

Yangtze Optical Fibre and Cable

Bloomberg: 6869 HK Equity | Reuters: 6869.HK

Refer to important disclosures at the end of this report

DBS Group Research . Equity

7 Apr 2022

BUY (Upgrade from Hold)

Last Traded Price (6 Apr 2022): HK\$10.82 (HSI : 22,081)

Price Target 12-mth: HK\$15.80 (46% upside) (Prev HK\$11.60)

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What's New

- Bottom out from the extreme cable price level after c.60% price recovery in China Mobile's tender under the improving supply-demand dynamics
- Operators' capex hike and global demand recovery underpins further cable demand and price growth
- Expect cable ASP for YOFC to recover 24% in FY22, leading to 2.9ppts gross margin expansion and 13% earnings upward revision
- Upgrade to BUY from HOLD with a higher TP of HK\$15.8, benefiting from cable price recovery

Hitting an inflection point

Investment Thesis

A leading integrated optical fibre maker. YOFC produces upstream products such as optical fibre preforms and optical fibres. The vertically integrated business model and advanced technology would help YOFC to achieve higher margins than its peers.

Expect preform supply shortage and price hike ahead, after two years of market consolidation. We expect cable ASP for YOFC to recover by 24% and 8% in FY22 and FY23, supporting earnings growth of 22% and 18% in FY22 and FY23 respectively.

Operators' capex and transferring computing resources from east to west are medium-term drivers. In Feb 2022, NDRC officially approved transferring computing resources from east to west. Domestic operators announced in Mar 2022 that their FY22 capex budget increased by 9% for fixed-line broadband networks.

Valuation:

Our TP of HK\$15.8 is based on a 12x FY22 PE (vs 10x FY22 PE previously) to reflect improving industry supply-demand dynamics.

Where we differ:

Expect preform supply shortage and cable price hike to sustain, due to domestic network buildout to support transferring computing resources from east to west project and global demand recovery.

Key Risks to Our View:

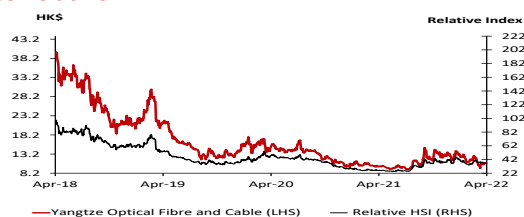
Sluggish cable demand. Telecom operators account for more than 80% of total cable demand in China. Sluggish optical fibre cable demand from telecom operators will be negative to the industry.

Price cut by preform players. A price cut by any player will lead to a decline in preform price in the industry.

At A Glance

Issued Capital - H shares (m shs)	352
- Non H shrs (m shs)	406
H shs as a % of Total	46
Total Mkt Cap (HK\$m/US\$m)	17,315 / 2,209
Major Shareholders (%)	
China Huaxin Post and Telecom Technologies Co., Ltd.	44.3
Wuhan Yangtze Communication Industry Group Co Ltd	29.5
Major H Shareholders (As % of H shares)	
Draka Holding BV	51.2
H Shares-Free Float (%)	48.8
3m Avg. Daily Val. (US\$m)	2.12
GICS Industry: Information Technology / Technology Hardware & Equipment	

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	8,222	9,536	12,014	13,380
EBITDA	997	856	1,372	1,590
Pre-tax Profit	579	748	979	1,156
Net Profit	544	709	865	1,022
Net Profit Gth (Pre-ex) (%)	(32.1)	30.3	22.1	18.1
EPS (RMB)	0.72	0.93	1.14	1.35
EPS (HK\$)	0.88	1.15	1.41	1.66
EPS Gth (%)	(32.1)	30.3	22.1	18.1
Diluted EPS (HK\$)	0.88	1.15	1.41	1.66
DPS (HK\$)	0.27	0.35	0.42	0.50
BV Per Share (HK\$)	14.71	15.91	16.97	18.21
PE (X)	12.2	9.4	7.7	6.5
P/Cash Flow (X)	47.2	12.6	7.1	5.9
P/Free CF (X)	nm	nm	46.3	20.1
EV/EBITDA (X)	6.2	7.2	4.5	3.9
Net Div Yield (%)	2.5	3.2	3.9	4.6
P/Book Value (X)	0.7	0.7	0.6	0.6
Net Debt/Equity (X)	CASH	CASH	CASH	CASH
ROAE(%)	6.1	7.5	8.6	9.4
Earnings Rev (%)			13	22
Consensus EPS (RMB)			1.15	1.30
Other Broker Recs:		B:12	S:0	H:5

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters



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WHAT'S NEW

Hitting an inflection point

Background

The cable price was Rmb112/fkm in China Mobile's cable tender in 2018. The attractive cable price offered c.20% gross margin for pure cable manufacturers without preform and fibre production capability, which encouraged many cable manufacturers to expand their capacity. However, China Mobile's tender volume declined by 4% in 2019. Due to the over-supply, the average selling price (ASP) in China Mobile's tender plummeted by c.50% to Rmb58/fkm in 2019. The ASP further declined by 30% to Rmb41/fkm in 2020. The significant drop of cable price made pure cable sales unprofitable. Accordingly, YOFC's share price plunged by c.70% from HK\$30.5 in Feb 2019 to HK\$8.9 in May 2021.

Expect cable price to rebound after market consolidation

We have re-evaluated the market dynamics and believe that the over-supply is over. We now expect preform and cable prices to increase in the next 1-2 years, and we have turned bullish on YOFC's prospects.

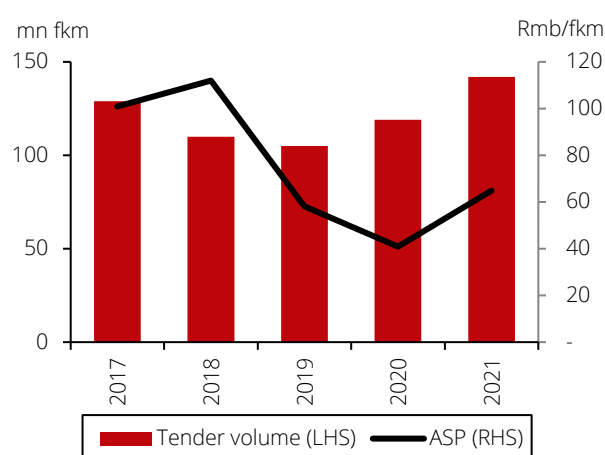
(1) The c.60% higher ASP in China Mobile's 2021 tender was an early sign of the improving supply-demand dynamics. The ASP recovered from Rmb41/fkm in 2020 to Rmb65/fkm and the tender volume increased by 19.3% from 119.2m fkm in 2020 to 142.3m fkm. As the leading industry player, YOFC maintained its No.1 position with further market share increase to 19.96% in 2021. (2) The decrease in the number of successful bidders implies market consolidation. The number of successful bidders dropped from 17 in 2018 to 14 in 2021, with the market share of the top five bidders expanding from 65% to 70%. (3) The rebound of domestic single-mode fibre spot price also responded to the better market dynamics. According to CRU, the single-mode fibre spot price has increased by c.60% from c.US\$2.5 in Jan 2021 to over US\$4 in Jan 2022.

YOFC's rank in China Mobile's cable tender

	2016	2017	2018	2019	2020	2021
Rank	1	1	1	6	1	1
Market share	16.77%	17.75%	17.31%	4.39%	19.44%	19.96%

Source: China Mobile, DBS HK

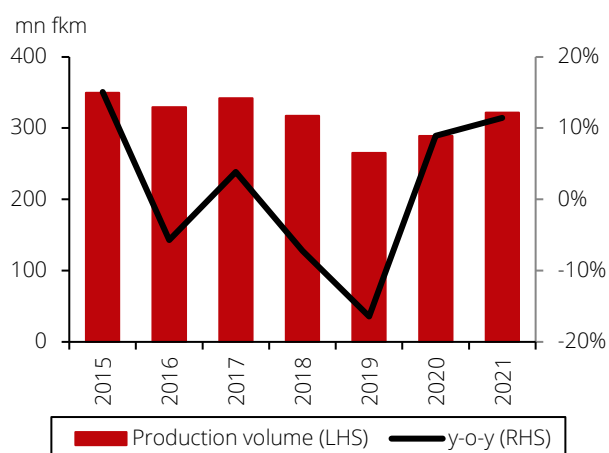
China Mobile's optical fibre cable tender



Source: China Mobile, DBS HK

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China's optical fibre cable production volume



Source: National Bureau of Statistics, DBS HK

Cable price drivers in the next 2-3 years

We expect further price hikes driven by increasing domestic and global demand. CRU expects cable demand to grow by 6%+ in China and 8%+ globally in 2022.

The three telecom operators had announced their FY22 capex budgets in Mar 2022. Total capex budget increased by 4% y-o-y to Rmb353bn, a positive surprise to the market. Fixed-line broadband capex went up by 9% y-o-y to Rmb81bn. We expect operators to expand the coverage of the gigabit broadband networks in China, with a target to reach 80% by 2023 as set by the Ministry of Industry and Information Technology (MIIT). As of Jun 2021, the gigabit broadband network coverage was only c.30%.

The National Development and Reform Commission (NDRC) officially announced the transferring computing resources from east to west ("东数西算") project in Feb 2022. We expect higher investments from operators in transmission networks to enhance the connectivity and lower the latency between the east and the west, which would lead to higher demand for communication optical fibre cable. The government has also planned to build eight national computing hubs with ten national IDC clusters. Besides, YOFC offers high-end multi-mode optical fibres, which could benefit from the data centre construction in the computing hubs.

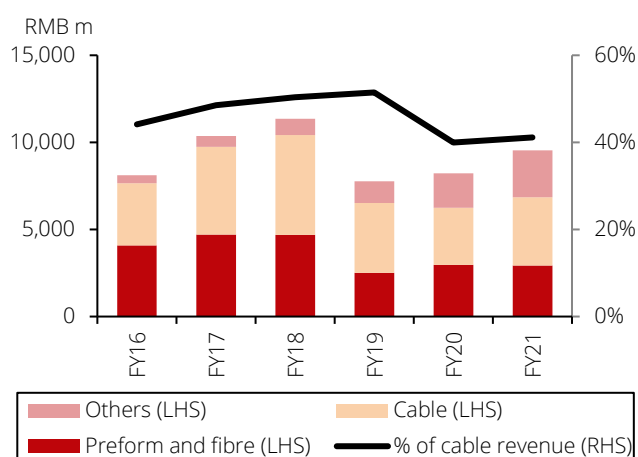
Global cable demand had also recovered in 2021, and CRU predicts the global optical fibre and cable industry will maintain steady growth in the next five years, especially in

Latin America, Central, Southern & Southeast Asia, and Africa where the broadband penetration is still rapidly expanding. The global demand for optical fibres is expected to grow at a CAGR of 6.3% in 2021-2024 from 500m fkm to more than 600m fkm. YOFC has improved its overseas production capacity layout and built localised supply and service capacity to capture overseas demand.

Why and how will YOFC benefit?

YOFC is a global leading provider of optical fibre preforms, optical fibres, optical fibre cables and integrated solutions, with c.40% revenue from cable sales. YOFC has two factories located in Wuhan and Qianjiang with preform production capacity of 2,000 tons each for communication. The Wuhan site can also be used to produce multi-mode/special preform with a capacity of c.200 tons. YOFC has an optical fibre and optical fibre cable production capacity of 80-90m fkm and 30m fkm respectively. YOFC only sells self-produced preform and fibre, while it has a trading arm for cables from the market, which account for c.50% of total cable sales. Gross margin for preform & fibre was c.40% in FY21. As sales of traded cable has nearly no margin, the actual gross margin for self-produced cable was around 17% in FY21.

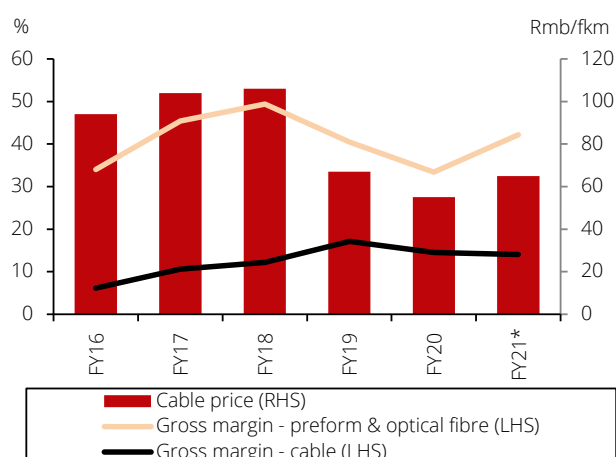
Revenue breakdown



Source: Companies, DBS HK

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Gross margin



Source: Companies, DBS HK

* pre-adjustment for Chinese GAAP

YOFC's vertically integrated business model with preform, fibre and cable production, and leading technologies has helped the company to realize efficiency and establish cost leadership. Despite significant cable price drop in 2020 and 2021, YOFC still maintained 20%+ gross profit margin and high-single digit net profit margin, higher than its peers. Looking forward, YOFC will further benefit from the improved supply-demand dynamics with earnings recovery. We expect the YOFC's cable ASP to increase 24% in FY22, leading to 22% earnings growth.

Peer comparison

GP margin	2016	2017	2018	2019	2020
YOFC	21%	27%	28%	24%	22%
Hengtong	21%	20%	19%	17%	16%
Futong	8%	12%	14%	19%	16%
JS Tongding	30%	31%	30%	18%	15%
JS Zhongtian	16%	15%	15%	13%	13%
FiberHome	24%	24%	23%	22%	22%
NP margin	2016	2017	2018	2019	2020
YOFC	8%	12%	13%	10%	7%
Hengtong	8%	9%	8%	4%	4%
Futong	4%	7%	4%	4%	2%
JS Tongding	14%	15%	12%	-59%	1%
JS Zhongtian	8%	7%	6%	5%	5%
FiberHome	5%	4%	4%	4%	1%

Source: Companies, DBS HK

Financial forecast and valuation

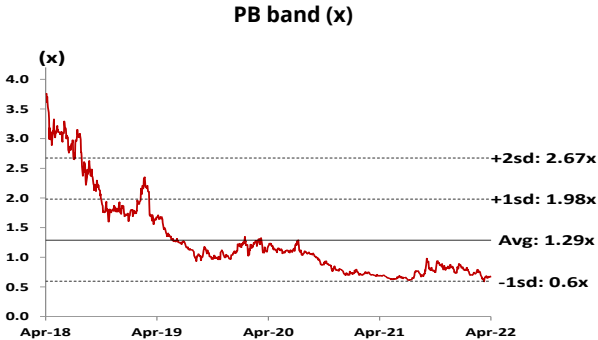
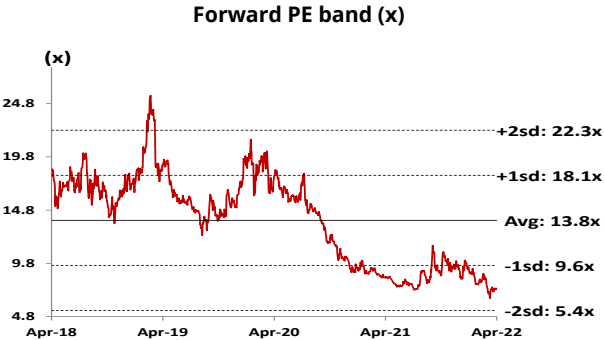
We expect cable ASP for YOFC to recover by 24% and 8% in FY22 and FY23 respectively, narrowing the gap between domestic and overseas prices. We forecast revenue to grow 26% and 11% in FY22 and FY23 respectively, riding on the cable price recovery. There was a 15% increase in raw material costs for YOFC in FY21 due to significant raw material price (e.g. silicon) increase in 2021. After factoring in the potential rising raw material costs in 2022, we expect the rising cable price could still lead to margin improvement and earnings recovery. We expect gross margin to improve from 19.6% in FY21 to 22.5% and 23.0% in FY22 and FY23 respectively. We forecast EBITDA to grow by 60% and 16% for FY22 and FY23 respectively and net profit to increase by 22% and 18% for FY22 and FY23 respectively. We have revised up our earnings forecasts by 13% and 22% for FY22 and FY23 respectively. If we exclude the Rmb339m gains from changes in fair value in FY21, net profit will increase by 134% y-o-y from Rmb369m in FY21 to Rmb865 in FY22. We upgrade YOFC from HOLD to BUY with a higher TP of HK\$15.8, as the company is hitting an inflection point from the improving supply and demand dynamics. Our TP is based on a 12x FY22 PE.

Company Background

Yangtze Optical Fibre and Cable (YOFC) is the largest optical fibre preform, optical fibre and optical cable supplier in China. Two of its major Chinese shareholders are Huaxin and YCIG, ultimately held by SASAC. Draka, the largest foreign shareholder, was a Dutch manufacturer of electrical cables, which was later acquired by Prysmian S.p.A (Prysmian, PRY.IM, NR) (listed on the Milan Stock Exchange). The Prysmian Group is the global leader in the energy and telecom cable and systems industry.

Yangtze Optical Fibre and Cable

Historical PE and PB band



Source: Thomson Reuters, DBS HK

Yangtze Optical Fibre and Cable

Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (RMB m)					
Optical fibre preform and fibre	2,508	2,953	2,919	3,502	3,677
Optical fibre cable	4,002	3,288	3,921	5,006	5,496
Others	1,259	1,981	2,697	3,506	4,207
Total	7,769	8,222	9,536	12,014	13,380

Yangtze Optical Fibre and Cable

Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	7,769	8,222	9,536	12,014	13,380
Cost of Goods Sold	(5,936)	(6,574)	(7,664)	(9,312)	(10,301)
Gross Profit	1,834	1,648	1,872	2,703	3,079
Other Opng (Exp)/Inc	(1,216)	(1,144)	(1,397)	(1,748)	(1,947)
Operating Profit	617	504	475	955	1,132
Other Non Opg (Exp)/Inc	281	136	396	145	145
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(15)	(61)	(123)	(121)	(121)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	884	579	748	979	1,156
Tax	(99)	(35)	(27)	(98)	(116)
Minority Interest	17	(1)	(12)	(16)	(19)
Preference Dividend	0	0	0	0	0
Net Profit	801	544	709	865	1,022
Net Profit before Except.	801	544	709	865	1,022
EBITDA	1,186	997	856	1,372	1,590
Growth					
Revenue Gth (%)	(31.6)	5.8	16.0	26.0	11.4
EBITDA Gth (%)	(38.5)	(15.9)	(14.2)	60.3	15.9
Opg Profit Gth (%)	(61.8)	(18.4)	(5.7)	101.0	18.6
Net Profit Gth (%)	(46.2)	(32.1)	30.3	22.1	18.1
Margins & Ratio					
Gross Margins (%)	23.6	20.0	19.6	22.5	23.0
Opg Profit Margin (%)	7.9	6.1	5.0	7.9	8.5
Net Profit Margin (%)	10.3	6.6	7.4	7.2	7.6
ROAE (%)	9.4	6.1	7.5	8.6	9.4
ROA (%)	6.0	3.7	4.0	4.3	4.8
ROCE (%)	5.3	4.0	3.4	5.7	6.5
Div Payout Ratio (%)	30.1	30.1	30.1	30.1	30.1
Net Interest Cover (x)	40.6	8.3	3.9	7.9	9.4

Source: Company, DBS HK

Interim Income Statement (RMB m)

FY Dec	2H2019	1H2020	2H2020	1H2021	2H2021
Revenue	4,450	3,407	4,815	4,352	5,184
Cost of Goods Sold	(3,398)	(2,556)	(4,017)	(3,340)	(4,324)
Gross Profit	1,052	850	798	1,011	861
Other Oper. (Exp)/Inc	(687)	(485)	(660)	(752)	(645)
Operating Profit	365	366	138	260	215
Other Non Opg (Exp)/Inc	47	(45)	182	304	92
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(11)	(46)	(15)	(47)	(76)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	401	274	305	517	231
Tax	(42)	(12)	(23)	(31)	3
Minority Interest	5	0	0	(7)	(6)
Net Profit	364	263	281	479	229
Net profit bef Except.	364	263	281	479	229
Growth					
Revenue Gth (%)	(22.3)	2.6	8.2	27.7	7.7
Opg Profit Gth (%)	(48.7)	45.0	(62.2)	(29.0)	56.1
Net Profit Gth (%)	(46.4)	(39.9)	(22.9)	82.5	(18.4)
Margins					
Gross Margins (%)	23.6	25.0	16.6	23.2	16.6
Opg Profit Margins (%)	8.2	10.7	2.9	6.0	4.2
Net Profit Margins (%)	8.2	7.7	5.8	11.0	4.4

Source: Company, DBS HK

Yangtze Optical Fibre and Cable

Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	3,756	3,953	4,372	4,768	5,124
Invt in Associates & JVs	1,495	1,636	1,684	1,684	1,684
Other LT Assets	673	816	1,108	1,090	1,071
Cash & ST Invt	2,134	2,336	4,302	4,257	4,351
Inventory	1,779	2,338	2,763	3,039	3,343
Debtors	3,451	4,189	4,663	5,130	5,643
Other Current Assets	487	587	586	586	586
Total Assets	13,776	15,856	19,479	20,554	21,802
ST Debt	896	1,034	1,718	1,718	1,718
Creditors	1,836	2,199	2,714	3,121	3,589
Other Current Liab	1,037	1,144	2,132	2,132	2,132
LT Debt	42	525	1,290	1,290	1,290
Other LT Liabilities	1,023	1,569	1,041	1,041	1,041
Shareholder's Equity	8,788	9,047	9,782	10,434	11,196
Minority Interests	154	338	803	819	838
Total Cap. & Liab.	13,776	15,856	19,479	20,554	21,802
Non-Cash Wkg. Capital	2,844	3,771	3,167	3,502	3,851
Net Cash/(Debt)	1,196	778	1,295	1,250	1,344
Debtors Turn (avg days)	161.3	169.6	169.4	148.8	146.9
Creditors Turn (avg days)	108.1	118.5	123.1	119.7	124.4
Inventory Turn (avg days)	89.6	120.9	127.8	119.1	118.3
Asset Turnover (x)	0.6	0.6	0.5	0.6	0.6
Current Ratio (x)	2.1	2.2	1.9	1.9	1.9
Quick Ratio (x)	1.5	1.5	1.4	1.3	1.3
Net Debt/Equity (X)	CASH	CASH	CASH	CASH	CASH
Net Debt/Equity ex MI (X)	CASH	CASH	CASH	CASH	CASH
Capex to Debt (%)	80.2	39.1	35.7	26.4	26.4
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

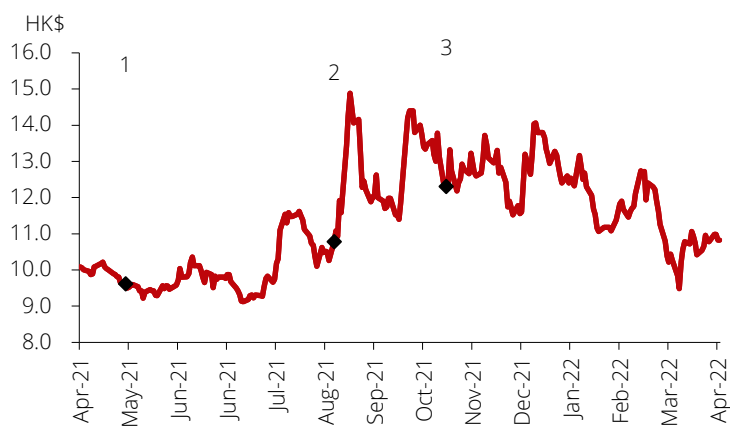
Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	884	579	748	979	1,156
Dep. & Amort.	287	357	381	418	458
Tax Paid	(99)	0	0	0	0
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	0	0	0	0	0
Chg in Wkg.Cap.	(157)	(800)	(406)	(336)	(349)
Other Operating CF	(71)	5	(196)	(122)	(140)
Net Operating CF	843	141	527	939	1,125
Capital Exp.(net)	(752)	(609)	(1,074)	(795)	(795)
Other Invt.(net)	(724)	(4,078)	(3,601)	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	809	3,136	3,285	120	120
Net Investing CF	(667)	(1,551)	(1,390)	(675)	(675)
Div Paid	(258)	(341)	(254)	(213)	(260)
Chg in Gross Debt	(392)	1,023	1,944	0	0
Capital Issues	0	64	623	0	0
Other Financing CF	(71)	(27)	(24)	(96)	(96)
Net Financing CF	(721)	719	2,289	(309)	(356)
Currency Adjustments	6	(32)	(43)	0	0
Chg in Cash	(540)	(722)	1,384	(45)	94
Opg CFPS (RMB)	1.32	1.24	1.23	1.68	1.95
Free CFPS (RMB)	0.12	(0.62)	(0.72)	0.19	0.44

Source: Company, DBS HK

Yangtze Optical Fibre and Cable

Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	3-May-21	HK\$9.65	HK\$8.70	Fully Valued
2:	30-Aug-21	HK\$10.26	HK\$8.70	Fully Valued
3:	2-Nov-21	HK\$12.26	HK\$11.60	Hold

Source: DBS HK

Analyst: Tsz Wang Tam
Harry Zhuang

Yangtze Optical Fibre and Cable

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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Yangtze Optical Fibre and Cable

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