

# Sunny Optical (2382 HK)

## Softer Sep shipment ahead of 5G transition

Sunny reported a mixed set of Sep shipment with handset lens (HLS) reaching record-high of 145mn (+44% YoY/+9% MoM) but handset camera module (HCM) slowdown to +1% YoY/-14% MoM. We believe the weakness was largely due to model transition and inventory destocking ahead of 5G ramp. We think investors may take profit in near term but we recommend to accumulate following the correction, as Sunny remains the major beneficiary of multi-cam, 3D sensing and 5G/video-driven upgrade in FY20-21E. Reiterate BUY with TP of HK\$140.

- **HCM slowdown implies destocking ahead of 5G model ramp.** Sunny reported HCM shipment of 48.4mn (+1% YoY/ -13% MoM), compared to growth of 22% YoY/16% MoM in Aug. We believe weaker-than-expected shipment was driven by 1) seasonal weakness after strong order pull-in in Jul/Aug (+82%/22% MoM), similar to 2017-18 (Fig 1), and 2) channel inventory correction ahead of 5G transition. Our latest check suggested global sell-in remains stronger than sell-through due to Huawei incident, and thus inventory woes may continue until 5G demand pick-up in year end.
- **Multi-cam/ 3D sensing adoption well on track.** Despite near-term volume volatility, global tri-cam/quad-cam (w/ ToF) is still at early stage with 23%/8% adoption in Aug (vs 21%/4% in Jul), mainly driven by Samsung and Huawei. In particular, Samsung and Huawei are the only major brands adopting quad-cam YTD (25% and 9% in Aug). As the major HCM/HLS supplier for Huawei/Samsung, we expect Sunny to continue to benefit from multi-cam and 3D sensing trend ahead. Note that Sunny's HCM peer, Q-tech delivered solid Sept shipment (53% YoY/ 17% MoM), while Sunny's HLS peer, Largan, reported strong Sept revenue (+20% YoY/+2% MoM) and guided positively with flattish MoM in Oct and slight decline in Nov.
- **China 5G rollout major upcoming catalyst; Reiterate BUY.** Pre-registration for 5G service in China reached 10mn+ as of 9 Oct, confirming strong consumer demand in China, and upcoming 5G service launch in late Oct will serve as major catalyst, in our view. Our SOTP-based TP of HK\$140 is based on target multiples of 22x/30x/35 for CCM/HLS/VLS. Implied FY20E P/E of 27.5x is 18% above 5-yr avg. P/E but 26% below 1-sd plus avg. P/E, which is justified for product upcycle in our view. We expect GPM recovery, multi-cam adoption, and ASP hike to drive 47%/53% YoY sales/NP growth in 2H19E. Sunny remains our sector top pick, given clear upgrade trend and strong earnings visibility.

### Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	22,366	25,932	36,097	42,905	48,484
YoY growth (%)	53.1	15.9	39.2	18.9	13.0
Net income (RMB mn)	2,902	2,491	3,434	4,984	6,420
EPS (RMB)	2.7	2.3	3.1	4.6	5.9
YoY growth (%)	126.8	(14.6)	37.9	45.1	28.8
P/E (x)	39.5	46.2	33.5	23.1	17.9
P/B (x)	15.1	12.2	9.7	7.5	5.8
Yield (%)	0.3	0.6	0.9	1.3	1.6
ROE (%)	39	27	29	33	32

Source: Company data, CMBIS estimates

### BUY (Maintain)

Target Price	HK\$140.0
(Previous TP	HK\$140.0)
Up/Downside	+19%
Current Price	HK\$118

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#### Stock Data

Mkt Cap (HK\$ mn)	126,138
Avg 3 mths t/o (HK\$ mn)	796.58
52w High/Low (HK\$)	126.10/58.55
Total Issued Shares (mn)	1,096.8

Source: Bloomberg

#### Shareholding Structure

SUN XU LTD	35.47%
JPMORGAN CHASE	4.28%
WENJIAN WANG	3.08%

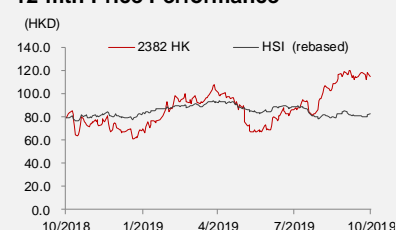
Source: HKEx

#### Share Performance

	Absolute	Relative
1-mth	-3.7%	-0.7%
3-mth	33.7%	43.6%
6-mth	10.9%	25.1%

Source: Bloomberg

#### 12-mth Price Performance



Source: Bloomberg

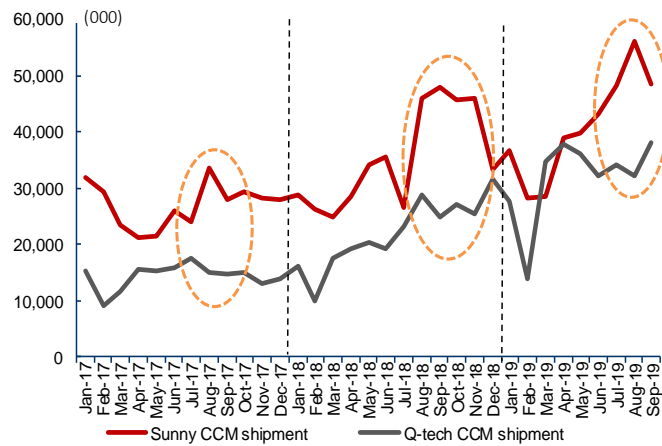
Auditor: Deloitte Touche Tohmatsu

#### Related Reports:

1. Sunny Optical (2382 HK) – Record-high Aug shipment; Strength continue into 4Q19E – 10 Sep 2019
2. Sunny Optical (2382 HK) – Conf-call takeaways: GPM recovery and ToF/ Samsung upside – 29 Aug 2019
3. Sunny Optical (2382 HK) – Strong 1H19; Accelerated lens upgrade cycle – 15 Aug 2019

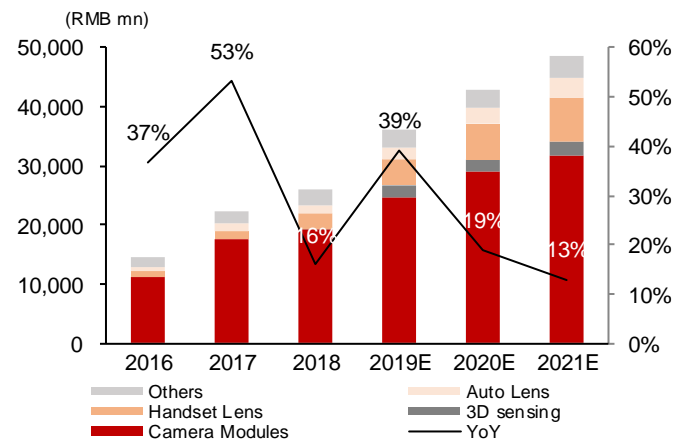
## Focus Charts

**Figure 1: Sunny/Q-tech HCM volume in FY17-19 YTD**



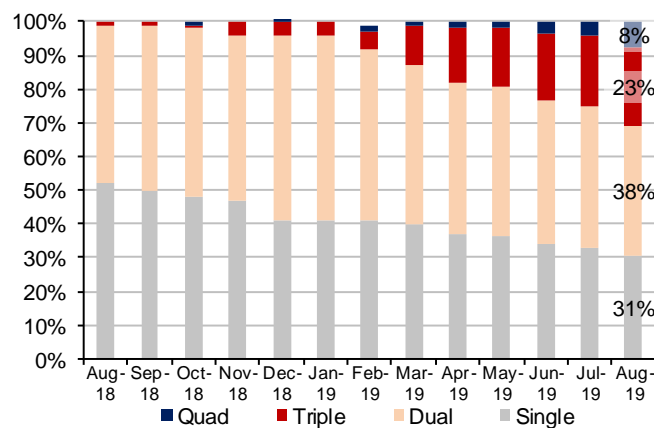
Source: Company data, CMBIS estimates

**Figure 2: Sunny Optical revenue trend**



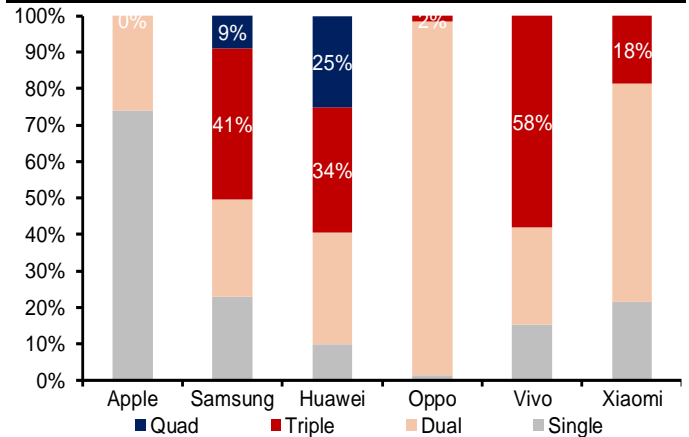
Source: Company data, CMBIS

**Figure 3: Global smartphone multi-cam adoption**



Source: Counterpoint, CMBIS estimates

**Figure 4: Multi-cam penetration by brand in Aug**



Source: Counterpoint, CMBIS estimates

**Figure 5: Huawei Mate 30 to adopt quad-cam**



Source: Company data, CMBIS estimates

**Figure 6: Sunny's handset lens upgrade trend**



Source: Company data, CMBIS estimates

Figure 7: Major assumptions

	FY16	FY17	FY18	FY19E	FY20E	FY21E
<b>Shipment volume (mn unit)</b>						
<b>Optical Components</b>						
Handset lens sets	379	608	951	1,268	1,648	2,014
...YoY(%)	26%	60%	56%	33%	30%	22%
Vehicle lens sets	23	32	40	50	62	75
...YoY(%)	37%	41%	25%	25%	23%	22%
<b>Optoelectronic Products</b>						
Handset camera modules	270	325	425	534	652	775
...YoY(%)	18%	20%	31%	26%	22%	19%
Other optoelectronic (3D sensing)	5	8	10	43	55	67
...YoY(%)	25%	76%	27%	328%	27%	22%
<b>Revenue (Rmb mn)</b>						
Optical Components	2,956	4,302	6,023	8,680	11,292	13,871
Optoelectronic Products	11,403	17,777	19,609	27,149	31,318	34,289
Optical instruments	253	294	300	268	295	324
<b>Total Revenue</b>	<b>14,612</b>	<b>22,372</b>	<b>25,932</b>	<b>36,097</b>	<b>42,905</b>	<b>48,484</b>
...YoY (%)	36.6%	53.1%	15.9%	39.2%	18.9%	13.0%
<b>Gross Margin</b>						
Optical Components	39.8%	44.0%	41.5%	44.3%	45.3%	46.3%
Optoelectronic products	10.5%	13.1%	8.4%	7.0%	8.4%	8.9%
Optical instruments	40.4%	43.2%	40.5%	41.6%	42.5%	42.5%

Source: Company data, CMBIS estimates

Figure 8: P&amp;L forecast

RMB mn	FY17	FY18	1H19	2H19E	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>22,366</b>	<b>25,932</b>	<b>15,575</b>	<b>20,522</b>	<b>36,097</b>	<b>42,905</b>	<b>48,484</b>
...YoY	53.1%	15.9%	30.0%	47.1%	39.2%	18.9%	13.0%
Cost of sales	(17,563)	(21,019)	(12,711)	(16,523)	(29,234)	(33,671)	(37,207)
<b>Gross profit</b>	<b>4,803</b>	<b>4,913</b>	<b>2,864</b>	<b>3,999</b>	<b>6,863</b>	<b>9,234</b>	<b>11,277</b>
<b>GPM (%)</b>	<b>21.5%</b>	<b>18.9%</b>	<b>18.4%</b>	<b>19.5%</b>	<b>19.0%</b>	<b>21.5%</b>	<b>23.3%</b>
...YoY	79.2%	2.3%	23.4%	54.2%	39.7%	34.6%	22.1%
SG&A	(594)	(644)	(388)	(529)	(918)	(1,073)	(1,212)
...% of rev	-2.7%	-2.5%	-2.5%	-2.6%	-2.5%	-2.5%	-2.5%
R&D	(1,168)	(1,362)	(827)	(1,231)	(2,058)	(2,446)	(2,715)
...% of rev	-5.2%	-5.3%	-5.3%	-6.0%	-5.7%	-5.7%	-5.6%
<b>Operating profit</b>	<b>3,383</b>	<b>3,077</b>	<b>1,789</b>	<b>2,423</b>	<b>4,212</b>	<b>5,973</b>	<b>7,641</b>
<b>OPM (%)</b>	<b>15.1%</b>	<b>11.9%</b>	<b>11.5%</b>	<b>11.8%</b>	<b>11.7%</b>	<b>13.9%</b>	<b>15.8%</b>
...YoY	129.4%	-9.0%	18.3%	54.8%	36.9%	41.8%	27.9%
<b>Net profit</b>	<b>2,902</b>	<b>2,491</b>	<b>1,431</b>	<b>2,003</b>	<b>3,434</b>	<b>4,984</b>	<b>6,420</b>
<b>NPM (%)</b>	<b>13.0%</b>	<b>9.6%</b>	<b>9.2%</b>	<b>9.8%</b>	<b>9.5%</b>	<b>11.6%</b>	<b>13.2%</b>
...YoY	128.3%	-14.2%	21.3%	52.8%	37.9%	45.1%	28.8%

Source: Company data, CMBIS estimates

## Valuation

### Reiterate BUY with TP HK\$140

We derived our 12-month TP from SOTP valuation methodology and our TP of HK\$140 is based on weighted-average target P/E multiple of 27.5x FY20E EPS, in order to reflect 1) Sunny's diversification in multiple businesses with different growth profiles, and 2) higher visibility of product upcycles across different segments.

We assign 22x P/E to its CCM business, given its China No.1 position, product upcycle and advanced technology capacity. We assign 35x P/E for its vehicle lens business to reflect the high-margin and high-growth industry nature of vehicle lens (25% CAGR FY19-21E) and Sunny's No.1 global market share. We apply a 30x P/E to its handset lens segment given secular upgrade trend, continued share gains from peers and robust shipment momentum (20% sales CAGR FY19-21E).

**Figure 9: Sunny Optical – SOTP valuation**

Business segment	% of FY20E Profit	FY20E EPS (RMB)	Target P/E
Camera modules	28.5%	1.30	22x
Handset lenses	43.8%	2.00	30x
Vehicle lenses	11.5%	0.53	35x
Others	16.1%	0.73	25x
<b>Total (RMB) /Implied P/E</b>		<b>4.56</b>	<b>27.5x</b>
<b>TP (HK\$)</b>			<b>140.0</b>

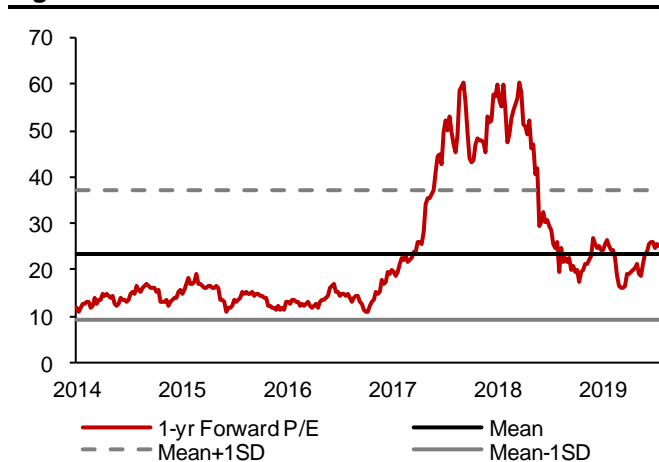
Sources: Company data, CMBIS

**Figure 10: Peers' valuation**

Company	Ticker	Rating	Market Cap (US\$ mn)	Price (LC)	TP (LC)	Up/Down-side	P/E (x) FY19E	P/E (x) FY20E	P/B (x) FY19E	P/B (x) FY20E	ROE (%) FY19E	ROE (%) FY20E
Sunny Optical	2382 HK	Buy	16,081	118.0	140.0	19%	33.7	23.2	9.7	7.5	28.9	32.4
Q tech	1478 HK	Buy	1,375	9.3	9.5	2%	22.8	17.6	3.7	3.2	16.4	18.0
Cowell	1415 HK	NR	137	1.31	NA	NA	12.7	6.9	0.4	0.4	5.1	5.2
Truly	732 HK	NR	440	1.05	NA	NA	4.5	4.6	0.5	0.4	5.1	8.3
Catcher	2474 TT	NR	6,480	252.00	NA	NA	13.3	10.9	1.3	1.2	9.5	11.6
Largan	3008 TT	NR	19,543	4460.00	NA	NA	20.6	17.7	4.7	3.9	24.7	24.9
Lite-on	2301 TT	NR	3,744	48.30	NA	NA	13.5	12.5	1.5	1.5	11.3	11.5
Primax	4915 TT	NR	909	62.20	NA	NA	12.5	11.0	1.8	1.6	14.9	15.0
O-film	002456 CH	NR	4,560	11.82	NA	NA	29.8	18.3	3.0	2.7	12.4	14.0
<b>Average</b>							<b>18.2</b>	<b>13.6</b>	<b>3.0</b>	<b>2.5</b>	<b>14.2</b>	<b>15.6</b>

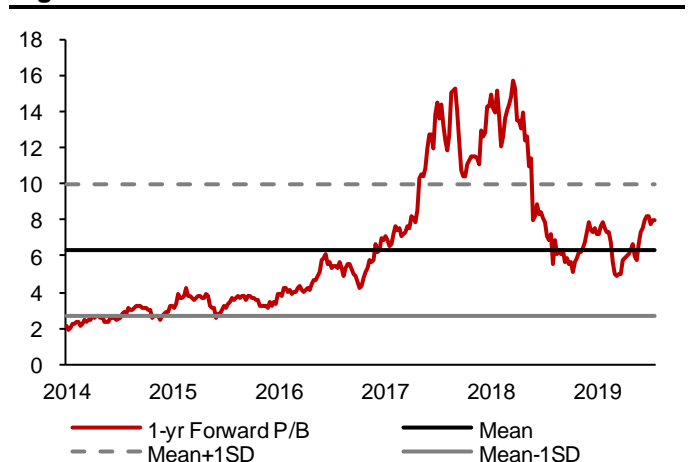
Source: Bloomberg, CMBIS

**Figure 11: 12M forward P/E band**



Source: Bloomberg, CMBIS

**Figure 12: 12M forward P/B band**



Source: Bloomberg, CMBIS

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Revenue</b>	<b>22,366</b>	<b>25,932</b>	<b>36,097</b>	<b>42,905</b>	<b>48,484</b>
Cost of sales	(17,563)	(21,019)	(29,234)	(33,671)	(37,207)
<b>Gross profit</b>	<b>4,803</b>	<b>4,913</b>	<b>6,863</b>	<b>9,234</b>	<b>11,277</b>
Selling expenses	(205)	(210)	(291)	(343)	(388)
Admin expenses	(389)	(434)	(627)	(729)	(824)
R&D expenses	(1,168)	(1,362)	(2,058)	(2,446)	(2,715)
Other income	206	467	413	472	533
Other gain/ losses	136	(293)	(88)	(215)	(242)
<b>Operating profit</b>	<b>3,383</b>	<b>3,077</b>	<b>4,212</b>	<b>5,973</b>	<b>7,641</b>
Financial costs	(49)	(202)	(238)	(261)	(288)
Investment income	(16)	(24)	(17)	(17)	(17)
<b>Pre-tax profit</b>	<b>3,318</b>	<b>2,851</b>	<b>3,958</b>	<b>5,695</b>	<b>7,336</b>
Income tax expense	(404)	(339)	(504)	(683)	(880)
NCI	13	22	19	28	36
<b>Net profit</b>	<b>2,902</b>	<b>2,491</b>	<b>3,434</b>	<b>4,984</b>	<b>6,420</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Profit before taxation</b>	<b>3,318</b>	<b>2,851</b>	<b>3,958</b>	<b>5,695</b>	<b>7,336</b>
Depreciation/amortisation	535	819	1,002	1,365	1,729
Change in working capital	(1,126)	(203)	(86)	(1,166)	104
Others	(290)	100	(283)	(433)	(602)
<b>Net cash from operating</b>	<b>2,436</b>	<b>3,568</b>	<b>4,591</b>	<b>5,462</b>	<b>8,568</b>
Capex	(1,128)	(2,104)	(4,000)	(4,000)	(4,000)
Other	(558)	(3,395)	0	0	0
<b>Net cash from investing</b>	<b>(1,686)</b>	<b>(5,499)</b>	<b>(4,000)</b>	<b>(4,000)</b>	<b>(4,000)</b>
Net borrowings	444	88	0	0	0
Dividend paid	(318)	(725)	(1,000)	(1,451)	(1,869)
Purchase of shares	(81)	(78)	0	0	0
Other	(33)	3,672	(238)	(261)	(288)
<b>Net cash from financing</b>	<b>12</b>	<b>2,957</b>	<b>(1,237)</b>	<b>(1,712)</b>	<b>(2,156)</b>
<b>Net change in cash</b>	<b>762</b>	<b>1,025</b>	<b>(646)</b>	<b>(250)</b>	<b>2,412</b>
Cash at beginning of the year	467	1,227	2,254	1,608	1,357
Exchange difference	(2)	2	0	0	0
<b>Cash at the end of the year</b>	<b>1,227</b>	<b>2,254</b>	<b>1,608</b>	<b>1,357</b>	<b>3,769</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Current assets</b>	<b>11,635</b>	<b>16,768</b>	<b>21,622</b>	<b>20,089</b>	<b>27,208</b>
Cash & equivalents	1,227	2,254	1,608	1,357	3,769
Financial assets	1,952	4,760	4,760	4,760	4,760
Deposits	160	235	235	235	235
Account receivables	5,666	6,231	8,909	9,087	11,249
Inventories	2,622	3,074	5,896	4,436	6,981
Other current assets	8	214	214	214	214
<b>Non-current assets</b>	<b>4,091</b>	<b>6,084</b>	<b>9,099</b>	<b>11,744</b>	<b>14,024</b>
Prepaid lease	163	214	214	214	214
PPE	2,586	4,523	7,521	10,155	12,426
Interest in associates	125	101	101	101	101
Other non-curr. assets	1,217	1,246	1,263	1,274	1,283
<b>Total assets</b>	<b>15,726</b>	<b>22,852</b>	<b>30,721</b>	<b>31,833</b>	<b>41,233</b>
<b>Current liabilities</b>	<b>7,705</b>	<b>8,677</b>	<b>14,092</b>	<b>11,644</b>	<b>16,456</b>
ST borrowings	1,348	1,482	1,482	1,482	1,482
Account payables	6,183	7,064	12,479	10,030	14,842
Other current liabilities	490	5,628	2,667	8,677	8,452
<b>Non-current liabilities</b>	<b>502</b>	<b>4,887</b>	<b>4,887</b>	<b>4,887</b>	<b>4,887</b>
LT borrowings					
Others	502	4,887	4,887	4,887	4,887
<b>Total liabilities</b>	<b>8,207</b>	<b>13,564</b>	<b>18,979</b>	<b>16,530</b>	<b>21,343</b>
Share capital	105	105	105	105	105
Reserves	7,383	9,129	11,564	15,097	19,647
Minority interest	31	54	73	101	138
<b>Shareholders' equity</b>	<b>7,519</b>	<b>9,288</b>	<b>11,742</b>	<b>15,303</b>	<b>19,890</b>
<b>Total equity &amp; liabilities</b>	<b>15,726</b>	<b>22,852</b>	<b>30,721</b>	<b>31,833</b>	<b>41,233</b>

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Optical components	19.2	23.2	24.0	26.3	28.6
Optoelectronic products	79.5	75.6	75.2	73.0	70.7
Optical instruments	1.3	1.2	0.7	0.7	0.7
<b>Growth (%)</b>					
Revenue	53.1	15.9	39.2	18.9	13.0
Gross profit	79.2	2.3	39.7	34.6	22.1
Operating profit	129.4	(9.0)	36.9	41.8	27.9
Net profit	128.3	(14.2)	37.9	45.1	28.8
<b>Profit &amp; loss ratio (%)</b>					
Gross margin	21.5	18.9	19.0	21.5	23.3
Operating margin	15.1	11.9	11.7	13.9	15.8
Net profit margin	13.0	9.6	9.5	11.6	13.2
<b>Balance sheet ratio</b>					
Net debt/total equity (x)	0.1	0.0	Net cash	Net cash	0.0
Current ratio (x)	1.5	1.9	1.5	1.7	1.7
Receivable turnover days	77	77	76.6	76.6	76.6
Inventory turnover days	57	57	56.0	56.0	56.0
Payable turnover days	122	122	122.0	122.0	122.0
<b>Profitability (%)</b>					
ROE	38.6	26.8	29.2	32.6	32.3
ROA	18.5	10.9	11.2	15.7	15.6
<b>Per share data (RMB)</b>					
EPS	2.67	2.28	3.14	4.56	5.87
DPS	0.29	0.66	0.91	1.33	1.71

Source: Company data, CMBIS estimates



# Disclosures & Disclaimers

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## CMBIS Ratings

<b>BUY</b>	: Stock with potential return of over 15% over next 12 months
<b>HOLD</b>	: Stock with potential return of +15% to -10% over next 12 months
<b>SELL</b>	: Stock with potential loss of over 10% over next 12 months
<b>NOT RATED</b>	: Stock is not rated by CMBIS
<b>OUTPERFORM</b>	: Industry expected to outperform the relevant broad market benchmark over next 12 months
<b>MARKET-PERFORM</b>	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
<b>UNDERPERFORM</b>	: Industry expected to underperform the relevant broad market benchmark over next 12 months

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