

# Yangtze Optical Fibre and Cable (6869.HK)

## Flagship of the Industry with Value Underestimated

### Hong Kong | TMT | Company report

10 Jun 2015

Yangtze Optical Fibre and Cable (YOFC) is a leading manufacturer of optical fibre and cable. In 2013, the Company became China's largest supplier of optical fibre preforms, optical fibres and optical fibre cables by volume, and the world's largest supplier of optical fibre preforms and the second largest supplier of optical fibre and cable. With strong R&D capability, YOFC has the only MOST-recognized national key laboratory in the optical communication industry. What's more, the Company is the most profitable in the industry.

The State Council issued a document stating expressly that the building of broadband network will be accelerated. For this end, it plans to invest over RMB430 billion in 2015 and at least RMB700 in 2016/2017, which we believe will help maintain a high level demand for optical fibre and cable and will definitely benefit YOFC as the leading company in the industry.

On May 18, Ministry of Commerce released a preliminary ruling on anti-dump investigation of optical fibre preforms, affirming that the imported fiber preforms with Japanese and American origins were dumped in China. This ruling indicated that the government supports Chinese optical communication companies for further development and will raise the shares of domestic fiber preforms. Being the largest manufacturer of fiber preforms in the world, YOFC is likely to benefit most. What's more, the ruling will help improve the supply and demand situation in China, and then the prices of optical fibre and cable will rise steadily.

YOFC has a capacity of 8 million core km and plans to increase another 8 million core km in a new facility which has carried out a trial production and is scheduled to start operation in the second half of the year. The policies such as "Broadband China" will significantly lift the demand. Besides, domestic competitors have no plan to expand capacity. All these will contribute to reinforcing the Company's leading position and support its sustainable growth.

### Flagship of the Industry with Value Underestimated

Despite the excess capacity for the whole optical fibre and cable industry, the accelerated implementation of "Broadband China" and "Fiber to the Home" will improve the supply and demand situation greatly. As an industry leader and having advantages in technology and profitability, its performance prospect is optimistic. We take 12 times as the PE ratio valuation of EPS in 2015 and the target price can reach 12.7 HKD, with the "Accumulate" rating initially. (Closing price at 8 June 2015)

### Leading Competition Position

YOFC is a leading manufacturer of optical fibre and cable. In 2013, the Company became China's largest supplier of optical fibre preforms, optical fibres and optical fibre cables by volume, and the world's largest supplier of optical fibre preforms and the second largest supplier of optical fibre and cable.

### Accumulate (Initially)

CMP: HKD 10.60

(Closing price at 8 June 2015)

TARGET: HKD 12.70 (+19.8%)

#### COMPANY DATA

O/S SHARES (MN) :	639
MARKET CAP (HKDMN) :	6,773
52 - WK HI/LO (HKD):	12.32/ 6.05

#### SHARE HOLDING PATTERN , %

Draka Comteq B.V. :	28.12
China Huaxin Post & Telecommunication Economy Development Center	28.12

#### PRICE PERFORMANCE , %

	1M	3M	1Y
YOFC	7.58	52.17	-
HSI	8.96	39.36	-

#### PRICE VS. HSI



Source: Phillip Securities (HK) Research

#### KEY FINANCIALS

CNY mn	FY13	FY14	FY15E	FY16E
Net Sales	4826	5677	6075	6577
Net Profit	415	466	534	633
EPS, CNY	0.87	0.95	0.84	0.99
PER, x	9.6	8.8	10.0	8.5
BVPS, CNY	3.15	4.40	5.14	5.83
P/BV, x	2.7	1.9	1.6	1.4
ROE, %	25.5	21.6	17.2	18.0
Debt/Equity (%)	231.7	126.4	127.3	127.3

Source: Company reports, Phillip Securities Est.

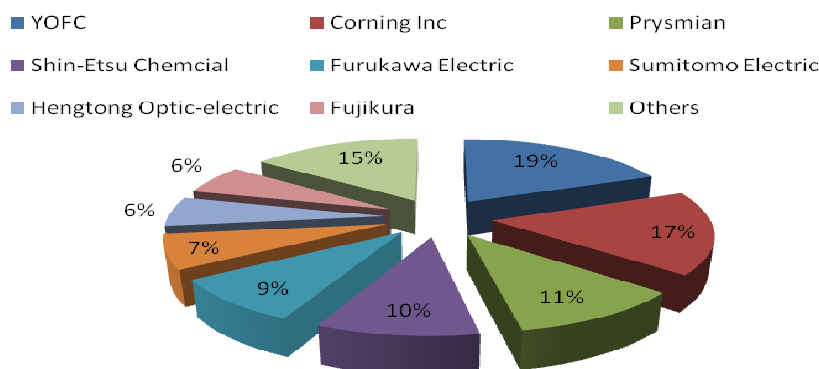
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### Global market share of optical fibre preforms

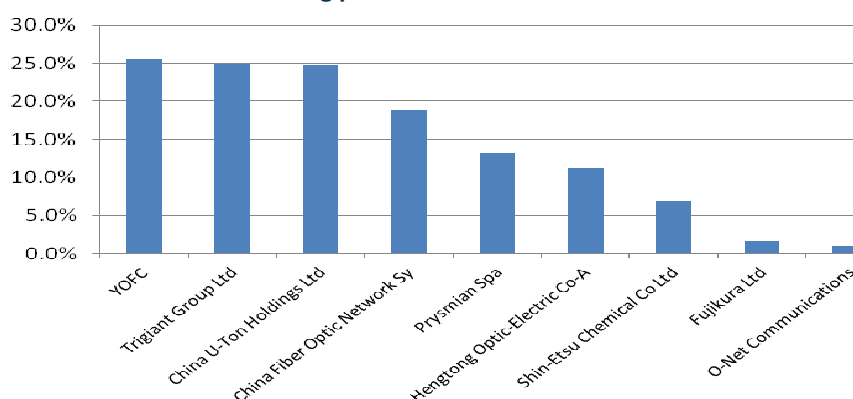


Source: Company reports, Phillip Securities (HK) Research

With strong R&D capability, YOFC has the only MOST-recognized national key laboratory in the optical communication industry. It has also formulated five of industry-specific criteria for China Communications Standards Association.

What's more, the Company is the most profitable in the industry thanks to its adoption of vertical integration business model and focusing more on optical fibre preforms and optical fibre manufacturing, achieving above-average ROE and net profit margin. In 2014, the optical fibre preforms and optical fibres business contributed 57% of the Company's total revenues. Especially, optical fibre preforms industry in China shows a good competition pattern for there are only five or six manufacturers across the country with 40% of demands relying on import. As the largest manufacturer, YOFC's sales of optical fibre preforms were three times that of the second largest, displaying remarkable advantage. Currently, the fiber preforms represent the best profitability in the optical fibre industry chain, contributing about 70% of the total profit.

### The ROE of YOFC takes leading position in 2014



Source: Company reports, Phillip Securities (HK) Research

### Booming Demand Backed up by Favorable Policies

Recently the State Council issued a document stating expressly that the building of broadband network will be accelerated by pushing the construction of "City of All Optical Network" and the 4G Mobile Communication network. For this end, it plans to invest over RMB430 billion in 2015 and at least RMB700 in 2016/2017, which we believe will help maintain a high level demand for optical fibre and cable and will definitely benefit YOFC as the leading company in the industry. According to the management, the industry is expected to see growth by 15% in next two to three

years, and YOFC will grow at an even higher rate. By far, the Company is good and stable in production with the demand exceeding the supply.

### **Optical Fibre Preforms Anti-dump Ruling Likely to Raise Prices**

On May 18, Ministry of Commerce released a preliminary ruling on anti-dump investigation of optical fibre preforms, affirming that the imported fiber preforms with Japanese and American origins were dumped in China. The ruling stated that from May 21 on, Chinese importers are required to pay a deposit at 7.8-39% to the Customs when importing the fiber preforms from the above origins.

Before the ruling, large quantity of optical fibre preforms originating in Japan and the U.S. have been exported to China, containing the capacity of Made-in-China products and their profitability. This ruling indicated that the government supports Chinese optical communication companies for further development and will raise the shares of domestic fiber preforms. Being the largest manufacturer of fiber preforms in the world, YOFC is likely to benefit most. What's more, the ruling will help improve the supply and demand situation in China, and then the prices of optical fibre and cable will rise steadily.

### **Capacity Expansion Supports the Growth**

YOFC has a capacity of 8 million core km and plans to increase another 8 million core km in a new facility which has carried out a trial production and is scheduled to start operation in the second half of the year. Despite the fact that only 70% of the optical cable capacity has been used, the policies such as "Broadband China" will significantly lift the demand. Besides, domestic competitors have no plan to expand capacity. All these will contribute to reinforcing the Company's leading position.

Also, to respond to "One Belt One Road" initiative, the Company announced in last December and in the beginning of this year to set up an optical cable plant in Burma and an optical fibre plant in Indonesia respectively. So far, the overseas market contributes only 10% of its revenues. As more sales offices are to be established abroad, it is likely that its export will increase substantially and the higher gross margin from overseas sales will improve the Company's profitability.

What's also worth mentioning is that YOFC's current capacity of the fibre preforms is 1700-1900 tons and by June 2016, it is estimated to increase by 1500 tons, representing 80-90% rise. To support the increased capacity of the fiber preforms, the capacity of optical fibre will increase as well. The planned expansion will further raise the proportion of products made by the Company itself and improve the gross margin.

### **Catalysts**

More supporting policies;  
Beyond-expectation progresses of new capacity.

### **Risks**

Fierce competition leads to falling profitability.

## Financials

FYE	2012	2013	2014	2015F	2016F
<b>Valuation Ratios</b>					
Price Earnings	11.0x	9.6x	8.8x	10.0x	8.5x
Price to Book	2.3x	2.7x	1.9x	1.6x	1.4x
Dividend Yield	0.0%	0.0%	2.0%	3.0%	3.6%
<b>Per share data(RMB)</b>					
EPS Adjusted	0.76	0.87	0.95	0.84	0.99
Book Value Per Share	3.65	3.15	4.40	5.14	5.83
Dividends Per Share	0.00	0.00	0.17	0.25	0.30
<b>Growth &amp; Margin</b>					
Revenue growth	14.4%	1.0%	17.6%	7.0%	8.3%
Gross Profit growth	19.0%	15.4%	6.9%	14.5%	13.6%
Net Profit growth	6.1%	13.8%	12.4%	14.6%	18.4%
<b>Profitability Ratios</b>					
Gross Margin	18.5%	21.1%	19.2%	20.5%	21.5%
Net Profit Margin	7.6%	8.6%	8.2%	8.8%	9.6%
Dividend Payout Ratio %	0.0%	0.0%	17.5%	29.9%	30.3%
<b>Key Ratios</b>					
Return on Assets	9.7%	9.2%	8.0%	7.6%	7.9%
Return on Equity	22.1%	25.5%	21.6%	17.2%	18.0%
Effective Tax Rate	9.0%	11.7%	13.2%	12.5%	12.5%
Liability ratio	56.3%	69.9%	55.8%	56.0%	56.0%
<b>Income Statement(RMB: mn)</b>					
<b>Revenue</b>	<b>4,778</b>	<b>4,826</b>	<b>5,677</b>	<b>6,075</b>	<b>6,577</b>
- Cost of Goods Sold	3,896	3,808	4,589	4,829	5,163
<b>Gross Income</b>	<b>882</b>	<b>1,018</b>	<b>1,088</b>	<b>1,245</b>	<b>1,414</b>
- Selling, General & Admin Expenses	528	549	565	607	658
<b>Operating Income</b>	<b>378</b>	<b>491</b>	<b>553</b>	<b>638</b>	<b>756</b>
- Interest Expense	62	40	67	75	81
- Foreign Exchange Losses (Gains)	-15	-42	-43	-45	-45
<b>Pretax Income</b>	<b>401</b>	<b>470</b>	<b>535</b>	<b>608</b>	<b>720</b>
- Income Tax Expense	36	55	71	76	90
<b>Income Before XO Items</b>	<b>365</b>	<b>415</b>	<b>464</b>	<b>532</b>	<b>630</b>
<b>Net Profit</b>	<b>365</b>	<b>415</b>	<b>466</b>	<b>534</b>	<b>633</b>

Source: Company, Phillip Securities (HK) Research Estimates  
 (Financial figures as at 8 June 2015)

**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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