

Plover Bay

Trade war risk is contained; warranty and support services become new drivers

Slow revenue growth in 1H18, gross margin expansion is the bright spot

Plover Bay reported 1H18 revenue of US\$19.7m, which grew by only 10.9% YoY. Sales to North America and EMEA grew by 22.1% and 25.1% YoY to US\$11.6m and US\$4.8m thanks to wide SD-WAN adoption across different segments including public transport, public safety and IoT applications. However, sales in Asia dropped 25.7% YoY to US\$2.9m due to project delay in Malaysia which dragged the overall growth rate. SD-WAN router sales recorded disappointing growth of 5.5% to US\$14.7m in 1H18 due to the delay of project in Malaysia, however, revenue from warranty and support services increased 35.1% to US\$4.2m on increasing SD-WAN customer bases, 1H18 gross margin improved 4.1ppt to 63.1% HoH thanks to 1) improving margin from SD-WAN router products and 2) an increase in revenue contribution from high-margin software licenses and warranty and support services. 1H18 net profit came in at US\$4.7m, up 14.7% YoY. Interim DPS of HK\$0.0292 was proposed, implies a generous payout of 80%, the same as last year.

Warranty and support service business became new drivers

Plover Bay provides one year free warranty and technical support to SD-WAN products, and will charge service fee afterwards. As the client base grows and requirement of extended services or warranties, warranty and support services are becoming an important source of income. We expect warranty and support services sales to grow 40.4% yoy to US\$9.3m in FY18 and contribute 20.9% of total revenue. Warranty and support service business' gross margin reached 89.1% in 1H18, an increasing sales portion from this segment will help improving overall margins.

Trade war impacts can be minimized by shifting some production to Taiwan

According to the list of proposed tariffed goods published by the US Trade Representative on 11 Jul, SD-WAN routers belong to a subcategory of goods being imposed with 10% tariff. As in 1H18, sales to North America (mostly the US) accounted for 58.9% of Plover Bay's revenue, while SD-WAN business accounted for 74.3% of revenue. Hence, we estimate 43.7% of total revenue was generated from SD-WAN product sales to the US, thus the proposed tariff will have meaningful financial impact on the company when the tariffs become effective on 30 Aug. Plover Bay has EMS contractors in both Dongguan and Taiwan while Dongguan contractors are responsible for SD-WAN products which mostly shipped to the US. The company took measure to minimize the US tariff impacts by shifting US-bound products to contractors in Taiwan. Production shifting between Taiwan and Dongguan contractors is expected to be completed by Sep while the company has enough inventories to fulfill market demand during the transitional period. Management stated the manufacturing cost in Taiwan and PRC is similar.

Currently trading at 15.8x FY18 PE, dividend yield is expected to be 5.9%

We assume Plover Bay to report 20.2% YoY in FY18 revenue growth on 1) increasing SD-WAN demand from various industries; and 2) strong growth momentum from warranty and support services. On the assumption that GPM in FY18 to improve to 63.6% on increasing sales proportion from warranty and support business and relatively stable opex to revenue ration, we estimate earnings in FY18 would be US\$10.9m (+25.0% YoY). Based on this rough estimate, the counter is trading at 15.8x FY18 PE. With strong operating cash inflow, which amounted to US\$11.3m in 1H18, we expect the company will maintain 90% payout in FY18. Dividend yield for FY18 is expected to be 5.9%.

Risk factor: Despite the US tariff risk is contained by shifting production to Taiwan, the investment atmosphere in SD-WAN market may be affected if global trade war intensified.

NON RATED

Last Price (HK\$)*	1.28
Target Price (HK\$)	N/A
Upside / (Downside)(%)	N/A
Previous rating	Non Rated
Previous TP	N/A
Hang Seng Index*	28,583.01
*Prices as of	31-7-2018

Key Data

Ticker	1523 HK
Market Cap (HK\$m)	1,302
3M avg Daily T/O (HK\$m)	1.2
52-week High/Low (HK\$)	2.40/ .98
Free Float (%)	25.7%
Shares O/S (m)	1,016.8

Performance Absolute Relative

1 month	-2.3%	-1.0%
3 months	-22.4%	-16.6%
6 months	-31.9%	-22.3%

Price Chart



Source: Bloomberg

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Figure 1 Income statement assumptions

Year ended 31 Dec (USD '000)	2016	2017	2018E	1H17	2H17	1H18	2H18E
SD-WAN routers	21,978	29,305	33,875	13,899	15,406	14,657	19,218
YoY%	24.4%	33.3%	15.6%	55.2%	18.3%	5.5%	24.7%
Wired	7,687	7,932	8,733	4,067	3,865	4,056	4,677
YoY%	10.0%	3.2%	10.1%	24.3%	-12.4%	-0.3%	21.0%
wireless	14,291	21,373	25,143	9,832	11,541	10,601	14,542
YoY%	33.7%	49.6%	17.6%	72.9%	34.1%	7.8%	26.0%
Warranty and support services	5,189	6,652	9,338	3,114	3,538	4,208	5,130
YoY%	32.9%	28.2%	40.4%	22.8%	33.4%	35.1%	45.0%
Software licenses	1,191	1,175	1,423	775	400	863	560
YoY%	322.3%	-1.3%	21.1%	43.8%	-38.7%	11.4%	40.0%
Turnover	28,358	37,132	44,636	17,788	19,344	19,728	24,908
YoY%	29.7%	30.9%	20.2%	47.8%	18.5%	10.9%	28.8%
COGS	(10,413)	(14,157)	(16,246)	(7,286)	(6,871)	(7,279)	(8,967)
Gross profit	17,945	22,975	28,390	10,502	12,473	12,449	15,941
Gross profit margin	63.3%	61.9%	63.6%	59.0%	64.5%	63.1%	64.0%
R&D	(4,990)	(7,189)	(8,169)	(3,268)	(3,921)	(3,511)	(4,658)
As % of rev	17.6%	19.4%	18.3%	18.4%	20.3%	17.8%	18.7%
Selling & Distribution	(1,697)	(1,636)	(2,303)	(637)	(999)	(1,058)	(1,245)
As % of rev	6.0%	4.4%	5.2%	3.6%	5.2%	5.4%	5.0%
Admin. Expenses	(3,412)	(3,958)	(4,657)	(1,974)	(1,984)	(2,166)	(2,491)
As % of rev	12.0%	10.7%	10.4%	11.1%	10.3%	11.0%	10.0%
Opex	(10,099)	(12,783)	(15,129)	(5,879)	(6,904)	(6,735)	(8,394)
As % of rev	35.6%	34.4%	33.9%	33.1%	35.7%	34.1%	33.7%
Operating profit	7,846	10,192	13,261	4,623	5,569	5,714	7,547
Operating profit margin	27.7%	27.4%	29.7%	26.0%	28.8%	29.0%	30.3%
Listing expenses	(1,252)	0	0	0	0	0	0
Other income	104	463	208	369	94	83	125
As % of rev	-0.4%	-1.2%	-0.5%	-2.1%	-0.5%	-0.4%	-0.5%
Other revenue, gains / losses	(1,148)	463	208	369	94	83	125
Finance cost	(23)	(26)	(42)	(11)	(15)	(21)	(21)
Pre-tax profit	6,675	10,629	13,427	4,981	5,648	5,776	7,651
Tax expenses	(1,435)	(1,875)	(2,487)	(846)	(1,029)	(1,033)	(1,454)
Effective Tax rate	21.5%	17.6%	18.5%	17.0%	18.2%	17.9%	19.0%
Minority Interests	0	0	0	0	0	0	0
Reported net profit	5,240	8,754	10,940	4,135	4,619	4,743	6,197
YoY%	56.1%	67.1%	25.0%	47.6%	89.4%	14.7%	34.2%
Reported net profit margin	18.5%	23.6%	24.5%	23.2%	23.9%	24.0%	24.9%
Recurring net profit	6,492	8,754	10,940	4,135	4,619	4,743	6,197
YoY%	49.0%	34.8%	25.0%	23.9%	46.4%	14.7%	34.2%
Recurring net profit margin	22.9%	23.6%	24.5%	23.2%	23.9%	24.0%	24.9%

Source: Company, Crosby Securities

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