

Innolight (300308 CH)

Fundamentals remain strong despite recent market volatility, reiterate BUY

CSP3 (Three Cloud Service Providers, namely Google, Microsoft and Amazon) plus Meta have announced their earnings recently. The Big Four spent an aggregate of US\$52.9bn in capex in 2Q24 (vs. previous Bloomberg consensus est. of US\$50.6bn), representing a surge of 57.1% following 30.4% growth in 1Q24. The growth is on an already-high base after three years of growth hikes in capex (38%/34%/19% YoY) from 2020-22 and reaching a nearly historical peak (US\$148bn) in 2023. Like Sundar Pichai said on Alphabet's 2Q24 earning call, "the risk of under-investing is dramatically greater than the risk of over-investing." **The Big Four confirmed that they will continue to make heavy investments to meet the rising AI compute demand.**

A number of investors have shown concern about the recent market turmoil in the tech sector, which we believe was driven primarily by 1) mixed earnings results, 2) fear of a US recession, and 3) uncertainty over the upcoming US presidential election. Market sell-offs intensified even further after the unexpected interest rate hike by the Bank of Japan as carry trades of USD and yen unwind.

Despite those noises, we remain positive on the longer-term AI investment theme as growth of major CSPs' capex remained intact in 2Q24. As a key beneficiary, Innolight remains our top pick. We think Innolight's current valuation (22.8x/15.3x 2024/25E P/E) appears attractive amid the recent market pull-back (35%+ decline since peak in July). **Reiterate BUY** with new TP at RMB150.8. Previous target price of RMB130.71 had already accounted for the effects of ex-rights and ex-dividends.

■ **The impact of Nvidia's design flaws in new chips should be limited.** Another concern on Innolight is Nvidia's recent design flaws on its new GPU chip ([link](#)). Investors worry this may lead to delay or even cancellations of Nvidia's products, which may negatively affect the revenue outlook of Innolight's supply chain. However, the impact should be limited in our view, given that this issue has been identified in the early stage and is a solvable technique difficulty. The mass production of Blackwell chips will begin in 4Q24 and the majority of revenue contribution is expected to be in 2025. In addition, any impact of new chip shipment should be offset by an extended lifecycle of H series.

■ **Reiterate BUY with adjusted TP at RMB150.76.** We revise up revenue forecasts by 6%/11% and NP forecasts by 11%/23% for 2024/25E, on stronger capex outlook of cloud companies (16%/21% increase in 2024/25E capex forecasts from Feb and 5%/8% increase from May). Based on recent earnings calls, hyperscalers will continue to invest in AI infrastructure (39%/13% capex growth for the Big Four in 2024/25E by Bloomberg consensus). As a key beneficiary, Innolight's strong product portfolio (400G/800G/1.6T coming by 2024 year-end) is well-positioned to capitalize on this AI momentum. The new TP is based on the same 30x 2024E P/E, which is 9% higher than 5-year historical avg. of forward P/E (27.4x), implying a PEG ratio close to 1x (vs. 32% 2024-26E EPS CAGR). Therefore, we think Innolight's current valuation (22.8x/15.3x 2024/25E P/E) looks attractive. **Reiterate BUY.** **Potential risks** include: 1) intensified geopolitical tensions, 2) slower-than-expected new product ramp-up progress, 3) slowdown in cloud capital spending and 4) supply chain bottlenecks.

BUY (Maintain)

Target Price RMB150.76

(Previous TP) RMB130.71

Up/Downside 31.7%

Current Price RMB114.48

China Semiconductors

Lily YANG, Ph.D

(852) 3916 3716

lilyyang@cmbi.com.hk

Kevin ZHANG

(852) 3761 8727

kevinzhang@cmbi.com.hk

Stock Data

Mkt Cap (RMB mn)	128,355.0
Avg 3 mths t/o (RMB mn)	3,175.6
52w High/Low (RMB)	157.53/60.87
Total Issued Shares (mn)	1121.2

Source: FactSet

Shareholding Structure

Shandong Zhongji Investment Holdings Co.	11.3%
Wang Weixiu	6.2%

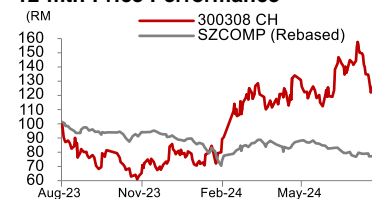
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-19.1%	-17.9%
3-mth	-12.5%	0.1%
6-mth	28.3%	23.4%

Source: FactSet

12-mth Price Performance



Source: FactSet

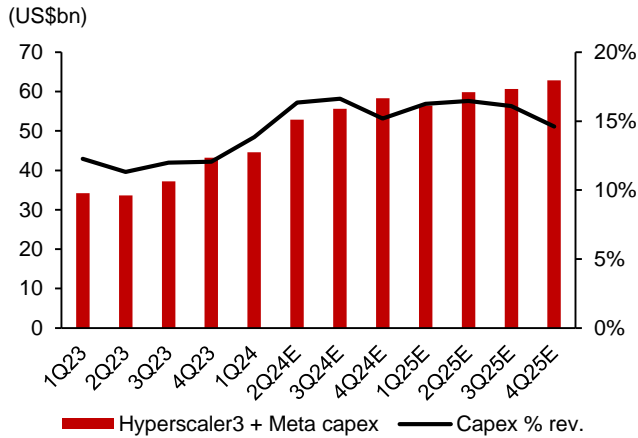
Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	9,642	10,718	23,877	34,149	41,026
YoY growth (%)	25.3	11.2	122.8	43.0	20.1
Gross margin (%)	29.3	33.0	33.2	32.3	31.4
Net profit (RMB mn)	1,224.0	2,173.5	5,462.1	8,127.3	9,497.7
YoY growth (%)	39.6	77.6	151.3	48.8	16.9
EPS (Reported) (RMB)	1.10	2.00	5.03	7.48	8.74
P/E (x)	104.1	57.2	22.8	15.3	13.1

Source: Company data, Bloomberg, CMBIGM estimates

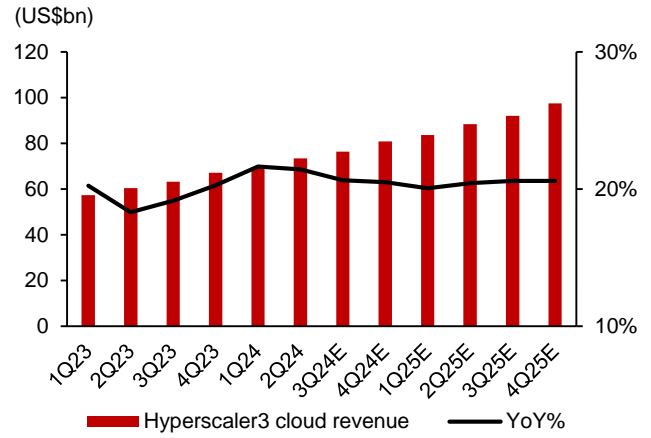
Hyperscalers and Meta's capex adjustment

Figure 1: Hyperscalers and Meta's capex



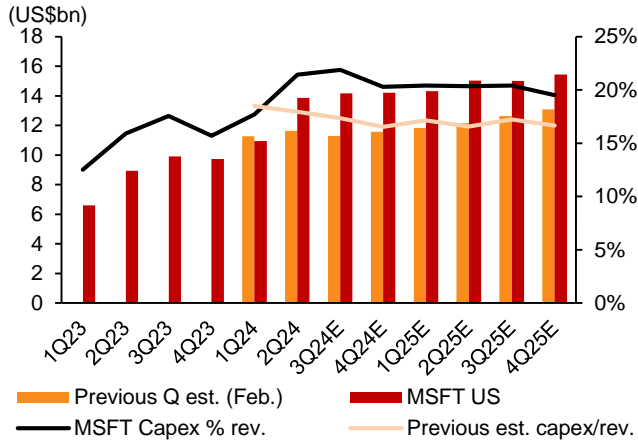
Source: Company data, Bloomberg consensus

Figure 2: Hyperscalers' and Meta's rev. adjustment



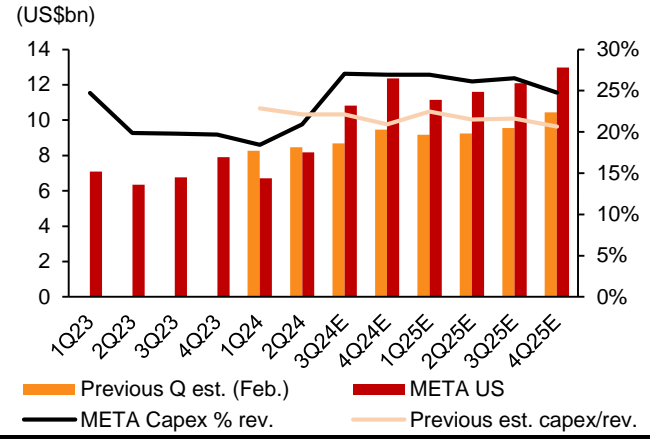
Source: Company data, Bloomberg consensus

Figure 3: Microsoft's capex adjustment



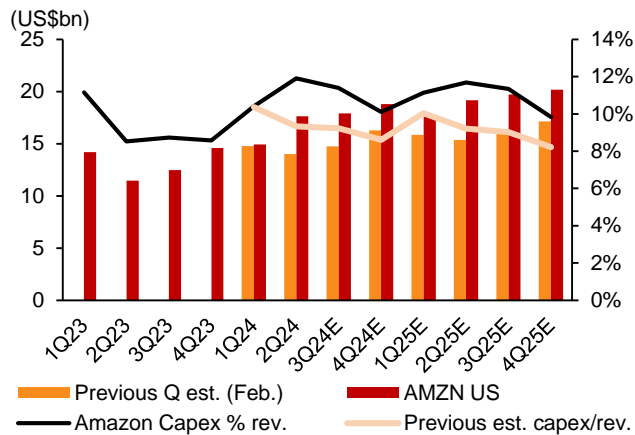
Source: Company data, Bloomberg consensus

Figure 4: Meta's capex adjustment



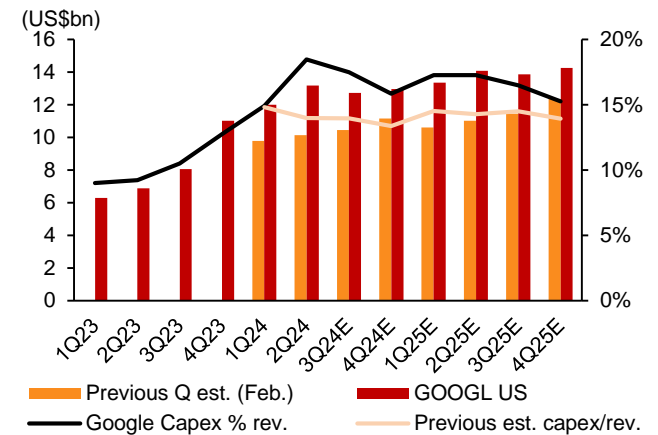
Source: Company data, Bloomberg consensus

Figure 5: Amazon's capex adjustment



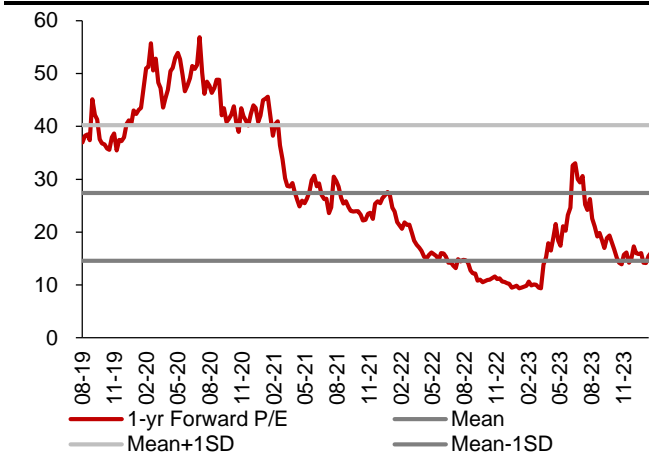
Source: Company data, Bloomberg consensus

Figure 6: Google's capex adjustment



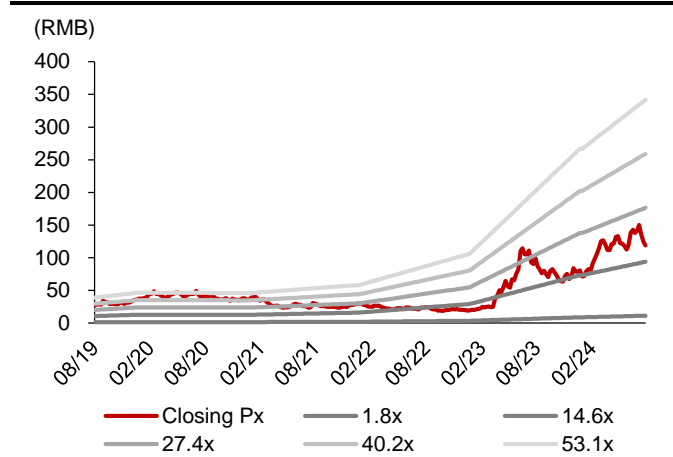
Source: Company data, Bloomberg consensus

Figure 7: 1-yr forward PE band



Source: Company data, Bloomberg

Figure 8: PE chart



Source: Company data, Bloomberg

Figure 9: Earnings revisions

RMB mn	New			Old			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	23,877	34,149	41,026	22,594	29,657	31,870	6%	15%	29%
Gross profit	7,917	11,016	12,901	7,636	9,704	9,993	4%	14%	29%
Net profit	5,462	8,127	9,498	4,904	6,319	6,446	11%	29%	47%
EPS (RMB)	5.03	7.48	8.74	4.36	5.62	5.74	15%	33%	52%
Gross margin	33.2%	32.3%	31.4%	33.8%	32.7%	31.4%	-0.6 ppt	-0.5 ppt	0.1 ppt
Net margin	22.9%	23.8%	23.2%	21.7%	21.3%	20.2%	1.2 ppt	2.5 ppt	2.9 ppt

Source: Company data, CMBIGM estimates

Figure 10: CMBIGM estimates vs. Bloomberg consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	23,877	34,149	41,026	25,754	38,071	45,003	-7%	-10%	-9%
Gross profit	7,917	11,016	12,901	8,616	12,884	15,195	-8%	-15%	-15%
Net profit	5,462	8,127	9,498	5,117	7,661	9,156	7%	6%	4%
EPS (RMB)	5.03	7.48	8.74	4.93	7.41	8.64	2%	1%	1%
Gross margin	33.2%	32.3%	31.4%	33.5%	33.8%	33.8%	-0.3 ppt	-1.6 ppt	-2.3 ppt
Net margin	22.9%	23.8%	23.2%	19.9%	20.1%	20.3%	3 ppt	3.7 ppt	2.8 ppt

Source: Company data, CMBIGM estimates, Bloomberg consensus

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	7,695	9,642	10,718	23,877	34,149	41,026
Cost of goods sold	(5,727)	(6,816)	(7,182)	(15,959)	(23,133)	(28,124)
Gross profit	1,968	2,826	3,536	7,917	11,016	12,901
Operating expenses	(1,005)	(1,499)	(1,042)	(1,651)	(1,709)	(2,002)
Selling expense	(21)	(63)	(51)	(118)	(121)	(137)
SG&A expense	(507)	(598)	(558)	(608)	(644)	(679)
R&D expense	(541)	(767)	(739)	(1,161)	(1,254)	(1,257)
Others	64	(71)	306	236	311	71
Operating profit	963	1,327	2,494	6,266	9,307	10,899
Other income	1	28	2	28	40	48
Other expense	(4)	(4)	(4)	(0)	(0)	(0)
Pre-tax profit	960	1,352	2,492	6,294	9,346	10,946
Income tax	(73)	(118)	(285)	(732)	(1,070)	(1,272)
After tax profit	886	1,234	2,208	5,562	8,276	9,674
Minority interest	10	10	34	100	149	177
Net profit	877	1,224	2,174	5,462	8,127	9,498
BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	10,022	9,587	11,319	18,095	26,200	35,001
Cash & equivalents	3,515	2,831	3,317	6,332	10,165	16,643
Account receivables	1,997	1,509	2,581	3,699	5,096	5,694
Inventories	3,799	3,888	4,295	6,549	9,042	10,375
Prepayment	72	64	59	138	197	237
Other current assets	638	1,295	1,067	1,378	1,700	2,051
Non-current assets	6,543	6,970	8,687	10,319	12,072	13,844
PP&E	3,152	3,217	3,948	4,878	5,804	6,750
Right-of-use assets	21	11	27	313	677	1,065
Deferred income tax	46	48	82	116	157	200
Intangibles	382	322	401	476	546	602
Goodwill	1,980	1,949	1,939	1,929	1,920	1,910
Other non-current assets	962	1,422	2,291	2,606	2,969	3,318
Total assets	16,565	16,557	20,007	28,414	38,272	48,845
Current liabilities	3,166	3,264	4,360	6,663	8,872	10,812
Short-term borrowings	794	385	62	167	301	487
Account payables	1,205	1,136	1,857	3,390	4,596	5,575
Tax payable	68	93	213	302	407	519
Other current liabilities	932	1,349	2,039	2,511	3,171	3,725
Contract liabilities	1	22	3	28	40	48
Accrued expenses	166	279	187	266	358	457
Non-current liabilities	1,796	1,224	872	1,346	1,618	1,911
Long-term borrowings	1,262	696	319	561	561	561
Bond payables	0	0	0	0	0	0
Deferred income	277	264	216	307	413	527
Other non-current liabilities	258	264	337	479	645	823
Total liabilities	4,962	4,488	5,232	8,009	10,490	12,722
Share capital	800	801	803	803	803	803
Retained earnings	2,861	3,893	5,870	10,878	17,969	25,970
Other reserves	7,828	7,251	7,589	8,111	8,249	8,411
Total shareholders equity	11,489	11,945	14,261	19,792	27,020	35,184
Minority interest	114	124	513	613	762	938
Total equity and liabilities	16,565	16,557	20,007	28,414	38,272	48,845

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	960	1,352	2,492	6,294	9,346	10,946
Depreciation & amortization	436	493	525	550	710	921
Tax paid	(73)	(118)	(285)	(732)	(1,070)	(1,272)
Change in working capital	(587)	291	(830)	(1,585)	(2,138)	(566)
Others	77	432	(6)	(156)	(156)	(132)
Net cash from operations	813	2,449	1,897	4,371	6,692	9,897
Investing						
Capital expenditure	(840)	(792)	(1,704)	(1,708)	(1,982)	(2,198)
Acquisition of subsidiaries/ investments	(1,529)	(5,967)	(3,971)	0	0	0
Net proceeds from disposal of short-term investments	1,109	5,167	4,435	0	0	0
Others	42	40	65	(139)	(93)	(72)
Net cash from investing	(1,219)	(1,553)	(1,176)	(1,846)	(2,076)	(2,270)
Financing						
Dividend paid	(168)	(233)	(207)	(383)	(925)	(1,364)
Net borrowings	(259)	(699)	(884)	391	134	187
Proceeds from share issues	2,665	33	(109)	433	0	0
Others	26	(742)	884	22	22	22
Net cash from financing	2,264	(1,641)	(316)	463	(770)	(1,155)
Net change in cash						
Cash at the beginning of the year	1,648	3,489	2,809	3,234	6,245	10,079
Exchange difference	(17)	64	20	0	0	0
Others	1,859	(745)	405	3,011	3,835	6,478
Cash at the end of the year	3,489	2,809	3,234	6,245	10,079	16,557

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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