

Sunny Optical (2382 HK)

Look beyond ongoing volatility; Upgrade to BUY on 2H recovery

We upgrade Sunny Optical to BUY (from Hold) as Sunny is well positioned to gain share amid recent industry downturn and regain growth sooner than peers during 2H20-1H21E demand recovery, driven by Samsung/Xiaomi restocking in 3Q20E and Apple-led cam upgrade cycle in 4Q20E. Overall, we remain positive on Sunny's industry leadership and strong pipeline across all segments. Our new SOTP-based TP of HK\$148 implies 25.2x FY21E P/E as we rollover to FY21E.

- Conservative tone as expected; Spec upgrade to re-accelerate in 2021.** During Investor Day on 24 Jun, mgmt. guided conservative FY20E outlook as anticipated, given 1) COVID-19 impact, 2) Huawei restriction, 3) de-spec on 5G models, and 4) VLS order delays. While monthly shipment will remain volatile in 3Q20E, we expect demand recovery is on track as Xiaomi/Samsung will start restocking in 3Q20E, offsetting Huawei share loss impact. In addition, following high-end weakness and 5G BOM cost pressure in FY20E, we expect cam upgrade cycle will re-accelerate in FY21E driven by Apple 5G iPhone with tri-cam/LiDAR 3D sensing and lower 5G cost pressure in 2021. We estimate HCM/HLS ASP to decline 7%/1.2% YoY to Rmb 4.7/4.98 in FY20E and rebound 14%/6% YoY to Rmb 44.2/50.3 in FY21E.
- HCM/HLS: R&D to enhance leadership and boost share gain.** We remain positive on Sunny's share gain across all segments, as it continues to invest into new packaging/processing technology (MOB II, MOC II, PAA, SV-AOI, WLT-mini, OLA, AMA) and achieved technology breakthroughs (hybrid lens) to strengthen market leadership. We are positive on mgmt.'s priority on efficiency and automation upgrade rather than capacity expansion in FY20E.
- VLS: LiDAR, HUD, smart headlights emerge as potential huge market.** Backed by extensive experience as global No.1 auto lens supplier, Sunny expect to enter a new phase LiDAR business and HUD market, which are estimated to grow 64% and 20% CAGR in next 5 years, according to TSR. Sunny started to supply LiDAR to global LiDAR/Tier-1 clients and HUD products to Lincoln, global first OEM adopting HUD with DLP technology.
- Leadership remains intact; Upgrade to BUY on 2H recovery.** We believe FY20E weakness is largely priced in given sluggish share price performance YTD. We recommend to look beyond the trough and accumulate the stock for smartphone demand recovery and multi/3D-cam and 5G/video-driven upgrade trend in 2021. We lowered FY20-22E EPS by 1-6% mainly to reflect COVID-19, and our new SOTP-based TP of HK\$148 implies 25.2x FY21 P/E.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	25,932	37,849	38,700	49,883	59,897
YoY growth (%)	15.9	46.0	2.2	28.9	20.1
Net income (RMB mn)	2,491	3,991	4,211	5,750	7,105
EPS (RMB)	2.3	3.65	3.85	5.26	6.49
YoY growth (%)	(14.6)	60.1	5.5	36.5	23.5
Consensus EPS (RMB)	NA	3.24	4.24	5.48	6.71
P/E (x)	47.1	29.5	27.9	20.4	16.5
P/B (x)	12.5	9.1	7.2	5.5	4.3
Yield (%)	0.6	0.5	0.6	0.8	0.9
ROE (%)	26.8	31.4	25.8	27.1	26.1

Source: Company data, CMBIS estimates

BUY (Up)

Target Price	HK\$148.0
(Previous TP	HK\$115.0)
Up/Downside	+24%
Current Price	HK\$119.8

China Technology Sector

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Stock Data

Mkt Cap (HK\$ mn)	131,403
Avg 3 mths t/o (HK\$ mn)	948.43
52w High/Low (HK\$)	149.2/ 75.05
Total Issued Shares (mn)	1,097

Source: Bloomberg

Shareholding Structure

SUN XU LTD	35.47%
JPMORGAN CHASE	4.50%
WENJIAN WANG	3.08%

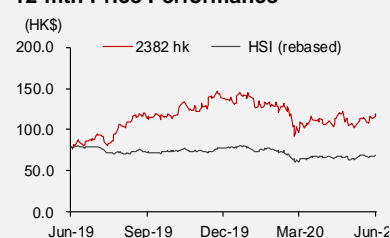
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	10.9%	2.1%
3-mth	21.6%	5.9%
6-mth	-15.6%	-5.4%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Deloitte Touche Tohmatsu

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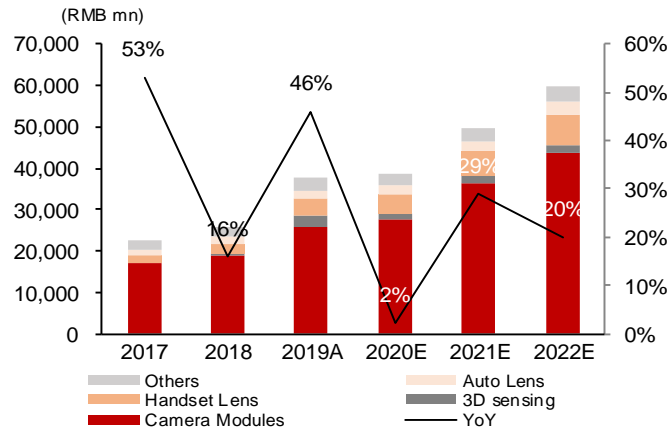
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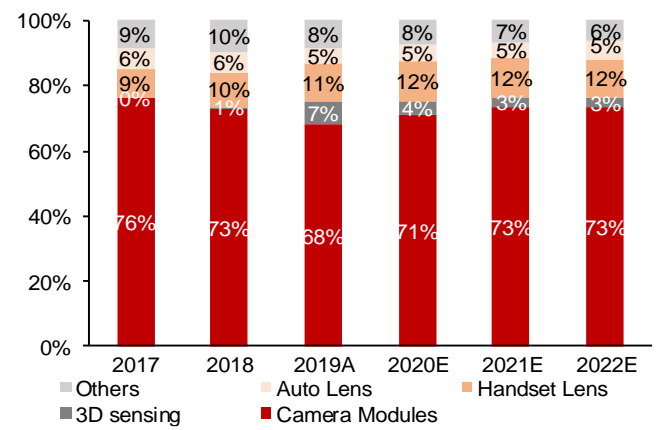
Focus Charts

Figure 1: Sunny Optical revenue trend



Source: Company data, CMBIS estimates

Figure 2: Sunny Optical revenue breakdown



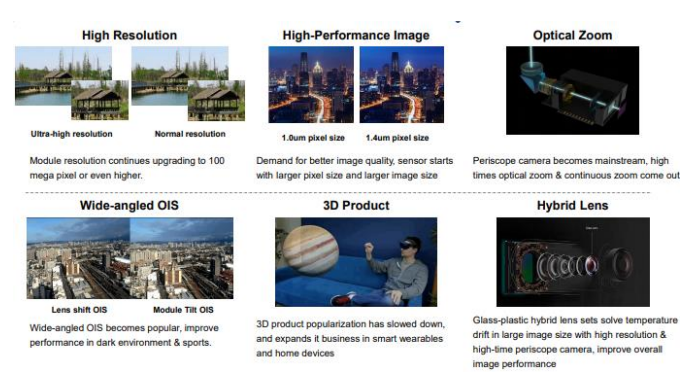
Source: Company data, CMBIS

Figure 3: Handset front-cam upgrade trend



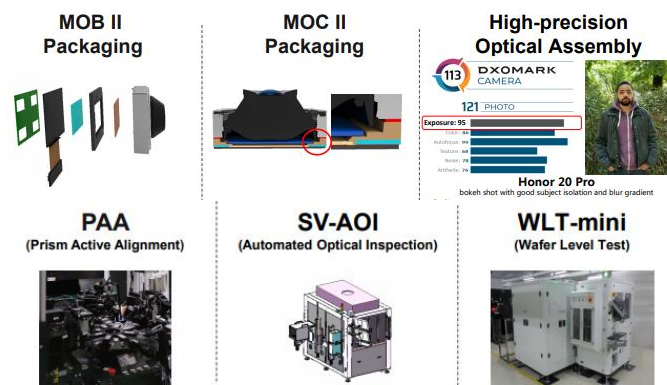
Source: Company data, CMBIS estimates

Figure 4: Sunny's target on next-gen camera



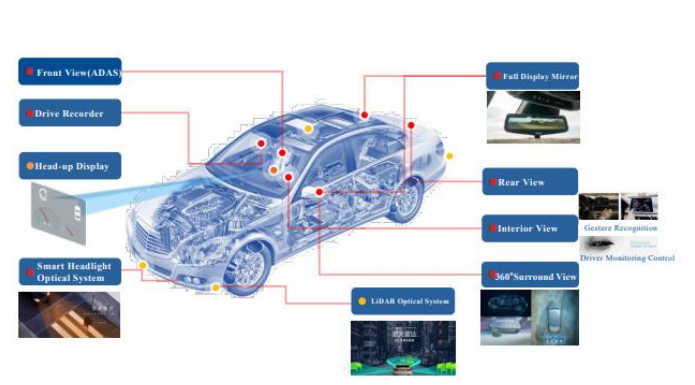
Source: Company data, CMBIS estimates

Figure 5: Sunny's packaging/processing capability



Source: Company data, CMBIS estimates

Figure 6: Sunny's automotive optical applications



Source: Company data, CMBIS estimates

Earnings forecasts

Figure 7: Major assumptions

	FY18	FY19	1H20E	2H20E	FY20E	FY21E	FY22E
Shipment volume (mn unit)							
Optical Components							
Handset lens sets	951	1,343	620	908	1,528	1,821	2,171
...YoY(%)	56%	41%	12%	15%	14%	19%	19%
Vehicle lens sets	40	50	21	32	52	65	81
...YoY(%)	25%	25%	-8%	15%	5%	24%	25%
Optoelectronic Products							
Handset camera modules	425	540	265	358	623	727	857
...YoY(%)	31%	27%	23%	10%	15%	17%	18%
Other optoelectronic (3D sensing)	10	49	18	29	46	55	65
...YoY(%)	27%	388%	-20%	5%	-6%	18%	20%
Revenue (Rmb mn)							
Optical Components	6,023	8,815	3,954	5,070	9,024	11,156	13,457
Optoelectronic Products	19,609	28,748	12,207	17,209	29,416	38,441	46,126
Optical instruments	300	285	134	126	260	286	314
Total Revenue	25,932	37,849	16,296	22,404	38,700	49,883	59,897
...YoY (%)	15.9%	46.0%	4.6%	0.6%	2.2%	28.9%	20.1%
Gross Margin							
Optical Components	41.5%	45.2%	44.0%	45.5%	44.8%	46.1%	46.3%
Optoelectronic products	8.4%	9.3%	8.3%	9.8%	9.2%	10.1%	10.4%
Optical instruments	40.5%	41.3%	41.0%	41.5%	41.2%	41.2%	41.2%

Source: Company data, CMBIS estimates

Figure 8: P&L forecast

RMB mn	FY18	1H19	2H19	FY19	1H20E	2H20E	FY20E	FY21E	FY22E
Revenue	25,932	15,575	22,274	37,849	16,296	22,404	38,700	49,883	59,897
...YoY	15.9%	30.0%	59.6%	46.0%	4.6%	0.6%	2.2%	28.9%	20.1%
Cost of sales	(21,019)	(12,711)	(17,387)	(30,098)	(13,009)	(17,724)	(30,732)	(39,298)	(46,989)
Gross profit	4,913	2,864	4,887	7,751	3,287	4,680	7,967	10,585	12,909
GPM (%)	18.9%	18.4%	21.9%	20.5%	20.2%	20.9%	20.6%	21.2%	21.6%
...YoY	2.3%	23.4%	88.5%	57.8%	14.8%	-4.2%	2.8%	32.9%	22.0%
SG&A	(644)	(388)	(541)	(929)	(440)	(543)	(983)	(1,247)	(1,497)
...% of rev	-2.5%	-2.5%	-2.4%	-2.5%	-2.7%	-2.4%	-2.5%	-2.5%	-2.5%
R&D	(1,362)	(827)	(1,383)	(2,209)	(864)	(1,344)	(2,208)	(2,893)	(3,474)
...% of rev	-5.3%	-5.3%	-6.2%	-5.8%	-5.3%	-6.0%	-5.7%	-5.8%	-5.8%
Operating profit	3,077	1,789	3,017	4,806	2,113	2,930	5,043	6,844	8,417
OPM (%)	11.9%	11.5%	13.5%	12.7%	13.0%	13.1%	13.0%	13.7%	14.1%
...YoY	-9.0%	18.3%	92.8%	56.2%	18.1%	-2.9%	4.9%	35.7%	23.0%
Net profit	2,491	1,431	2,560	3,991	1,715	2,496	4,211	5,750	7,105
NPM (%)	9.6%	9.2%	11.5%	10.5%	10.5%	11.1%	10.9%	11.5%	11.9%
...YoY	-14.2%	21.3%	95.3%	60.2%	19.8%	-2.5%	5.5%	36.5%	23.5%

Source: Company data, CMBIS estimates

Valuation

Upgrade to BUY with new TP HK\$148

We upgrade to BUY rating (from HOLD) with new TP HK\$148. We derived our 12-month TP from SOTP valuation methodology and our new TP is based on weighted-average target P/E multiple of 25.2x FY21E EPS, in order to reflect 1) Sunny's diversification in multiple businesses with different growth profiles, and 2) visibility of product upcycles across different segments.

We assign 20x P/E to its CCM business, given its China No.1 position, product upcycle and advanced technology capacity. We assign 30x 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 28x P/E to its handset lens segment given secular upgrade trend, continued share gains from peers and robust shipment momentum (18% sales CAGR FY19-21E).

Figure 9: Sunny Optical – SOTP valuation

Business segment	% of FY21E Profit	FY20E EPS (RMB)	Target P/E
Camera modules	36.6%	1.93	20x
Handset lenses	52.3%	2.75	28x
Vehicle lenses	10.1%	0.53	30x
Others	1.0%	0.05	25x
Total (RMB) /Implied P/E		5.26	25.2x
TP (HK\$)			148.0

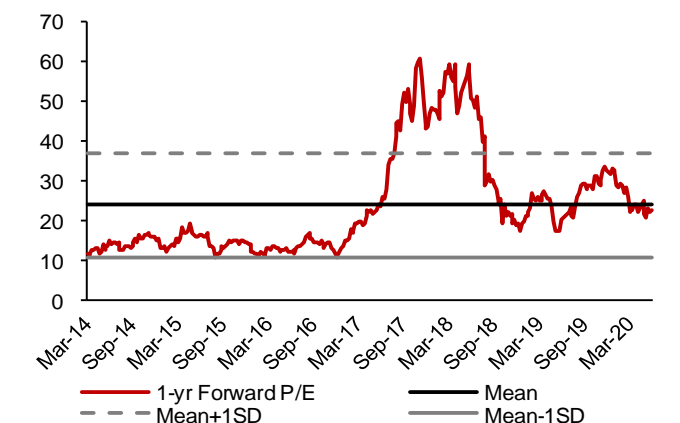
Sources: Company data, CMBIS

Figure 10: Peers' valuation

Company	Ticker	Rating	Market Cap (US\$ mn)	Price (LC)	TP (LC)	Up/Down -side	P/E (x) FY20E	P/E (x) FY21E	P/B (x) FY20E	P/B (x) FY21E	ROE (%) FY20E	ROE (%) FY21E
Sunny Optical	2382 HK	Buy	16,955	119.8	148.0	24%	27.9	20.4	7.2	5.5	25.8	27.1
Q tech	1478 HK	Buy	1,609	10.6	14.8	39%	20.1	15.8	3.8	3.2	18.9	20.0
Cowell	1415 HK	NR	202	1.88	NA	NA	10.1	6.6	0.6	0.6	8.6	10.6
Truly	732 HK	NR	361	0.85	NA	NA	-	-	-	-	-	-
Catcher	2474 TT	NR	5,806	222.50	NA	NA	13.6	10.1	1.1	1.1	8.5	11.1
Largan	3008 TT	NR	18,219	4010.00	NA	NA	19.0	17.7	4.2	3.6	24.1	22.4
Lite-on	2301 TT	NR	3,747	47.30	NA	NA	11.8	12.3	1.5	1.4	12.1	11.5
Primax	4915 TT	NR	726	47.75	NA	NA	9.2	9.5	1.5	1.5	15.5	15.1
O-film	002456 CH	NR	6,668	17.50	NA	NA	90.2	36.1	5.2	4.4	5.9	12.2
Average							25.4	16.8	3.5	2.9	15.9	16.2

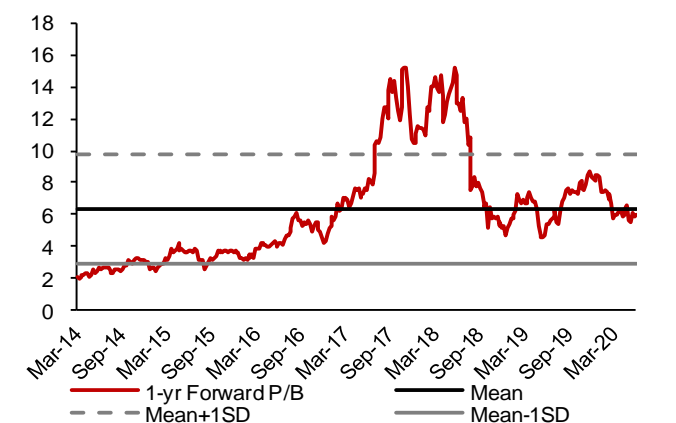
Source: Bloomberg, CMBIS

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)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	25,932	37,849	38,700	49,883	59,897
Cost of sales	(21,019)	(30,098)	(30,732)	(39,298)	(46,989)
Gross profit	4,913	7,751	7,967	10,585	12,909
Selling expenses	(210)	(279)	(295)	(399)	(479)
Admin expenses	(434)	(650)	(688)	(848)	(1,018)
R&D expenses	(1,362)	(2,209)	(2,208)	(2,893)	(3,474)
Other income	467	406	471	549	659
Other gain/ losses	(293)	(201)	(204)	(150)	(180)
Operating profit	3,077	4,806	5,043	6,844	8,417
Financial costs	(202)	(250)	(250)	(275)	(303)
Investment income	(24)	(6)	(6)	(6)	(6)
Pre-tax profit	2,851	4,550	4,787	6,563	8,108
Income tax expense	(339)	(531)	(548)	(774)	(957)
NCI	22	28	28	38	47
Net profit	2,491	3,991	4,211	5,750	7,105

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Profit before taxation	2,851	4,550	4,787	6,563	8,108
Depreciation/amortisation	819	1,171	1,191	1,509	1,828
Change in working capital	(203)	(1,213)	794	(2,665)	996
Others	100	152	(300)	(523)	(675)
Net cash from operating	3,568	4,662	6,473	4,885	10,256
Capex	(2,104)	(3,242)	(3,000)	(3,500)	(3,500)
Other	(3,395)	(314)	0	0	0
Net cash from investing	(5,499)	(3,556)	(3,000)	(3,500)	(3,500)
Net borrowings	88	0	0	0	0
Dividend paid	(725)	(623)	(657)	(898)	(1,109)
Purchase of shares	(78)	0	0	0	0
Other	3,672	(818)	(250)	(275)	(303)
Net cash from financing	2,957	(1,441)	(908)	(1,173)	(1,412)
Net change in cash	1,025	(336)	2,565	211	5,344
Cash at beginning of the year	1,227	2,254	1,917	4,482	4,694
Exchange difference	2	0	0	0	0
Cash at the end of the year	2,254	1,919	4,482	4,694	10,038

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Current assets	16,768	22,446	21,108	32,537	33,220
Cash & equivalents	2,254	1,917	4,482	4,694	10,038
Financial assets	4,760	5,663	5,663	5,663	5,663
Deposits	235	21	21	21	21
Account receivables	6,231	9,630	6,588	14,316	10,785
Inventories	3,074	5,146	4,284	7,774	6,644
Other current assets	214	69	69	69	69
Non-current assets	6,084	8,247	10,059	12,088	13,795
Prepaid lease	214	0	0	0	0
PPE	4,523	6,567	8,376	10,366	12,039
Interest in associates	101	1	1	1	1
Other non-curr. assets	1,246	1,680	1,683	1,721	1,756
Total assets	22,852	30,693	31,167	44,626	47,016
Current liabilities	8,677	12,630	9,522	18,091	14,438
ST borrowings	1,482	1,119	1,119	1,119	1,119
Account payables	7,064	11,322	8,212	16,766	13,101
Other current liabilities	5,628	5,622	12,313	8,650	18,358
Non-current liabilities	4,887	5,336	5,336	5,336	5,336
LT borrowings	4,887	5,336	5,336	5,336	5,336
Others	4,887	5,336	5,336	5,336	5,336
Total liabilities	13,564	17,967	14,859	23,427	19,775
Share capital	105	105	105	105	105
Reserves	9,129	12,448	16,002	20,855	26,850
Minority interest	54	173	201	239	285
Shareholders' equity	9,288	12,726	16,308	21,198	27,241
Total equity & liabilities	22,852	30,693	31,167	44,626	47,016

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
Optical components	23.2	23.3	23.3	22.4	22.5
Optoelectronic products	75.6	76.0	76.0	77.1	77.0
Optical instruments	1.2	0.8	0.7	0.6	0.5
Growth (%)					
Revenue	15.9	46.0	2.2	28.9	20.1
Gross profit	2.3	57.8	2.8	32.9	22.0
Operating profit	(9.0)	56.2	4.9	35.7	23.0
Net profit	(14.2)	60.2	5.5	36.5	23.5
Profit & loss ratio (%)					
Gross margin	18.9	20.5	20.6	21.2	21.6
Operating margin	11.9	12.7	13.0	13.7	14.1
Net profit margin	9.6	10.5	10.9	11.5	11.9
Balance sheet ratio					
Net debt/total equity (x)	0.0	Net cash	Net cash	Net cash	Net cash
Current ratio (x)	1.9	1.8	2.2	1.8	2.3
Receivable turnover days	84	76.5	76.5	76.5	76.5
Inventory turnover days	49	49.8	56.0	56.0	56.0
Payable turnover days	115	111.5	116.0	116.0	116.0
Profitability (%)					
ROE	26.8	31.4	25.8	27.1	26.1
ROA	10.9	13.0	13.5	12.9	15.1
Per share data (RMB)					
EPS	2.28	3.65	3.85	5.26	6.49
DPS	0.66	0.57	0.60	0.82	1.01

Source: Company data, CMBIS estimates

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