

Buy on overreaction with 2H margin recovery

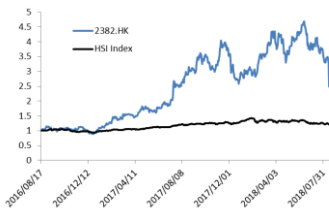
Sunny Optical (2382.HK)

Technology hardware

Stock Rating	Buy
Industry View	Overweight
Price target	HKD108.9
Up/downside	+21.3%
Close price	HKD89.75
52-Week	HKD86.6-174.9
18EPS	RMB3.04
18EPS growth	7.8%
18PE	31.5X
Market cap	HKD98.456bn

Source: Bloomberg, CASH

Relative performance chart



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Weak 2H results: 1H18 earnings of RMB1.18bn (-32% HoH, +2% YoY) were 22% lower than market consensus with weaker gross margin of camera module and FX loss (USD600mn debts issued in January leading to Rmb130mn FX loss owing to RMB depreciation). 1H18 operating profit of Rmb1.5bn (+20% YoY, -17% HoH) was 11% lower than market consensus.

Camera module: Shipment increased 16% YoY in 1H18. The company expects shipment to rise 20% YoY for the full year given previous guidance of 15-20% YoY. 10MP+ unit mix improved to 78% in 1H18 (from 64% in 1H17). Dual camera adoption rate was 20%, similar to 1H17. GPM declined YoY due to (1) rising cost of CMOS sensor denominated in USD due to RMB depreciation, (2) pricing competition on legacy products with little contribution from bigger aperture, triple camera in 1H18 and (3) short-term disruption because of internal process re-engineering and personnel structure adjustment and (4) low loading rate for the newly built capacity. **The ASP/GPM of handset CCM in 2H18 will improve due to tri-cam solutions and efficiency gain.**

Handset lens: Shipment was up 54% YoY in 1H18. The company revises up full year guidance to 45-50% YoY growth (previous: 30-35% YoY). 10MP+ unit mix expanded to 52% in 1H18 (from 43% in 1H17). Handset lens GPM improved YoY. **The ASP of handset lens in 2H18 will improve further due to tri-cam/3D sensing solutions.**

Vehicle lens: Shipments increased 18% YoY in 1H18, lower than full-year guidance of 30-35% YoY growth. Vehicle lens GPM declined YoY on RMB appreciation from January to April given its high exposure to overseas customers (Magna, Continental, Bosch etc.). **The GPM trend should be reversed in 2H due to RMB depreciation.**

1H margin pressure but recover in 2H18: Management said that GPM YoY decline is due to internal factors, such as lower production efficiency (attributed by ongoing process optimization), lower utilization rate on new capacity built and personnel structure realignment with external factors including competition owing to lack of product upgrade and FX. Management also receives active feedback from clients for

triple camera and 3D sensing carrying higher ASP/margins in 2H18. In near-term, the likely adoption of triple camera from Huawei Mate20, OPPO R17 Pro, OnePlus 6T, Vivo Xplay 7 and Samsung Galaxy S10 may drive better user experience, accelerating the penetration rate of triple cam. On the production line side, automation can also improve long-term profitability.

Stronger capex guidance: The Company spent Rmn1bn capex in 1H2018 and raised full-year capex guidance to Rmb2.6bn (from Rmb2bn). Full year handset lens capex was now raised to Rmb1.2bn (previous: Rmb800mn-900mn) with handset lens capacity to expand to 120mn per month from 90mn per month. Camera module and auto lens capex maintained at Rmb700mn and Rmb200mn respectively. New production base was around Rmb600mn (previous: Rmb400mn). We think this shows management's confidence on handsets lens business triggered by triple camera and 3D sensing trend.

High entry barrier of lens market: Sunny said that the entry barrier for lens is higher compared with CCM due to technology know-how and IP protection. Sunny Optical has obtained 757 patents with 123 patents newly added in 1H18. Key R&D achievements include (1) 16MP ultra-wide angle lens, (2) lens with f/1.5 aperture and (3) f/1.4 aperture with 7P lens, (4) 3D sensing collimating lens sets and (5) 24MP miniaturized head handset lens sets.

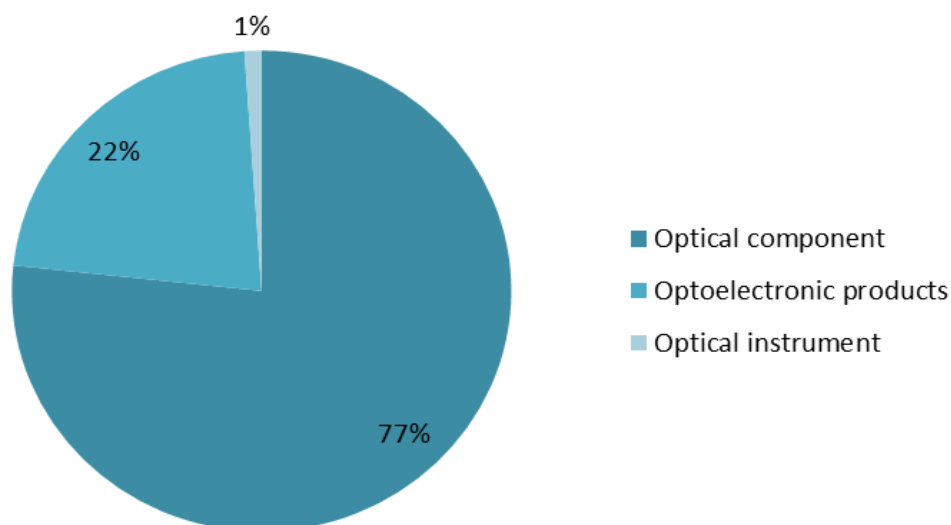
Reiterate its leading position in vehicle lens/modules market: The vehicle camera modules for a world well-known Tier 1 customer have commenced mass production in Aug. Demand for sensing camera and surround view is growing fast. Also, Sunny has its own comparative advantage to peers in this new market: (1) technology dominance and experiences in working with automotive customers in the industry; and (2) experiences in packaging learnt from handset CCM production.

Retain Buy with target price HKD108.9: We reiterate buy with TP lowered to HKD108.9 from HKD200 based on PEG=0.58 (around 10-year average), implying a 21.3% upside. We believe Sunny will have room for upside earning revisions and re-rating from the current PE given its long-term growth on triple cams, 3D sensing ability, strengthened capabilities in vehicles lens, and penetration into vehicles modules market.

Background

Sunny Optical, which was established in 1984, is a leading supplier of optical-related products in China with strong design and production capabilities (manufacture both lenses (5MP/8MP/13MP/16MP/20MP) and modules (5MP/8MP/13MP/16MP/OIS and 3D). The group is mainly engaged in three business segments: 1) Optical components (Defocus Control lens, handset lens and vehicle lens); 2) Optoelectronic products (handset camera modules); 3) Optical instruments (microscopic instruments and analytical instruments). It has a diversified customer mix, including Huawei, Samsung, Xiaomi, OPPO, Lenovo with 5 production bases in China, as well as R&D centers in China, Singapore, South Korea and the US.

Figure: Sunny Optical's revenue exposure in 2018H1



Source: CASH, Company data

Key data on Sunny Optical

Compact Camera Module Shipment (in mn units) and YoY

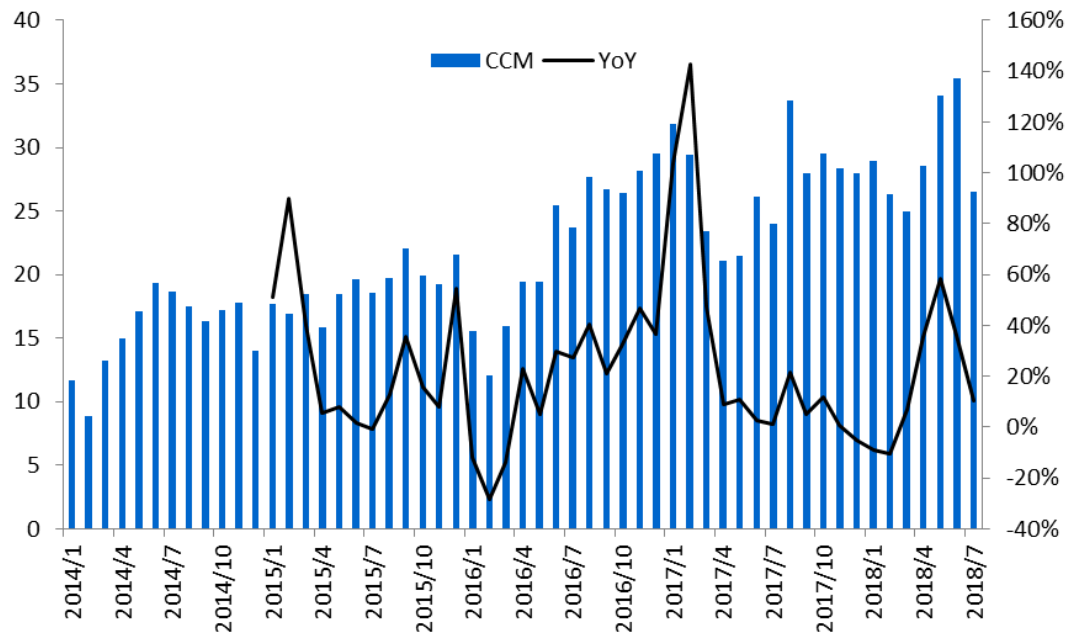
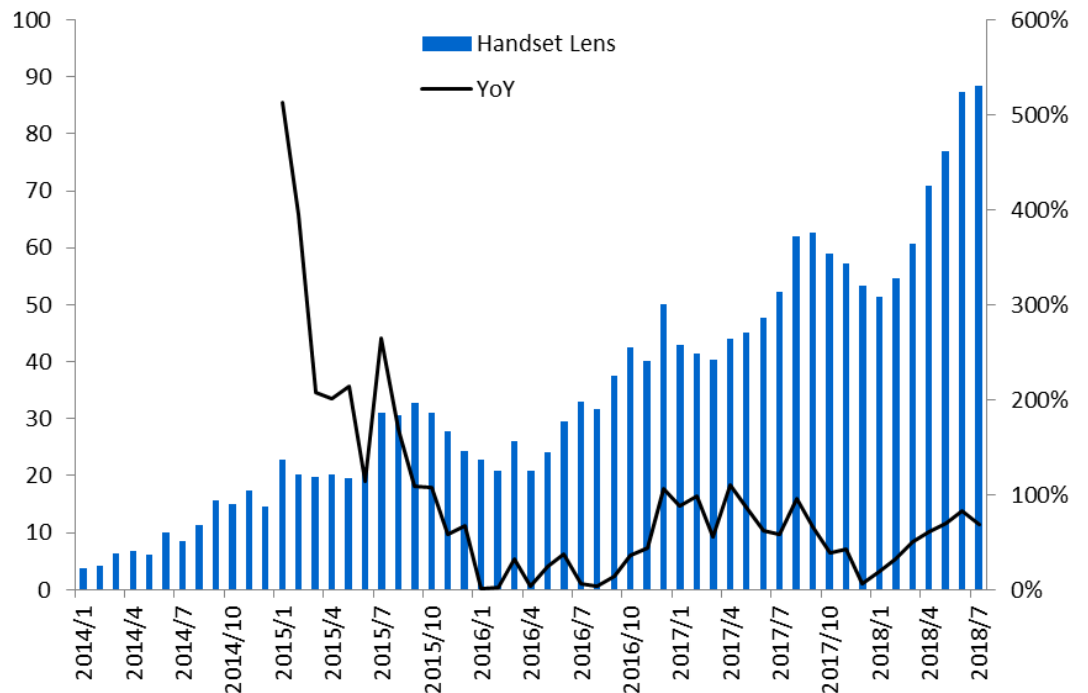
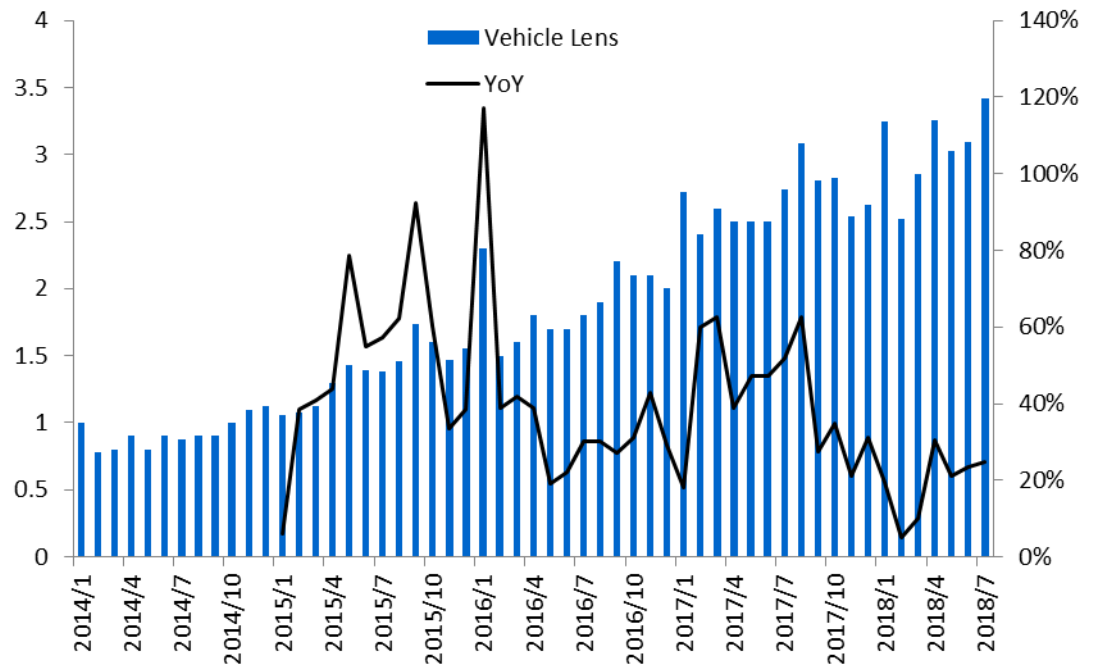


Figure: Handset Lens Shipment (in mn units) and YoY



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Figure: Vehicle Lens Shipment (in mn units) and YoY



Source: Company data, CASH

Sunny Optical

Income Statement (thousands RMB\$)					
Year-end 31 Dec	FY16	FY17	FY18E	FY19E	FY20E
Revenue	14,612	22,366	26,937	38,104	50,611
Cost of goods sold	-11,932	-17,563	-20,976	-29,172	-38,083
Gross profit	2,680	4,803	5,961	8,932	12,528
SG&A	-1,205	-1,420	-2,097	-2,923	-3,849
R&D	-694	-1,168	-1,436	-2,107	-2,900
Other expense	-26	343	-26	-26	-26
Employee share expense	0	0	0	0	0
Operating profit	1,475	3,383	3,864	6,009	8,679
EBITDA	1,792	3,874	4,462	6,855	9,803
Depreciation	-317	-491	-598	-846	-1,124
Amortization	-0	-44	-18	-25	-33
EBIT	1,475	3,383	3,864	6,009	8,679
Net interest expense	-16	-49	-283	-313	-319
Associates & JCEs	-12	-16	-16	-16	-16
Other income	0	0	0	0	0
Earnings before tax	1,447	3,318	3,565	5,680	8,344
Income tax	-175	-404	-424	-676	-994
Net profit After tax	1,272	2,914	3,141	5,004	7,351
Minority interests	-3	-13	-13	-13	-13
Other items	0	0	0	0	0
Preferred dividends	0	0	0	0	0
Normalised NPAT	1,269	2,902	3,128	4,991	7,338
Extraordinary items	0	0	0	0	0
Reported NPAT	1,269	2,902	3,128	4,991	7,338
Dividends	-228	-318	-343	-547	-805
Transfer to reserves	1,041	2,583	2,785	4,444	6,534
EPS	1.16	2.64	2.85	4.55	6.69
DPS	0.21	0.29	0.31	0.50	0.73

Cashflow statement (thousands RMB\$)					
Year-end 31 Dec	FY16	FY17	FY18E	FY19E	FY20E
Net income	1,269	2,902	3,128	4,991	7,338
Depreciation	317	491	598	846	1,124
Amortization	0	44	18	25	33
Change in Net Working Capital	-323	-954	145	-869	-995
Cashflow from operations	1,616	2,436	3,889	4,993	7,500
Capital expenditures	-400	-1,766	-2,600	-2,000	-2,000
Other non current assets	-47	-587	0	0	0
Other non current liabilities	13	437	0	0	0
CF from investing acts	-1,260	-1,686	-2,600	-2,000	-2,000
CF after investing acts	356	750	1,289	2,993	5,500
Equity issue	-167	22	-13	-13	-13
Debt issue	221	444	4,313	597	116
Convertible debt issue	0	0	0	0	0
Dividends	-228	-318	-343	-547	-805
CF from financial acts	-81	12	3,957	37	-701
Net cashflow	274	762	5,246	3,030	4,799
Beginning cash	187	467	1,227	6,473	9,503
Adjustments	6	-2	0	0	0
Ending cash	467	1,227	6,473	9,503	14,302
Ending net debt	437	121	-812	-3,246	-7,928

Source: Company data, CASH

2382.HK, Buy, TargetPrice: 108.9

Balance Sheet (thousands RMB\$)					
Year-end 31 Dec	FY16	FY17	FY18E	FY19E	FY20E
Cash & equivalents	467	1,227	6,473	9,503	14,302
Marketable securities	2,302	2,114	2,114	2,114	2,114
Accounts receivable	3,716	5,666	7,063	9,991	12,984
Inventories	2,828	2,622	3,014	4,192	6,391
Other current assets	5	7	10	14	18
Total current assets	9,318	11,635	18,673	25,814	35,808
LT investments	177	308	308	308	308
Fixed assets	1,794	2,586	4,588	5,742	6,618
Goodwill	0	0	0	0	0
Other intangible assets	0	392	375	350	317
Other LT assets	348	804	804	804	804
Total assets	11,637	15,726	24,749	33,018	43,856
ST debt	904	1,348	1,667	1,667	1,667
Accounts payable	5,573	6,183	8,008	11,137	15,244
Other current liabilities	181	175	287	399	493
Total current liabilities	6,658	7,705	9,962	13,203	17,403
LT debt	0	0	3,994	4,591	4,707
Convertible debt	0	0	0	0	0
Other LT liabilities	65	502	502	502	502
Total liabilities	6,723	8,207	14,457	18,295	22,612
Minority interest	18	31	18	6	-7
Preferred interest	0	0	0	0	0
Common stock	105	105	105	105	105
Retained earnings	3,949	6,532	9,317	13,761	20,295
Proposed dividend	-228	-318	-343	-547	-805
Other equity and reserves	841	851	851	851	851
Total shareholders' equity	4,913	7,519	10,292	14,723	21,244
Total equity & liabilities	11,637	15,726	24,749	33,018	43,856

Key Ratios					
Year-end 31 Dec	FY16	FY17	FY18E	FY19E	FY20E
Growth (%)					
EPS	66.7%	128.6%	7.8%	59.6%	47.0%
Revenue	36.6%	53.1%	20.4%	41.5%	32.8%
Profitability (%)					
Gross margin	18.3%	21.5%	22.1%	23.4%	24.8%
EBITDA margin	12.3%	17.3%	16.6%	18.0%	19.4%
EBIT margin	10.1%	15.1%	14.3%	15.8%	17.1%
Net Margin	8.7%	13.0%	11.7%	13.1%	14.5%
Effective tax rate	12.1%	12.2%	11.9%	11.9%	11.9%
Dividend payout	18.0%	11.0%	11.0%	11.0%	11.0%
ROE	26.0%	38.9%	30.6%	34.0%	34.6%
ROA	10.9%	18.5%	12.6%	15.1%	16.7%
Liquidity (x)					
Current ratio	1.40	1.51	1.87	1.96	2.06
Interest coverage	91.17	69.33	13.65	19.21	27.24
Leverage					
Net Debt/EBITDA (x)	0.24	0.03	net cash	net cash	net cash
Net Debt/Equity (%)	0.09	0.02	net cash	net cash	net cash
Activity (days)					
Days receivable	92.8	92.5	95.7	95.7	93.6
Days inventory	70.7	42.8	40.8	40.2	46.1
Days payable	139.2	100.9	108.5	106.7	109.9
Cash cycle	24.3	34.3	28.0	29.2	29.8

Source: Company data, CASH

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