

Last Closing: HK\$ 5.59

Upside: +16%

Target Price: HK\$ 6.50 →

Technology Sector

O-net Technologies (877 HK)

Optical sector demand stabilizing; other businesses a bright spot

UP

MP

OP

Financial Highlights

Y/E 31 Dec	2015	2016	2017E	2018E	2019E
Revenue (HK\$ m)	1,136	1,598	1,941	2,276	2,739
YoY growth (%)	37	41	21	17	20
Net profit (HK\$ m)	83	131	197	278	345
EPS (HK\$)	0.12	0.18	0.26	0.36	0.45
Vs. Consensus (+/- %)	NA	NA	-3	-2	-4
EPS growth (%)	100	50	46	38	24
P/E (x)	46.6	31.1	21.2	15.4	12.4
P/B (x)	2.9	2.9	2.8	2.3	2.0
Dividend yield (%)	0.0	0.0	0.0	0.0	0.0

Source: Company data, BOCOM Int'l estimates

- 2H17 operation impacted by soft sector demand and product delays.** For its optical business, we believe O-net was impacted by slowing sector demand in 2H17, similar to its peers. However, the impact from China demand decline was likely limited due to relatively small exposure of the company to Huawei, in our view. Specifically for datacom, we believe the delay in the adoption of 100G (from 40G) dampened the growth in new optical products during 2H17. For its telecom business, due to softer sector demand, we believe revenue growth in 2H17 remained muted (similar to 1H17). However, we believe that its other businesses, such as coating, automation, and industrial laser, continued to see robust growth in 2H17.
- Non-optical businesses could once again be the bright spot in 2018.** For the optical component sector, we expect gradual demand recovery this year, following demand disappointment in 2017. We expect O-net's passive product revenue (such as amplifiers and isolators) to largely track industry growth this year while we expect several new active products (such as ICR for telecom, 100G AOC and possibly CWDM4 for datacom) to make more meaningful contribution. For the other businesses such as coating, we expect the increased capacity and the continued strength of glass and ceramic smartphone casing to be the key drivers. We expect the industrial laser business to make more meaningful contributions this year due to new product launches. For the LIDAR business, we expect contribution to remain limited in 2018. In terms of profitability, we expect overall GPM to remain steady in 2018 helped by favorable product mix (stronger growth from higher-margin businesses such as coating and industrial laser) offsetting possible ASP pressure on the optical side.
- Maintain Buy.** In the longer term, we continue to believe the optical component market will see steady growth due to the rapid growth of data consumption on mobile devices and further adoption of higher-speed optical networks (such as further 100G adoption) and 5G. We believe O-net is one of the better telecom equipment/component plays in the market due to its technology capabilities and solid earnings outlook. We revise down our 2017/18 EPS estimates by -5%/-2% on the back of softer-than-expected optical component sector demand. Our unchanged TP of HK\$6.50 is based on 18x 2018E P/E. Maintain **Buy**.



- 2H17 was impacted by soft sector demand and product delay on the optical side; however, robust growth continued for other non-optical businesses, in our view.**
- Expect coating and industrial laser to make more meaningful contributions in 2018; GPM to remain steady helped by favorable product mix.**
- Fine-tune estimates on softer optical demand; maintain Buy.**

Stock data

52w High (HK\$)	7.55
52w Low (HK\$)	3.65
Market cap (HK\$ m)	4,004.82
Issued shares (m)	797.94
Avg daily vol (m)	6.54
1-mth change (%)	17.89
YTD change (%)	12.00
50d MA (HK\$)	5.11
200d MA (HK\$)	5.10
14-day RSI	60.2

Source: Bloomberg

1-year Performance chart



Source: Bloomberg

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Figure 1: O-net earnings forecasts

HK\$ m	1H16	2H16	1H17	2H17E	1H18E	2H18E	1H19E	2H19E	2015	2016	2017E	2018E	2019E
Revenue	746	852	881	1,060	1,049	1,227	1,258	1,480	1,136	1,598	1,941	2,276	2,739
(YoY%)	43	39	18	24	19	16	20	21	37	41	21	17	20
Optical network	674	724	725	866	850	984	1,002	1,168	975	1,398	1,591	1,834	2,170
(YoY%)	51	37	8	20	17	14	18	19	0	43	14	15	18
Other businesses	73	128	149	194	199	243	256	312	161	201	343	442	568
(YoY%)	-1	47	106	51	33	25	29	28	0	25	71	29	29
COGS	509	520	563	671	666	773	802	935	773	1,029	1,234	1,439	1,737
% of sales	68	61	64	63	64	63	64	63	68	64	64	63	63
Gross profit	238	332	318	389	383	454	457	545	363	570	707	837	1,001
GPM (%)	31.8	39.0	36.1	36.7	36.5	37.0	36.3	36.8	31.9	35.6	36.4	36.8	36.6
Opex	176	232	216	233	236	255	269	300	282	407	449	491	570
% of sales	23.5	27.2	24.5	22.0	22.5	20.8	21.4	20.3	24.8	25.5	23.1	21.6	20.8
Operating profit	62	100	102	156	147	199	187	244	81	162	258	346	432
OPM (%)	8.3	11.8	11.6	14.7	14.0	16.2	14.9	16.5	7.1	10.1	13.3	15.2	15.8
Pretax profit	53	101	89	151	138	194	177	239	82	154	239	332	417
Taxes (benefit)	9	17	17	27	23	33	32	43	3	26	44	56	75
Net profit	45	86	74	124	117	161	149	196	83	131	197	278	345
EPS (HK\$)	0.06	0.12	0.10	0.16	0.15	0.21	0.19	0.26	0.12	0.18	0.26	0.36	0.45
EPS growth (%)	50	50	67	36	51	30	27	22	100	50	46	38	24
Revenue breakdown (%)													
Optical network	90	85	83	82	81	80	80	79	86	87	82	81	79
Other businesses	10	15	17	18	19	20	20	21	14	13	18	19	21
Total	100	100	100	100	100	100	100	100	100	100	100	100	100

Source: Company data, BOCOM Int'l estimates

Company background

O-net is a component and sub-system supplier to the optical component industry, supplying to the global leading telecommunication equipment makers. The company is based in Shenzhen with a R&D and manufacturing center in Canada, Germany and the US. O-net has been listed on the main board of the HKEx since 2010.

O-net (877 HK): Financial Statements

Profit & loss (HK\$ m)					
Year ended 31 Dec	2015	2016	2017E	2018E	2019E
Revenue	1,136	1,598	1,941	2,276	2,739
COGS	773	1,029	1,234	1,439	1,737
Gross Profit	363	570	707	837	1,001
OPEX	282	407	449	491	570
OP	81	162	258	346	432
Net interest expense	4	(6)	(19)	(14)	(15)
Equity Method	(3)	(1)	-	-	-
Others	-	-	-	-	-
Non-OP income	1	(8)	(19)	(14)	(15)
Pre-tax income	82	154	239	332	417
Tax	3	26	44	56	75
Net income (before minority)	79	129	195	275	342
Minority interest	(3)	(2)	(3)	(3)	(3)
Net income	83	131	197	278	345
EPS	0.12	0.18	0.26	0.36	0.45

Balance sheet (HK\$ m)					
Year ended 31 Dec	2015	2016	2017E	2018E	2019E
Cash & cash equiv.	134	169	191	321	540
Marketable Securities	41	364	364	364	364
Account Receivables	509	647	758	883	1,053
Inventory	228	270	328	384	462
Others	2	37	37	37	37
Current Assets	914	1,487	1,677	1,989	2,456
Land/CIP	26	24	24	24	24
PP&E, net	699	702	781	816	798
Investment securities	-	-	-	-	-
Interest bearing asset	14	15	15	15	15
Intangible asset	65	88	88	88	88
Other fixed assets	55	170	170	170	170
Total Assets	1,773	2,487	2,756	3,103	3,551
Accounts payable	341	290	352	413	497
Short-term debt	74	684	684	684	684
Others	7	7	7	7	7
Current Liabilities	422	995	1,044	1,104	1,188
Long term debt	-	-	-	-	-
Others	16	63	87	95	115
Total Liabilities	438	1,058	1,130	1,199	1,303
Common stock	7	7	7	7	7
Retained earnings	539	669	866	1,145	1,489
Share premium	784	745	745	745	745
Shareholder equity	1,330	1,421	1,618	1,897	2,241
Minority interest	5	8	8	8	8
Total capital	1,773	2,487	2,756	3,103	3,551

Source: Company data, BOCOM Int'l estimates

Cash flow (HK\$ m)					
Year ended 31 Dec	2015	2016	2017E	2018E	2019E
Profit before tax	82	154	239	332	417
Depreciation/Amortization	60	62	79	85	118
Changes in working capital	(5)	(304)	(139)	(166)	(216)
Forex gain/loss	-	-	-	-	-
Others	(9)	28	-	-	-
Cash flow from operations	128	(60)	180	250	319
Capex	(153)	(115)	(159)	(120)	(100)
Sales of tangible assets	6	18	-	-	-
Investments	64	23	-	-	-
Others	(33)	(482)	-	-	-
Cash flow from investing	(116)	(555)	(159)	(120)	(100)
Dividends paid	-	-	-	-	-
New share issued	(3)	-	-	-	-
Debt issuance/(repayment)	74	639	-	-	-
Other	(10)	18	-	-	-
Cash flow from financing	61	657	-	-	-
Other	(8)	(7)	-	-	-
Net cash flow	64	35	21	130	219
Cash at beginning	70	134	169	191	321
Cash at end	134	169	191	321	540

Financial ratios					
Year ended 31 Dec	2015	2016	2017E	2018E	2019E
GPM%	31.9	35.6	36.4	36.8	36.6
OM%	7.1	10.1	13.3	15.2	15.8
EPS growth%	100.0	50.0	46.4	38.1	24.1
P/E (x)	46.6	31.1	21.2	15.4	12.4
P/B (x)	2.9	2.9	2.8	2.3	2.0
P/S (x)	0.4	0.3	0.3	0.3	0.2
EV/EBITDA (x)	22.3	17.6	12.6	9.4	7.0
Dividend yield%	0.0	0.0	0.0	0.0	0.0
Net debt/equity	(0.0)	0.4	0.3	0.2	0.1
ROE%	6.2	9.5	13.0	15.8	16.7
ROA%	4.8	6.0	7.4	9.4	10.3
ROIC%	5.8	7.3	8.8	11.3	12.4

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Rating System

Analyst Stock Ratings:

Buy: The stock's total return is expected to **exceed** that of the corresponding industry over the next 12 months.

Neutral: The stock's total return is expected to be **in line with** that of the corresponding industry over the next 12 months.

Sell: The stock's total return is expected to be **below** that of the corresponding industry over the next 12 months.

Not-Rated: The analyst **does not have conviction** regarding the outlook of the stock's total return relative to that of the corresponding industry over the next 12 months.

Trading Buy: The stock's **absolute** return is expected to be **very attractive** in the near term. This rating can be different from the rating with a view over the next 12 months.

Trading Sell: The stock's **absolute** return is expected to be **very unattractive** in the near term. This rating can be different from the rating with a view over the next 12 months.

Analyst Industry Views:

Outperform: The analyst expects the industry coverage universe to be **attractive** relative to the relevant broad market benchmark over the next 12 months.

Market perform: The analyst expects the industry coverage universe to be **in line with** the relevant broad market benchmark over the next 12 months.

Underperform: The analyst expects the industry coverage universe to be **unattractive** relative to the relevant broad market benchmark over the next 12 months.

Broad market benchmark for Hong Kong is **the Hang Seng Composite Index**, for China A-shares is the **MSCI China A Index**, for US-listed Chinese companies is **S&P US Listed China 50 (USD) Index**.

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