Hardware & Networking

Optical Pullback on Recent CPO Concerns Getting Overblown; Reit. OW on COHR & LITE

IT Hardware/ Telecom & Networking Equipment

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Shares of optical suppliers such as Coherent and Lumentum are trading down nearly -20% from early-June highs (vs. -5% for S&P 500), weighed down by a host of concerns that began with limited summer catalysts following strong year-to-date runs and have been exacerbated more recently by worries around delays in CPO adoption. While we understand the former, which led us to favor copper companies following OFC (see report here), given our expectations for relative underperformance in optical on valuation grounds (*and better-than-feared outcomes for copper*), we believe the latter is likely overblown, particularly in light of our recent checks, which suggest an on-track, if not better, ramp of Nvidia's CPO for key suppliers. Importantly, with these dynamics driving an outsized pullback in shares, we see a more interesting setup emerging as once-lofty optical premiums begin to look more palatable to investors. For example, shares of Coherent and Lumentum are now trading at an average ~25x consensus CY28 earnings (*and likely even lower on buyside expectations*) despite earnings growth forecasts of 40%+, implying <1x PEG ratio, well below the valuation multiples we have seen investors willing to pay for these names recently. Thus, with shares appearing more attractive from a valuation perspective, and given our expectation for continued upside in both CPO as well as other areas of the portfolios (*TRx, DCI, EMLs, etc.*), we would view the sell-off as a buying opportunity and reiterate our OW rating on both Coherent and Lumentum.

- **Nvidia CPO ramp remains unchanged and, if anything, tracking better.** Based on recent discussions with key suppliers, and feedback from checks at Computex, the ramp of Nvidia's scale-out CPO in 2H26 is tracking better than expected. For example, Lumentum noted that CPO-supported switch mix from Nvidia is now trending greater than 50% (vs. 40%–50% prior), with demand from Tier 2s and Neoclouds increasingly accompanied by emerging interest from select hyperscalers. As a result, Nvidia is looking to actively source additional InP capacity from Lumentum, prompting the company to suggest that another new sixth fab could be on the horizon even before the current new one ramps.
- **Expect laser content to benefit whether customers pursue NPO or CPO solutions.** Investors have also expressed concerns that NPO solutions could push out the adoption of CPO, with potential implications for suppliers like Coherent and Lumentum; however, we view the impact as limited as the content opportunity for laser suppliers will remain solid whether customers adopt a NPO or CPO solution. In our view, the bigger swing factor is instead scale-up adoption, which we expect to remain unchanged relative to the inter- and intra-rack opportunities in 2028 and beyond, with the timing of scale-up giving the supply chain enough runway to work through any yield issues that surface during the lower-volume deployments of scale-out CPO.
- **NPO / CPO interest broadening beyond Nvidia's solution; albeit, timeline**

See page 3 for analyst certification and important disclosures.

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remains toward the latter part of the decade. Beyond Nvidia, interest in NPO and CPO solutions is starting to build across hyperscalers (ex-Google) and chipset suppliers, which would be additive to current forecasts in our view, given that Nvidia likely accounts for the majority of existing outlooks. For example, Lumentum has already signaled expectations for a "near-term" ELS win from a non-Nvidia customer looking for a turnkey pluggable solution.

- **Addition of Innolight and Eoptolink to Pentagon list could materialize into a potential tailwind for COHR and LITE's TRx demand.** The DoD published an updated 1260H list, adding leading Chinese transceiver suppliers Innolight and Eoptolink. While the designation likely carries no direct implications given their limited DoD exposure, it could create second-order headwinds, such as an accelerated move by U.S. hyperscalers and others to source supply from alternative manufacturers, like U.S.-based and vertically integrated Coherent and Lumentum, driven by plans to de-risk supply chains should the designation prove a precursor to broader restrictions.