

# Sunny Optical Technology (2382 HK)

 Target price: **HKD44.30** (from HKD40.70)

 Share price (4 Nov): **HKD36.30** | Up/downside: **+22.0%**

 5 4 3 2 **1**

**Buy**

(from Outperform)

## Solid earnings outlook; pullback a good entry point

- Intact industry trends: multi-cams in smartphones and smart cars
- We expect 32-55% YoY EPS growth in 2016-18 with rising ROE
- Upgrading to Buy (1) from Outperform (2); raising TP to HKD44.30

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**What's new:** Sunny Optical's (Sunny) share price has corrected by 15% over the past two months, due to market worries over the impact of Samsung Electronics' (SEC) (005930 KS, KRW1,627,000, Buy [1]) Note 7 issue and the status of orders from China smartphone brands, in our view. Our channel checks suggest that Sunny's business is on track and we view the recent pullback as a good entry point for investors. Sunny remains one of our top picks in the Greater China smartphone space

**What's the impact: Handset lens sets (HLS) orders from SEC and China smartphone brands remain solid.** The market seems concerned that Sunny's HLS shipments might miss its guidance (+20-30% YoY) due to the halt in production of the Note 7 and muted sentiment from China brands. Our channel checks indicate that orders from SEC remain solid as: 1) Sunny is not a Note 7 supplier, and 2) SEC targets to promote its mid-range models (A/J/C series) in 4Q16-1Q17 to offset units lost from the Note 7, with Sunny a major supplier and set to benefit from the volume ramp-up, in our view. We also expect Sunny to ramp up volume in 10MP+ products for China clients in 2H16 on more project wins. Overall, we think Sunny is on track to meet our forecast of 23% YoY HLS shipment growth in 2016.

**Well-positioned in the next smartphone and car mega trend.** As previously discussed (see "[The more the merrier: multi-cameras are the next mega trend in smartphones](#)", 2 August 2016), we expect the number of dual-cam smartphones to grow to 230m in 2017 and 390m in 2018, from 60m units in 2016, with Sunny, a major supplier of handset camera modules (HCM) and HLS, well positioned to benefit from this trend. Indeed, our industry surveys show that more tier-1 China brands (ie, Huawei, Oppo, Vivo and Xiaomi) are expected to launch dual-cam smartphones in 2H16-1H17, with Sunny as the major HCM supplier. Driven by an ASP increase from dual-cams and an improving product mix, we expect Sunny's HCM ASP to grow by 10-18% YoY in 2016-18 (vs. 3% YoY decline in 2015). For HLS, Sunny should enjoy the spill-over benefits from an increase in overall HLS demand as a result of increased dual-cam adoption. For vehicle lenses, we expect shipments to grow 40% YoY in 2016-18 due multi-cam trends in cars as a result of the rising adoption of advanced driver assistance systems (ADAS) and regulation requirements.

**What we recommend:** We raise our 2016-18E EPS by 1-2% to factor in ASP upside from dual-cams. We raise our 12-month target price to HKD44.30 (from HKD 40.70), based on an unchanged 25x PER on our revised 2017E EPS (from 2H16-1H17), which is at the high end of the stock's past-3-year trading range of 9-26x. Our TP represents 22% upside potential from current levels; thus we upgrade Sunny to Buy (1) from Outperform (2). Key risk: worse-than-expected pricing competition in HCM.

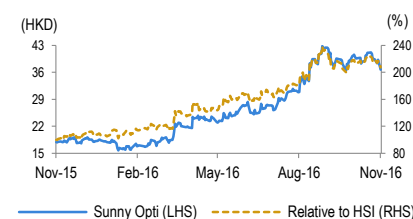
**How we differ:** Our 2017-18E EPS are 5-10% above consensus due to our more optimistic revenue assumptions on multi-cam trends.

### Forecast revisions (%)

Year to 31 Dec	16E	17E	18E
Revenue change	0.6	0.9	2.8
Net profit change	0.8	1.1	2.2
Core EPS (FD) change	0.8	1.1	2.2

Source: Daiwa forecasts

### Share price performance



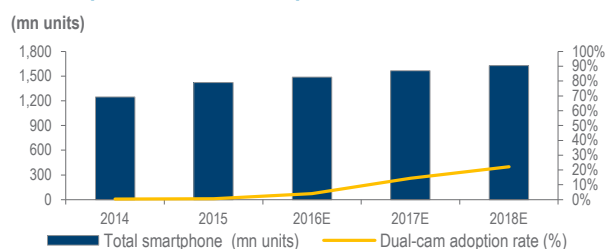
12-month range	15.72-42.35
Market cap (USDbn)	5.04
3m avg daily turnover (USDm)	36.39
Shares outstanding (m)	1,077
Major shareholder	Sun Xu Ltd (38.4%)

### Financial summary (CNY)

Year to 31 Dec	16E	17E	18E
Revenue (m)	14,010	17,165	20,930
Operating profit (m)	1,317	1,799	2,386
Net profit (m)	1,182	1,596	2,104
Core EPS (fully-diluted)	1.097	1.482	1.953
EPS change (%)	54.8	35.1	31.8
Daiwa vs Cons. EPS (%)	1.6	5.1	10.4
PER (x)	28.8	21.4	16.2
Dividend yield (%)	0.7	1.0	1.4
DPS	0.207	0.329	0.445
PBR (x)	7.1	5.6	4.4
EV/EBITDA (x)	20.0	14.5	10.8
ROE (%)	27.3	29.4	30.7

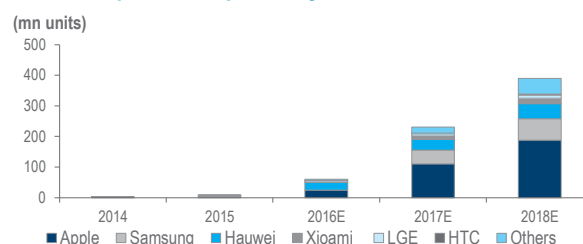
Source: FactSet, Daiwa forecasts

### Dual-cam penetration in smartphones in 2014-18E



Source: Daiwa forecasts

### Dual-cam adopted smartphone by brand 2014-18E



Source: Daiwa forecasts

### Sunny Optical: revisions to revenue and earnings forecasts

	Revised forecasts			Previous forecasts			Change		
	2016E	2017E	2018E	2016E	2017E	2018E	2016E	2017E	2018E
<b>CNYm</b>									
Revenues	14,010	17,165	20,930	13,930	17,015	20,360	0.6%	0.9%	2.8%
Gross profit	2,438	3,090	3,914	2,427	3,070	3,828	0.5%	0.7%	2.3%
Op. profits	1,317	1,799	2,386	1,309	1,785	2,341	0.6%	0.8%	1.9%
Pre-tax income	1,379	1,860	2,452	1,372	1,846	2,408	0.5%	0.8%	1.9%
Net profit	1,182	1,596	2,104	1,172	1,578	2,058	0.8%	1.1%	2.2%
EPS (CNY)	1.10	1.48	1.95	1.09	1.47	1.91	0.8%	1.1%	2.2%
<b>Margins (%)</b>									
Gross margin	17.4%	18.0%	18.7%	17.4%	18.0%	18.8%			
Operating margin	9.4%	10.5%	11.4%	9.4%	10.5%	11.5%			
Pretax margin	9.8%	10.8%	11.7%	9.8%	10.9%	11.8%			
Net margin	8.4%	9.3%	10.1%	8.4%	9.3%	10.1%			

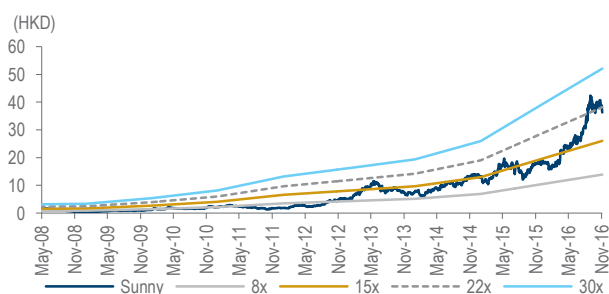
Source: Daiwa forecasts

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

	2016E		2017E		2016E	2017E	2018E
(CNYm)	1H	2HE	1HE	2HE			
<b>Net sales</b>	5,910	8,100	7,462	9,703	14,010	17,165	20,930
COGS	4,922	6,651	6,149	7,926	11,572	14,075	17,016
<b>Gross profit</b>	988	1,450	1,313	1,776	2,438	3,090	3,914
Operating costs	485	636	574	716	1,121	1,291	1,528
<b>Operating profit</b>	503	814	739	1,060	1,317	1,799	2,386
Pre-tax income	552	827	749	1,111	1,379	1,860	2,452
<b>Net income</b>	465	716	640	956	1,182	1,596	2,104
<b>Net EPS (CNY)</b>	0.43	0.67	0.59	0.89	1.10	1.48	1.95
<b>Operating ratios</b>							
Gross margin	16.7%	17.9%	17.6%	18.3%	17.4%	18.0%	18.7%
Operating margin	8.5%	10.0%	9.9%	10.9%	9.4%	10.5%	11.4%
Pre-tax margin	9.3%	10.2%	10.0%	11.5%	9.8%	10.8%	11.7%
Net margin	7.9%	8.8%	8.6%	9.8%	8.4%	9.3%	10.1%
<b>YoY (%)</b>							
Net revenue	27%	34%	26%	20%	31%	23%	22%
Gross profit	37%	39%	33%	23%	38%	27%	27%
Operating income	56%	39%	47%	30%	45%	37%	33%
Pre-tax income	58%	61%	36%	34%	60%	35%	32%
Net income	51%	58%	38%	33%	55%	35%	32%
<b>HoH (%)</b>							
Net revenue	-2%	37%	-8%	30%			
Gross profit	-5%	47%	-9%	35%			
Operating income	-14%	62%	-9%	43%			
Pre-tax income	8%	50%	-9%	48%			
Net income	2%	54%	-11%	49%			

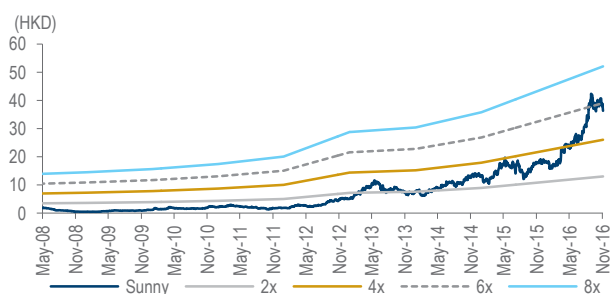
Source: Company, Daiwa forecasts

### 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	260	291	322
Blended ASP of handset CCM (USD)	2.38	3.78	4.98	5.68	5.51	6.52	7.14	7.87
Vehicle lens shipment (m units)	0	0	8	11	17	23	32	45
Handset lens shipment (m units)	32	36	26	75	302	370	446	535

### 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	10,493	12,885	15,694
Vehicle Lens Revenues	100	167	291	421	651	901	1,309	1,898
Other Revenue	1,329	1,510	1,365	1,429	2,260	2,617	2,971	3,338
<b>Total Revenue</b>	<b>2,499</b>	<b>3,984</b>	<b>5,813</b>	<b>8,426</b>	<b>10,696</b>	<b>14,010</b>	<b>17,165</b>	<b>20,930</b>
Other income	0	0	0	0	0	0	0	0
COGS	(1,976)	(3,243)	(4,846)	(7,137)	(8,933)	(11,572)	(14,075)	(17,016)
SG&A	(182)	(214)	(254)	(320)	(352)	(448)	(491)	(565)
Other op.expenses	(131)	(163)	(251)	(392)	(502)	(672)	(800)	(963)
<b>Operating profit</b>	<b>210</b>	<b>363</b>	<b>462</b>	<b>577</b>	<b>909</b>	<b>1,317</b>	<b>1,799</b>	<b>2,386</b>
Net-interest inc./(exp.)	(3)	(3)	(7)	(14)	(16)	(21)	(22)	(22)
Assoc/forex/extraord./others	33	37	49	71	(31)	85	85	90
<b>Pre-tax profit</b>	<b>240</b>	<b>397</b>	<b>504</b>	<b>634</b>	<b>862</b>	<b>1,381</b>	<b>1,862</b>	<b>2,454</b>
Tax	(38)	(58)	(64)	(73)	(99)	(197)	(264)	(349)
Min. int./pref. div./others	14	7	(0)	5	(2)	(2)	(2)	(2)
<b>Net profit (reported)</b>	<b>215</b>	<b>346</b>	<b>440</b>	<b>566</b>	<b>762</b>	<b>1,182</b>	<b>1,596</b>	<b>2,104</b>
<b>Net profit (adjusted)</b>	<b>215</b>	<b>346</b>	<b>440</b>	<b>566</b>	<b>762</b>	<b>1,182</b>	<b>1,596</b>	<b>2,104</b>
<b>EPS (reported)(CNY)</b>	<b>0.223</b>	<b>0.360</b>	<b>0.443</b>	<b>0.529</b>	<b>0.709</b>	<b>1.097</b>	<b>1.482</b>	<b>1.953</b>
<b>EPS (adjusted)(CNY)</b>	<b>0.223</b>	<b>0.360</b>	<b>0.443</b>	<b>0.529</b>	<b>0.709</b>	<b>1.097</b>	<b>1.482</b>	<b>1.953</b>
<b>EPS (adjusted fully-diluted)(CNY)</b>	<b>0.223</b>	<b>0.360</b>	<b>0.443</b>	<b>0.529</b>	<b>0.709</b>	<b>1.097</b>	<b>1.482</b>	<b>1.953</b>
<b>DPS (CNY)</b>	<b>0.044</b>	<b>0.071</b>	<b>0.102</b>	<b>0.112</b>	<b>0.154</b>	<b>0.207</b>	<b>0.329</b>	<b>0.445</b>
<b>EBIT</b>	<b>210</b>	<b>363</b>	<b>462</b>	<b>577</b>	<b>909</b>	<b>1,317</b>	<b>1,799</b>	<b>2,386</b>
<b>EBITDA</b>	<b>298</b>	<b>472</b>	<b>609</b>	<b>792</b>	<b>1,155</b>	<b>1,629</b>	<b>2,226</b>	<b>2,907</b>

### Cash flow (CNYm)

Year to 31 Dec	2011	2012	2013	2014	2015	2016E	2017E	2018E
Profit before tax	240	397	504	634	862	1,381	1,862	2,454
Depreciation and amortisation	88	109	147	215	246	312	427	521
Tax paid	(38)	(58)	(64)	(73)	(99)	(197)	(264)	(349)
Change in working capital	(264)	(169)	55	(898)	609	(299)	(559)	(545)
Other operational CF items	14	7	(0)	5	(2)	(2)	(2)	(2)
<b>Cash flow from operations</b>	<b>40</b>	<b>286</b>	<b>643</b>	<b>(117)</b>	<b>1,616</b>	<b>1,194</b>	<b>1,464</b>	<b>2,080</b>
Capex	(112)	(265)	(286)	(465)	(351)	(850)	(700)	(700)
Net (acquisitions)/disposals	1	13	1	(62)	(64)	0	0	0
Other investing CF items	0	(38)	(26)	(178)	(60)	60	0	0
<b>Cash flow from investing</b>	<b>(111)</b>	<b>(291)</b>	<b>(311)</b>	<b>(705)</b>	<b>(475)</b>	<b>(790)</b>	<b>(700)</b>	<b>(700)</b>
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)	(354)	(479)
Other financing CF items	(20)	(27)	589	(55)	(2)	0	0	0
<b>Cash flow from financing</b>	<b>(97)</b>	<b>(61)</b>	<b>879</b>	<b>(120)</b>	<b>(0)</b>	<b>(229)</b>	<b>(354)</b>	<b>(479)</b>
Forex effect/others	0	0	0	0	0	0	0	0
<b>Change in cash</b>	<b>(169)</b>	<b>(66)</b>	<b>1,211</b>	<b>(942)</b>	<b>1,141</b>	<b>176</b>	<b>409</b>	<b>901</b>
Free cash flow	(73)	20	357	(582)	1,265	344	764	1,380

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	2,200	2,610	3,511
Inventory	472	748	768	896	897	1,361	1,717	2,182
Accounts receivable	627	901	1,172	2,388	3,003	3,455	4,232	5,161
Other current assets	42	4	1	36	93	122	156	209
<b>Total current assets</b>	<b>1,822</b>	<b>2,267</b>	<b>3,766</b>	<b>4,204</b>	<b>6,017</b>	<b>7,138</b>	<b>8,715</b>	<b>11,062</b>
Fixed assets	489	646	785	1,035	1,141	1,679	1,952	2,131
Goodwill & intangibles	0	0	0	0	0	0	0	0
Other non-current assets	64	89	114	354	478	418	418	418
<b>Total assets</b>	<b>2,375</b>	<b>3,002</b>	<b>4,665</b>	<b>5,594</b>	<b>7,636</b>	<b>9,235</b>	<b>11,085</b>	<b>13,611</b>
Short-term debt	62	103	489	522	683	684	684	684
Accounts payable	599	939	1,257	1,744	2,914	3,646	4,242	5,128
Other current liabilities	9	11	36	31	142	56	69	84
<b>Total current liabilities</b>	<b>671</b>	<b>1,052</b>	<b>1,782</b>	<b>2,297</b>	<b>3,739</b>	<b>4,386</b>	<b>4,995</b>	<b>5,896</b>
Long-term debt	17	0	18	36	33	36	36	36
Other non-current liabilities	7	18	6	11	19	10	10	10
<b>Total liabilities</b>	<b>694</b>	<b>1,070</b>	<b>1,805</b>	<b>2,343</b>	<b>3,791</b>	<b>4,432</b>	<b>5,041</b>	<b>5,942</b>
Share capital	98	98	105	105	105	105	105	105
Reserves/R.E./others	1,584	1,834	2,755	3,145	3,740	4,698	5,939	7,564
<b>Shareholders' equity</b>	<b>1,681</b>	<b>1,932</b>	<b>2,860</b>	<b>3,251</b>	<b>3,845</b>	<b>4,803</b>	<b>6,044</b>	<b>7,670</b>
Minority interests	0	0	0	0	0	0	0	0
<b>Total equity &amp; liabilities</b>	<b>2,375</b>	<b>3,002</b>	<b>4,665</b>	<b>5,594</b>	<b>7,636</b>	<b>9,235</b>	<b>11,085</b>	<b>13,611</b>
EV	33,481	33,571	32,763	33,756	32,774	32,602	32,193	31,292
<b>Net debt/(cash)</b>	<b>(601)</b>	<b>(512)</b>	<b>(1,319)</b>	<b>(327)</b>	<b>(1,309)</b>	<b>(1,480)</b>	<b>(1,890)</b>	<b>(2,791)</b>
<b>BVPS (CNY)</b>	<b>1.741</b>	<b>2.007</b>	<b>2.876</b>	<b>3.038</b>	<b>3.579</b>	<b>4.460</b>	<b>5.612</b>	<b>7.121</b>

### 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	31.0	22.5	21.9
EBITDA (YoY)	30.3	58.1	29.1	30.0	45.9	41.0	36.6	30.6
Operating profit (YoY)	48.0	73.0	27.1	24.9	57.6	44.8	36.6	32.6
Net profit (YoY)	49.7	60.8	27.2	28.5	34.5	55.1	35.1	31.8
Core EPS (fully-diluted) (YoY)	51.7	61.3	23.1	19.4	34.0	54.8	35.1	31.8
Gross-profit margin	20.9	18.6	16.6	15.3	16.5	17.4	18.0	18.7
EBITDA margin	11.9	11.8	10.5	9.4	10.8	11.6	13.0	13.9
Operating-profit margin	8.4	9.1	7.9	6.8	8.5	9.4	10.5	11.4
Net profit margin	8.6	8.7	7.6	6.7	7.1	8.4	9.3	10.1
ROAE	13.4	19.2	18.4	18.5	21.5	27.3	29.4	30.7
ROAA	9.7	12.9	11.5	11.0	11.5	14.0	15.7	17.0
ROCE	12.3	19.1	17.1	16.1	21.7	26.1	29.3	31.5
ROIC	18.9	24.8	27.3	22.9	29.5	38.5	41.3	45.3
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	14.3	14.2	14.2
Accounts receivable (days)	79.0	70.0	65.1	77.1	92.0	84.1	81.7	81.9
Current ratio (x)	2.7	2.2	2.1	1.8	1.6	1.6	1.7	1.9
Net interest cover (x)	70.4	115.7	70.0	41.3	56.8	63.2	83.3	110.5
Net dividend payout	19.8	19.8	22.9	21.3	21.8	18.9	22.2	22.8
Free cash flow yield	n.a.	0.1	1.0	n.a.	3.7	1.0	2.2	4.0

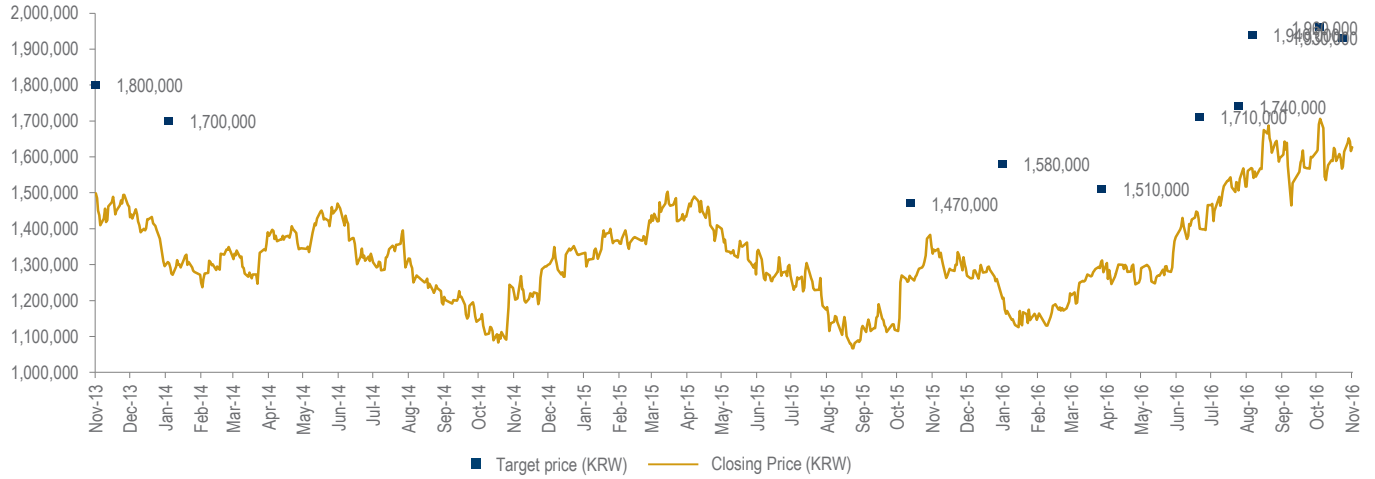
Source: FactSet, Daiwa forecasts

## 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.

**Samsung Electronics: share price and Daiwa recommendation trend**

Date	Target price	Rating	Date	Target price	Rating	Date	Target price	Rating
07/01/14	1,700,000	Buy	31/03/16	1,510,000	Buy	07/10/16	1,960,000	Buy
29/07/15	0		24/06/16	1,710,000	Buy	27/10/16	1,930,000	Buy
16/10/15	1,470,000	Buy	28/07/16	1,740,000	Buy			
31/12/15	1,580,000	Buy	09/08/16	1,940,000	Buy			



Source: Daiwa

Note: where appropriate, historical target prices have been adjusted to reflect the current share count

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