

# Plover Bay Tech (1523 HK)

## Roadshow Recap – 1 March 2017

We remain positive on Plover Bay despite 4% miss on our FY16 core earnings forecast, as the miss was due to one-off costs. After the roadshow, we are more convinced on the prospects of SD-WAN and believe PB's strong product lineup and lean operating structure offers potential for multiyear growth. The stock looks attractive at 12x FY16 P/E (vs 15-20x avg for legacy peers) and offers 5% dividend yield. We expect a re-rating as the market awareness on SD-WAN increases.

### FY16 Core Earnings Rose 49% YoY

Plover Bay's (PB) announced its annual results on 28 February and its Chairman Alex Chan and CEO Keith Chau presented in our post result NDR. To recap, core net profit (ex. listing fee) rose 49% YoY, slightly below our forecast of +55% growth due to an one-off increase in opex. Revenue growth of 30% YoY was 7% above our forecast, and GPM improved to 63.3% (FY15: 58.1%) as expected. Opex rose to 35.6% of revenue (FY15: 34.9%) mainly due to one-off selling & dist. expenses to host its distributors after IPO. Tax rates came in at 21.5% (vs FY15: 18.9%). PB declared HKD0.0193 final div. (HKD0.037 full year), implying 90% payout for FY16.

### Expanding To New Verticals

SD-WAN's rapid deployment time and cost savings compared to traditional fixed networking methods are the core value propositions in industrial networking and enterprise networking, respectively. PB's future strategy is to focus on industrial networking, where reliability (eg. network stability, extreme operating temperatures, waterproof and impact resistance etc.) is a primary concern and pricing is often secondary. It currently serves end users in mainly four verticals (transportation, public safety, maritime and unmanned systems) including global leading internet companies and overseas security forces. In 2017, it aims to expand into streaming/ professional broadcasting market by working with JVC, which could be disruptive as current satellite-based broadcasting is much more expensive. It will also launch a router capable of carrying 14 LTE connections aimed at high-end users, which is a first in the market.

### ASP and margins expected to be stable

Sustainability of its ASPs / margins and potential competition are investors' top concerns. PB expects stable ASP and margins because i) industrial networking customers tend to be reluctant to switch suppliers due to high switching cost, and ii) even though management does not rule out taking bulk orders that may dilute GPM, these bulk orders should be positive to op. margin due to operating leverage. Regarding potential competition, PB believes its advantage over peers include its one-stop solutions in both hardware and software (many peers offer just SD-WAN software where clients have to source their own hardware).

Figure 1: Financial Summary

	FY13A	FY14A	FY15A	FY16A
<b>Revenue</b>	<b>13,306</b>	<b>17,946</b>	<b>21,860</b>	<b>28,358</b>
Operating Profit	3,012	4,289	5,142	7,950
<b>Underlying Profit</b>	<b>2,565</b>	<b>3,743</b>	<b>4,358</b>	<b>6,492</b>
<b>Underlying EPS (USD)</b>	<b>0.003</b>	<b>0.005</b>	<b>0.006</b>	<b>0.007</b>
Underlying EPS growth (%)	0.0	45.9	16.4	28.8
P/E (x)	27.1	18.6	16.0	12.4
P/B (x)	10.6	10.5	9.8	3.2
Dividend Yield (%)	1.9	5.3	4.0	5.9
ROE (%)		56.8	63.6	40.2
<b>Net debt/equity (%)</b>	<b>(54.1)</b>	<b>(48.2)</b>	<b>(67.8)</b>	<b>(95.9)</b>

Source: Company data, Guosen Securities (HK) Research

Hong Kong TMT  
Technology

03 March 2017 Non rated

Target price N/A

Last price (1 Mar 17) **HKD0.72**

Upside/downside (%)

HSI 23776.49

Mkt cap (HKDm/USDm) 720/92.8

52 week range (HKD) 0.40 - 0.80

Avg trading volume daily (USDm) 0.6

Free float (%)

Source: Bloomberg

### Performance



Source: Bloomberg

Performance	1M	3M	12M
Absolute (%)	28.6	33.3	
Absolute (USD, %)	28.5	33.2	
Relative to HSI (%)	26.6	29.4	

Source: Bloomberg

### Company background

Plover Bay Technologies Limited designs, develops, markets and sells both wired and wireless SD-WAN router products and services. The Company offers its products and services to numerous industries around the world including the transportation, retail, and education markets.

Source: Bloomberg

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## Quick recap on FY16 results

Figure 2 FY16 results summary

FY-Dec 31 (USD thousands	FY15	FY16A	YoY	FY16F	Var	Comments
Revenue	21,860	28,358	30%	26,459	7%	
Gross profit	12,693	17,945	41%	16,664	8%	
GPM	58.1%	63.3%	+5.2ppt	63.0%	+0.3ppt	
Total opex	-7,551	-9,995	32%	-8,649	16%	Due to one-off IPO related spending
Profit before tax	4,140	6,675	61%	6,815	-2%	Tax rate of 21.5%. Should be 18% if listing fee excluded
Core net profit	4,358	6,492	49%	6,756	-4%	

Source: Company data, Guosen Securities (HK) Research

## Highlights from the road show:

- Management believes SD-WAN market is at an early stage of growth. According to Gartner, SD-WAN adoption will reach 50% by 2020 (from current ~5%) while IDC expects the SD-WAN market to grow at 90% CAGR from 2015-2020.
- SD-WAN's core value propositions are rapid deployment, mobility and cost savings compared to traditional fixed networking methods. Rapid deployment, mobility and reliability are key concerns for industrial networking, while cost savings over traditional networks is an important attribute for enterprise customers.
- PB's future strategy is to focus on industrial networking, where reliability (eg. network stability, extreme operating temperatures, waterproof and impact resistance etc.) is a primary concern and pricing is often secondary. It currently serves end users in mainly four verticals (transportation, public safety, maritime and unmanned systems) including global leading internet companies, driverless cars and overseas security forces. In these use cases, unbreakable internet connection is often the key requirement. In 2017, it aims to expand into streaming/ professional broadcasting market by working with JVC, which could be disruptive as current satellite broadcasting is much more expensive. It will also launch a router capable of carrying 14 LTE connections aimed at high-end users, which is a first in the market.
- Management highlighted that PB's expertise is in product development and maintains no in-house sales & marketing or manufacturing. With a relatively fixed cost base (mainly R&D salary and office rent), we believe PB's op. margin should scale well with top line growth.
- Management also explained that by going public, i) increased transparency on PB would help secure new orders from large customers and suppliers and ii) enables share-based compensation to employees to help motivate, attract and retain talents in the long run
- Management has no fixed dividend policy, but commits to pay as much dividend as possible

## Market concerns:

- Sustainability of its ASPs / margins and potential competition - PB expects ASP and margins to stay stable because i) industrial networking customers tend to be reluctant to switch suppliers due to time needed for re-certification and potential unforeseen reliability issues with new suppliers, and ii) even though management does not rule out taking bulk orders that may dilute GPM, these bulk orders should be positive to operating margin due to operating leverage. Regarding potential competition, PB believes its core competency over peers include its one-stop solutions in both hardware and software (many peers offer just SD-WAN software where clients have to source their own hardware).
- Limited order visibility – due to its sole reliance on third party distributors who tend to run a just-in-time approach to managing their inventories, PB's order visibility is limited to 1-3 months. The company's target is to grow FY17 revenue by at least 25% YoY. We believe this is achievable given the favorable adoption trend in SD-WAN.

## Summary financial statements (Year to Dec 31)

<b>Profit &amp; Loss (USDt)</b>	<b>FY13A</b>	<b>FY14A</b>	<b>FY15A</b>	<b>FY16A</b>
<b>Revenue</b>	<b>13,306</b>	<b>17,946</b>	<b>21,860</b>	<b>28,358</b>
Revenue growth (%)	0.0	34.9	21.8	29.7
Cost of sales	(4,655)	(6,910)	(9,166)	(10,413)
<b>Gross profit</b>	<b>8,651</b>	<b>11,036</b>	<b>12,693</b>	<b>17,945</b>
Other income/(expense)	34	306	69	104
Operating expenses	(5,672)	(7,053)	(7,620)	(10,099)
<b>Operating profit</b>	<b>3,012</b>	<b>4,289</b>	<b>5,142</b>	<b>7,950</b>
Operating profit growth (%)	0.0	42.4	19.9	54.6
Other non-operating inc/(exp)	0	0	(1,001)	(1,252)
Finance income	0	0	0	0
Finance expenses	(4)	(4)	(1)	(23)
Associates & JCE	0	0	0	0
<b>Profit before taxation</b>	<b>3,009</b>	<b>4,285</b>	<b>4,140</b>	<b>6,675</b>
Taxation	(444)	(542)	(783)	(1,435)
Non-controlling interests	0	0	0	0
<b>Net profit</b>	<b>2,565</b>	<b>3,743</b>	<b>3,357</b>	<b>5,240</b>
Other Adjustments on UP	0	0	1,001	1,252
<b>Underlying Profit</b>	<b>2,565</b>	<b>3,743</b>	<b>4,358</b>	<b>6,492</b>
Underlying profit growth (%)	0.0	45.9	16.4	49.0
EPS (USD)	0.003	0.005	0.004	0.006
<b>Underlying EPS (USD)</b>	<b>0.003</b>	<b>0.005</b>	<b>0.006</b>	<b>0.007</b>
Underlying EPS growth (%)	0.0	45.9	16.4	28.8
DPS (USD)	1.73	4.94	3.73	5.44
DPS growth (%)	0.0	185	(24.4)	45.7

Source: Company data, Guosen Securities (HK) Research

<b>Balance Sheet (USDt)</b>	<b>FY13A</b>	<b>FY14A</b>	<b>FY15A</b>	<b>FY16A</b>
Fixed assets	446	595	556	518
Associates & JCE	0	0	0	0
Others	56	90	277	508
<b>Non-current assets</b>	<b>502</b>	<b>685</b>	<b>833</b>	<b>1,026</b>
Inventories	2,585	3,651	4,138	4,279
Debtors & prepayments	2,136	3,328	3,857	4,662
Bank deposits & cash	4,133	3,696	6,062	25,171
Others	1,393	816	459	459
<b>Current assets</b>	<b>10,247</b>	<b>11,491</b>	<b>14,516</b>	<b>34,571</b>
Bank & other borrowings	59	60	1,239	1,000
Trade & payables	1,514	1,983	1,045	2,140
Taxation	342	499	516	516
Others	1,503	1,922	4,661	5,724
<b>Current liabilities</b>	<b>3,418</b>	<b>4,464</b>	<b>7,460</b>	<b>9,380</b>
Bank & other borrowings	517	455	0	0
Others	237	660	776	1,019
<b>Non-current liabilities</b>	<b>754</b>	<b>1,116</b>	<b>776</b>	<b>1,019</b>
<b>Net assets</b>	<b>6,577</b>	<b>6,596</b>	<b>7,113</b>	<b>25,198</b>
Share capital	0	0	0	1,285
Premium & reserves	6,577	6,596	7,113	23,913
<b>Shareholders' funds</b>	<b>6,577</b>	<b>6,596</b>	<b>7,113</b>	<b>25,198</b>
<b>Non-controlling interests</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>
<b>Total equity</b>	<b>6,577</b>	<b>6,596</b>	<b>7,113</b>	<b>25,198</b>
<b>BVPS (USD)</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Source: Company data, Guosen Securities (HK) Research

<b>Financial Ratios</b>	<b>FY13A</b>	<b>FY14A</b>	<b>FY15A</b>	<b>FY16A</b>
Gross profit margin (%)	65.0	61.5	58.1	63.3
Operating profit margin (%)	22.6	23.9	23.5	28.0
Underlying profit margin (%)	19.3	20.9	19.9	22.9
Net debt/equity (%)	(54.1)	(48.2)	(67.8)	(95.9)
Net debt/total assets (%)	(33.1)	(26.1)	(31.4)	(67.9)
Current ratio (%)	300	257	195	369
Dividend payout (%)	50.7	98.9	64.2	72.7
Interest cover (x)	828	969	3,934	346
Dividend cover (x)	2.0	1.0	1.6	1.4
Acct. receivable turnover days		55.6	60.0	54.8
Acct. payable turnover days		92.4	60.3	55.8
Inventory turnover days		164.7	155.1	147.5
Cash cycle days		127.9	154.8	146.5
<b>Dupont Analysis</b>	<b>FY13A</b>	<b>FY14A</b>	<b>FY15A</b>	<b>FY16A</b>
Tax burden (%)	85.3	87.3	81.1	78.5
Interest burden (%)	99.9	99.9	80.5	84.0
Operating profit margin (%)	22.6	23.9	23.5	28.0
Asset turnover (x)		1.6	1.6	1.1
Leverage ratio (x)		1.7	2.0	1.6
<b>ROA (%)</b>	<b>32.7</b>	<b>31.7</b>	<b>25.5</b>	
<b>ROE (%)</b>	<b>56.8</b>	<b>63.6</b>	<b>40.2</b>	

Source: Company data, Guosen Securities (HK) Research

<b>Cashflow (USDt)</b>	<b>FY13A</b>	<b>FY14A</b>	<b>FY15A</b>	<b>FY16A</b>
EBIT	3,012	4,289	5,142	7,950
Depreciation & amortization	201	244	332	525
Interest expense	(4)	(4)	(1)	(23)
Change in working capital	(221)	(1,134)	(712)	1,455
Tax paid	(103)	(358)	(777)	(1,435)
Other operating cashflow	187	52	(965)	(1,252)
<b>Operating activities</b>	<b>3,073</b>	<b>3,089</b>	<b>3,018</b>	<b>7,220</b>
Capex	(238)	(352)	(215)	(320)
<b>Free cash flow</b>	<b>2,835</b>	<b>2,736</b>	<b>2,803</b>	<b>6,900</b>
Disposal of non-current assets	2	0	0	0
Associates & JCE (net)	0	0	0	0
Interest received	13	7	0	0
Dividends received	0	0	0	0
Other investing cashflow	204	476	(700)	(397)
<b>Investing activities</b>	<b>(19)</b>	<b>130</b>	<b>(915)</b>	<b>(717)</b>
New loans raised	0	0	1,239	(239)
Repayment of loans	0	0	0	0
Dividends paid	(1,300)	(3,701)	(2,800)	(3,222)
Other financing cashflow	13	66	1,764	16,067
<b>Financing activities</b>	<b>(1,287)</b>	<b>(3,635)</b>	<b>203</b>	<b>12,607</b>
<b>Inc/(dec) in cash</b>	<b>1,766</b>	<b>(416)</b>	<b>2,306</b>	<b>19,109</b>
Cash at beginning of year	2,365	4,133	3,696	6,062
Foreign exchange effect	1	(20)	60	0
<b>Cash at end of year</b>	<b>4,133</b>	<b>3,696</b>	<b>6,062</b>	<b>25,171</b>

Source: Company data, Guosen Securities (HK) Research

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