

Sunny Optical Technology (2382 HK)

 Target price: **HKD29.00** (from HKD26.70)

 Share price (20 Jun): **HKD25.30** | Up/downside: **+14.6%**

 5 4 3 **2** 1

Outperform
 (unchanged)

Highlights from site visit: confident of strong 2016

- Sunny remains upbeat on 2016, with guidance unchanged
- Benefiting from favourable industry trends, new opportunities ahead
- Reiterating Outperform (2), with target price raised to HKD29

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What's new: We joined Sunny's factory tour in Zhejiang, China, on 17-18 June and came away impressed by the long-term vision, comprehensive product roadmap, and in-house equipment R&D capability on display.

What's the impact: Confident tone for 2016. Management is upbeat on the 2016 outlook and kept its 2016 shipment guidance unchanged: handset camera module (HCM) up 15-25% YoY, handset lens sets (HLS) up 20-30% YoY, and vehicle lens sets (VLS) up 30%-plus YoY. The company's positive tone for 2016 should relieve some investors' concerns over HLS and HCM after the slow shipments of January-May (HLS up 12% YoY, HCM down 6% YoY), and echoes our earlier point that we expect Sunny to have a backend-loaded 2016 thanks to a ramp-up of shipments for new projects wins and spec upgrades in 2H16 (see [On track for a robust 2016](#)).

Favourable industry trends ahead. For the handset business, Sunny sees dual cams as an important emerging trend and believes it is well-positioned to benefit. For HCM, Sunny sees itself having a competitive advantage over its peers thanks to its high yields and operating efficiency on the back of its use of highly automated production lines and in-house equipment design capability. For HLS, Sunny sees optical zoom being a key feature for dual-cam usage and hence has a solution ready and targets mass production soon. In addition to dual cams, Sunny expects camera-spec upgrades in smartphones, such as mega pixel migration, OIS, and PDAF, to continue. For VLS, Sunny is positive on the long-term growth prospects, driven by regulatory requirements, the increasing penetration of ADAS and the rising autopilot trend. Sunny expects to outgrow the 20-30% YoY industry revenue growth in a few years on its market-leading position.

Well-positioned for emerging opportunities. Management targets to become a total optical solution ("smart eye") supplier in the long term. In addition to handsets and vehicles, Sunny sees new opportunities from drones, AR/VR, and 360-degree cameras. We currently assume a limited revenue contribution from these new devices over our forecast horizon but believe Sunny is well-positioned for such business growth through its comprehensive product offerings. Thus, if there is significant volume ramp-up in these segments in the near future, that should bring further earnings upside, in our view.

What we recommend: We leave our 2016-18 earnings forecasts unchanged. We reaffirm Outperform (2) with a higher target price of HKD29 (from HKD26.7), based on an unchanged 21x PER, near the high point of its past-3-year trading range of 9-22x, on our 1-year-forward EPS (from 2016E EPS). We view the muted 1H16 as an opportunity to accumulate the shares. Key risk: worse-than-expected competition in HCM and HLS.

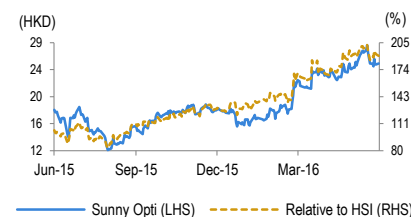
How we differ: We are more positive than the market on Sunny's gross-margin expansion, and hence are 2-4% above the consensus on our 2016-17E EPS.

Forecast revisions (%)

Year to 31 Dec	16E	17E	18E
Revenue change	-	-	-
Net profit change	-	-	-
Core EPS (FD) change	-	-	-

Source: Daiwa forecasts

Share price performance



12-month range	12.08-28.10
Market cap (USDbn)	3.50
3m avg daily turnover (USDm)	19.39
Shares outstanding (m)	1,074
Major shareholder	Sun Xu Ltd (38.4%)

Financial summary (CNY)

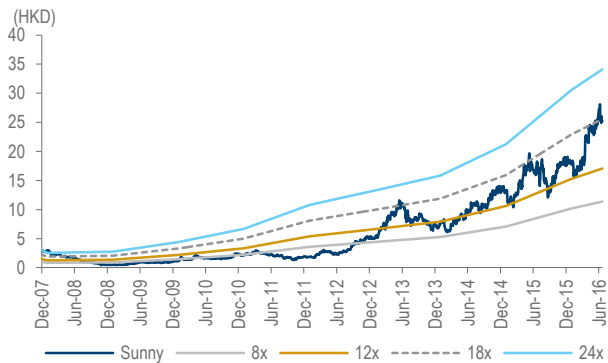
Year to 31 Dec	16E	17E	18E
Revenue (m)	13,120	15,570	17,600
Operating profit (m)	1,215	1,532	1,897
Net profit (m)	1,096	1,366	1,677
Core EPS (fully-diluted)	1.020	1.271	1.561
EPS change (%)	43.9	24.6	22.8
Daiwa vs Cons. EPS (%)	3.6	1.7	4.0
PER (x)	21.1	16.9	13.8
Dividend yield (%)	1.4	1.8	2.2
DPS	0.306	0.381	0.468
PBR (x)	4.9	4.0	3.3
EV/EBITDA (x)	14.3	10.9	8.5
ROE (%)	25.6	26.1	26.2

Source: FactSet, Daiwa forecasts

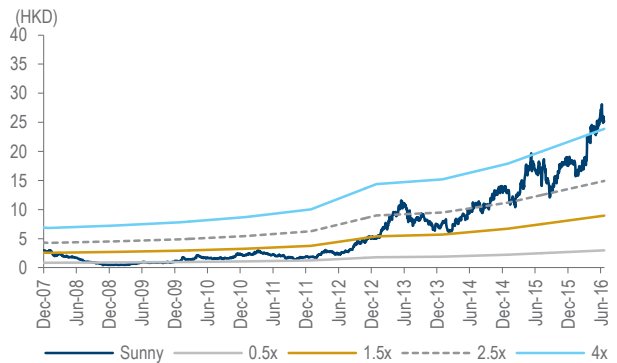
Sunny Optical: semi-annual and annual P&L statement

	2016E		2017E		2016E	2017E	2018E
(CNYm)	1H	2H	1HE	2HE			
Net sales	5,341	7,779	6,897	8,673	13,120	15,570	17,600
COGS	4,443	6,396	5,711	7,069	10,840	12,780	14,295
Gross profit	897	1,383	1,186	1,604	2,280	2,790	3,305
Operating costs	442	623	554	705	1,065	1,258	1,408
Operating profit	455	760	633	899	1,215	1,532	1,897
Pre-tax income	470	787	648	926	1,257	1,573	1,939
Net income	409	687	560	805	1,096	1,366	1,677
Net EPS (CNY)	0.38	0.64	0.52	0.75	1.02	1.27	1.56
Operating ratios							
Gross margin	16.8%	17.8%	17.2%	18.5%	17.4%	17.9%	18.8%
Operating margin	8.5%	9.8%	9.2%	10.4%	9.3%	9.8%	10.8%
Pre-tax margin	8.8%	10.1%	9.4%	10.7%	9.6%	10.1%	11.0%
Net margin	13.0%	12.7%	13.5%	13.0%	8.4%	8.8%	9.5%
YoY (%)							
Net revenue	15%	29%	29%	12%	23%	19%	13%
Gross profit	24%	33%	32%	16%	29%	22%	19%
Operating income	41%	30%	39%	18%	34%	26%	24%
Pre-tax income	35%	53%	38%	18%	46%	25%	23%
Net income	33%	51%	37%	17%	44%	25%	23%
HoH (%)							
Net revenue	-12%	46%	-11%	26%			
Gross profit	-14%	54%	-14%	35%			
Operating income	-22%	67%	-17%	42%			
Pre-tax income	-8%	67%	-18%	43%			
Net income	-10%	68%	-18%	44%			

Source: Company, Daiwa forecasts

Sunny Optical: 1-year-forward PER


Source: Bloomberg, Daiwa forecasts

Sunny Optical: 1-year-forward PBR


Source: Bloomberg, Daiwa forecasts

Financial summary

Key assumptions

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Handset CCM shipment (m units)	70	97	133	187	228	264	303	330
Blended ASP of handset CCM (USD)	2.38	3.78	4.98	5.68	5.51	5.75	5.99	6.14
Vehicle lens shipment (m units)	0	0	8	11	17	23	33	47
Handset lens shipment (m units)	32	36	26	75	302	376	463	550

Profit and loss (CNYm)

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Handset CCM Revenues	1,069	2,307	4,157	6,576	7,785	9,404	11,266	12,576
Vehicle Lens Revenues	100	167	291	421	651	958	1,413	2,048
Other Revenue	1,329	1,510	1,365	1,429	2,260	2,757	2,891	2,976
Total Revenue	2,499	3,984	5,813	8,426	10,696	13,120	15,570	17,600
Other income	0	0	0	0	0	0	0	0
COGS	(1,976)	(3,243)	(4,846)	(7,137)	(8,933)	(10,840)	(12,780)	(14,295)
SG&A	(182)	(214)	(254)	(482)	(597)	(745)	(850)	(952)
Other op. expenses	(131)	(163)	(251)	(231)	(257)	(320)	(408)	(456)
Operating profit	210	363	462	577	909	1,215	1,532	1,897
Net-interest inc./(exp.)	(3)	(3)	(7)	(14)	(16)	(21)	(22)	(22)
Assoc/forex/extraord./others	33	37	49	71	(31)	65	65	65
Pre-tax profit	240	397	504	634	862	1,259	1,575	1,941
Tax	(38)	(58)	(64)	(73)	(99)	(161)	(208)	(262)
Min. int./pref. div./others	14	7	(0)	5	(2)	(2)	(2)	(2)
Net profit (reported)	215	346	440	566	762	1,096	1,366	1,677
Net profit (adjusted)	215	346	440	566	762	1,096	1,366	1,677
EPS (reported)(CNY)	0.223	0.360	0.443	0.529	0.709	1.020	1.271	1.561
EPS (adjusted)(CNY)	0.223	0.360	0.443	0.529	0.709	1.020	1.271	1.561
EPS (adjusted fully-diluted)(CNY)	0.223	0.360	0.443	0.529	0.709	1.020	1.271	1.561
DPS (CNY)	0.071	0.105	0.121	0.155	0.208	0.306	0.381	0.468
EBIT	210	363	462	577	909	1,215	1,532	1,897
EBITDA	298	472	609	792	1,155	1,527	1,932	2,351

Cash flow (CNYm)

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Profit before tax	240	397	504	634	862	1,259	1,575	1,941
Depreciation and amortisation	88	109	147	215	246	312	400	454
Tax paid	(38)	(58)	(64)	(73)	(99)	(161)	(208)	(262)
Change in working capital	(264)	(169)	55	(898)	609	(650)	(310)	(273)
Other operational CF items	14	7	(0)	5	(2)	(2)	(2)	(2)
Cash flow from operations	40	286	643	(117)	1,616	758	1,455	1,858
Capex	(112)	(265)	(286)	(465)	(351)	(650)	(400)	(400)
Net (acquisitions)/disposals	1	13	1	(62)	(64)	0	0	0
Other investing CF items	0	(38)	(26)	(178)	(60)	60	0	0
Cash flow from investing	(111)	(291)	(311)	(705)	(475)	(590)	(400)	(400)
Change in debt	(35)	34	392	56	167	(5)	0	0
Net share issues/(repurchases)	0	0	0	0	0	0	0	0
Dividends paid	(43)	(69)	(101)	(120)	(166)	(223)	(329)	(410)
Other financing CF items	(20)	(27)	589	(55)	(2)	0	0	0
Cash flow from financing	(97)	(61)	879	(120)	(0)	(229)	(329)	(410)
Forex effect/others	0	0	0	0	0	0	0	0
Change in cash	(169)	(66)	1,211	(942)	1,141	(60)	726	1,048
Free cash flow	(73)	20	357	(582)	1,265	108	1,055	1,458

Source: FactSet, Daiwa forecasts

Financial summary continued ...

Balance sheet (CNYm)

As at 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Cash & short-term investment	681	614	1,826	884	2,025	1,964	2,690	3,739
Inventory	472	748	768	896	897	1,141	1,345	1,505
Accounts receivable	627	901	1,172	2,388	3,003	3,415	4,052	4,581
Other current assets	42	4	1	36	93	52	62	70
Total current assets	1,822	2,267	3,766	4,204	6,017	6,573	8,150	9,894
Fixed assets	489	646	785	1,035	1,141	1,479	1,479	1,425
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	64	89	114	354	478	418	418	418
Total assets	2,375	3,002	4,665	5,594	7,636	8,470	10,048	11,738
Short-term debt	62	103	489	522	683	684	684	684
Accounts payable	599	939	1,257	1,744	2,914	2,970	3,501	3,916
Other current liabilities	9	11	36	31	142	52	62	70
Total current liabilities	671	1,052	1,782	2,297	3,739	3,706	4,248	4,671
Long-term debt	17	0	18	36	33	36	36	36
Other non-current liabilities	7	18	6	11	19	10	10	10
Total liabilities	694	1,070	1,805	2,343	3,791	3,752	4,294	4,717
Share capital	98	98	105	105	105	105	105	105
Reserves/R.E./others	1,584	1,834	2,755	3,145	3,740	4,612	5,649	6,916
Shareholders' equity	1,681	1,932	2,860	3,251	3,845	4,717	5,754	7,021
Minority interests	0	0	0	0	0	0	0	0
Total equity & liabilities	2,375	3,002	4,665	5,594	7,636	8,470	10,048	11,738
EV	22,481	22,570	21,763	22,756	21,774	21,838	21,112	20,064
Net debt/(cash)	(601)	(512)	(1,319)	(327)	(1,309)	(1,244)	(1,970)	(3,019)
BVPS (CNY)	1.741	2.007	2.876	3.038	3.579	4.391	5.356	6.536

Key ratios (%)

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Sales (YoY)	37.4	59.5	45.9	45.0	26.9	22.7	18.7	13.0
EBITDA (YoY)	30.3	58.1	29.1	30.0	45.9	32.2	26.5	21.7
Operating profit (YoY)	48.0	73.0	27.1	24.9	57.6	33.6	26.1	23.8
Net profit (YoY)	49.7	60.8	27.2	28.5	34.5	43.9	24.6	22.8
Core EPS (fully-diluted) (YoY)	51.7	61.3	23.1	19.4	34.0	43.9	24.6	22.8
Gross-profit margin	20.9	18.6	16.6	15.3	16.5	17.4	17.9	18.8
EBITDA margin	11.9	11.8	10.5	9.4	10.8	11.6	12.4	13.4
Operating-profit margin	8.4	9.1	7.9	6.8	8.5	9.3	9.8	10.8
Net profit margin	8.6	8.7	7.6	6.7	7.1	8.4	8.8	9.5
ROAE	13.4	19.2	18.4	18.5	21.5	25.6	26.1	26.2
ROAA	9.7	12.9	11.5	11.0	11.5	13.6	14.7	15.4
ROCE	12.3	19.1	17.1	16.1	21.7	24.3	25.7	26.7
ROIC	18.9	24.8	27.3	22.9	29.5	35.3	36.7	42.2
Net debt to equity	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Effective tax rate	15.8	14.7	12.6	11.5	11.5	12.8	13.2	13.5
Accounts receivable (days)	79.0	70.0	65.1	77.1	92.0	89.3	87.5	89.5
Current ratio (x)	2.7	2.2	2.1	1.8	1.6	1.8	1.9	2.1
Net interest cover (x)	70.4	115.7	70.0	41.3	56.8	58.3	70.9	87.8
Net dividend payout	31.8	29.2	27.3	29.3	29.3	30.0	30.0	30.0
Free cash flow yield	n.a.	0.1	1.5	n.a.	5.5	0.5	4.6	6.3

Source: FactSet, Daiwa forecasts

Company profile

Founded in 1984, Sunny Optical is the leading optical component manufacturer in the China technology supply chain. It develops and provides optical-related products with various applications, including instruments, components and opto-electronic modules. The company's major customers include leading China smartphone brand name makers Huawei, Lenovo and OPPO.

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Disclosure of investment ratings

Rating	Percentage of total
Buy*	66.9%
Hold**	19.7%
Sell***	13.5%

Source: Daiwa

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