unwarranted drop provides compelling entry opportunities. Factoring in the potential impacts of the China-U.S. trade war, we trimmed our FY18E/19E revenue estimates by 7.2%/6.9% and earnings forecasts by 14.7%/18.8% (on lower gross margin assumption) respectively and lowered our DCF-based price target to HKD6.50 (from HKD7.60). O-Net's share price has dropped by more than 40% over the past few months along with a broad-based selloff in technology names, which in our view, is unwarranted and provides compelling entry opportunities.

O-Net Technology (877 HK)

Buy

(unchanged)

Price Target	HK\$6.50
(Revision)	(-14.5%)
(upside)	(100.6%)

EPS	2018E	2019E
revision	(-14.7%)	(-18.8%)

Close price	HKD3.24
Market cap.	HKD2,599mn
Free float	48.3%
52-week range	HKD3.20 – HKD6.44
3-mth ave. T/O	HKD6.5mn

Price as of 15 Oct 2018

Stock rel HSI performance (%)


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Income statement (HKDm)

Year end: Dec	2016	2017	2018E	2019E	2020E
Revenue	1,598	2,035	2,369	2,866	3,388
COGS	(1,029)	(1,309)	(1,582)	(1,883)	(2,216)
Gross profit	570	726	788	983	1,172
Selling and marketing	(63)	(76)	(93)	(104)	(118)
R&D	(188)	(231)	(265)	(313)	(365)
Admin	(178)	(177)	(203)	(223)	(252)
Operating profit	141	242	227	343	437
Other income	21	30	106	67	73
EBIT	162	273	333	410	510
Net interest	(6)	(24)	(24)	(26)	(28)
Associates and JVs	(1)	(0)	-	-	-
Exceptional items	-	-	-	-	-
Pretax profit	154	249	309	384	482
Taxation	(26)	(43)	(63)	(82)	(108)
Minority	2	3	3	3	4
Net profit	131	209	249	305	378
Net profit (adjusted)	131	209	249	305	378
Basic EPS (HKD)	0.18	0.28	0.33	0.41	0.50
EPS (adjusted) (HKD)	0.18	0.27	0.32	0.39	0.48
DPS (RMB)	-	-	-	-	-

Cash flow statement (HKDm)

Year end: Dec	2016	2017	2018E	2019E	2020E
EBIT	162	273	333	410	510
Depreciation & amortisation	62	83	91	99	105
Net interest	6	24	24	26	28
Taxes paid	(5)	(20)	(63)	(82)	(108)
Changes in working capital	(304)	(350)	(185)	(196)	(181)
Others	19	(30)	(41)	(46)	(47)
Cash flow from operations	(60)	(20)	159	211	307
Capex	(115)	(246)	(200)	(180)	(160)
Acquisitions	(124)	(77)	-	-	-
Disposals	1	2	-	-	-
Others	(37)	153	(8)	(7)	(9)
Cash flow from investing	(555)	(169)	(208)	(187)	(169)
Dividends	-	-	-	-	-
Issue of shares	18	275	-	-	-
Change in debt	639	46	33	34	(72)
Others	-	-	-	-	-
Cash flow from financing	657	321	33	34	(72)
Change in cash	42	131	(16)	58	66
Free cash flow	86	72	153	239	339

Balance sheet (HKDm)

Year end: Dec	2016	2017	2018E	2019E	2020E
Cash	169	321	305	363	430
Short term investments	10	2	3	3	3
Accounts receivables	647	975	1,152	1,342	1,520
Inventory	270	377	423	473	530
Other current assets	391	105	109	112	116
Total current assets	1,487	1,781	1,991	2,294	2,600
PP&E	702	916	1,039	1,133	1,201
Intangible Assets and goodwill	88	83	70	57	44
Associates and JVs	-	2	2	2	2
Other long term assets	210	322	340	359	379
Total long term assets	999	1,323	1,450	1,551	1,627
TOTAL ASSETS	2,487	3,104	3,441	3,845	4,226
Short term debt	684	654	686	721	649
Accounts payables	290	367	426	494	573
Other current liabilities	21	33	33	33	33
Total current liabilities	995	1,053	1,145	1,247	1,254
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	1,163	1,265	1,272
Shareholders' funds	1,421	2,032	2,280	2,585	2,962
Minority Interests	8	2	(2)	(5)	(8)
TOTAL LIAB AND EQUITY	2,487	3,104	3,441	3,845	4,226
Net cash / (debt)	(544)	(333)	(381)	(357)	(219)

Key ratios

Year end: Dec	2016	2017	2018E	2019E	2020E
Operating ratios					
EBIT margin (%)	10.1	13.4	14.0	14.3	15.0
EBITDA margin (%)	14.0	17.5	17.9	17.8	18.2
Effective tax rate (%)	16.6	17.3	20.5	21.4	22.4
Revenue growth (%)	40.8	27.3	16.4	21.0	18.2
Net income growth (%)	62.5	59.8	19.2	22.8	24.2
EPS growth adj (%)	62.5	59.8	19.2	22.8	24.2
DPS growth (%)	n.a.	n.a.	n.a.	n.a.	n.a.
Efficiency ratios					
ROE (%)	9.2	10.3	10.9	11.8	12.8
ROCE (%)	16.2	20.6	22.9	26.4	31.3
Asset turnover (x)	0.6	0.7	0.7	0.7	0.8
Op cash / EBIT (x)	(0.4)	(0.1)	0.5	0.5	0.6
Depreciation / CAPEX (x)	0.5	0.3	0.5	0.5	0.7
Accounts receivable days	132.0	145.5	163.8	158.8	154.2
Accounts payable days	112.0	91.6	91.5	89.1	87.8
Leverage ratios					
Net gearing (%)	38.3	16.4	16.7	13.8	7.4
Net debt / EBITDA (x)	2.4	0.9	0.9	0.7	0.4
Interest cover (x)	n.a.	n.a.	n.a.	n.a.	n.a.
Current ratio (x)	15	17	17	18	2.1
Valuation					
PER (x)	18.3	12.2	10.2	8.3	6.7
EV/EBITDA (x)	9.5	5.9	5.0	4.1	3.3
PBR (x)	16	12	11	0.9	0.8

Source: Company, Bloomberg, CSCI Research estimates

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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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