

## Sunny Optical (2382 HK)

## Neutral (V)

Target price (HKD)	14.10
Share price (HKD)	13.46
Forecast dividend yield (%)	1.4
Potential return (%)	6.2

Note: Potential return equals the percentage difference between the current share price and the target price, plus the forecast dividend yield

Dec	2013 a	2014 e	2015 e
HSBC EPS	0.44	0.52	0.75
HSBC PE	24.5	20.7	14.5
<b>Performance</b>	<b>1M</b>	<b>3M</b>	<b>12M</b>
Absolute (%)	29.4	-1.5	85.1
Relative <sup>A</sup> (%)	31.6	-3.9	70.9

Note: (V) = volatile (please see disclosure appendix)

10 March 2015

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N(V): Handset camera module business margin pressure remains

- ▶ **Lower than we expected 2H14 earnings**
- ▶ **Upbeat handset and vehicle lens guidance likely in the price**
- ▶ **Maintain Neutral (V) with TP of HKD14.1 (from HKD13.3)**

**Lower than we expected 2H14 earnings.** Net income came in at CNY309m (EPS: CNY0.29, up 20% HoH and 19% YoY) on sales of CNY4.6bn (up 20% HoH and 52% YoY). 2H14 earnings were 5% below our estimates on faster handset camera module ASP erosion. 2H14 handset camera module blended ASP declined 7% HoH (vs. our estimate of flatish HoH) on fiercer than expected competition at the low end.

**Handset camera module business margin pressure remains.** During the analyst meeting, management guided for shipments to grow 20-30% YoY in 2015, in line with our estimates of China-made smartphone shipment growth of 26% YoY. We believe the company will continue to suffer from competition at the low end before the benefits of high-end products kick in. We estimate handset camera module gross margin to decline 0.4pts YoY this year (c.55% of Sunny Optical 2015e total gross profit.)

**Upbeat handset camera lens business guidance likely in the price.** The company indicates handset lens business gross margin will increase to 35-40% in 2015 (versus our estimate of 30-35%) from 30% in 2014. However, as the stock price has outperformed HSI by 20% in the past one month, we believe this guidance could already be priced in.

**Maintain Neutral (V) with TP of HKD14.1 (from HKD13.3):** We revised up our 2015e/2016e EPS by 6%/4% to CNY0.75/CNY0.92 to reflect the better than we expected handset camera lens business. Our target price of HKD14.1 (from HKD13.3) is based on 15x FY15e earnings; this multiple is the weighted average of the 13x assigned to camera module (c70% of profit), 20x to lenses (c30% of profit), which are the average trading multiples for these sectors.

## Sunny Optical: Financials and valuation

	Revenue (CNYm)	Cons revenue (CNYm)	EPS (CNY)	Con EPS (CNY)	P/E (x)	ROE (%)	Div yield (%)
2014a	8,426	NA	0.52	NA	20.7	18.5	1.4
2015e	12,149	10,903	0.75	0.73	14.5	22.6	2.0
2016e	14,276	13,384	0.92	0.90	11.9	23.2	2.5

Source: Company data, Bloomberg (consensus), HSBC estimates

Index <sup>A</sup>	HANG SENG INDEX	Enterprise value (CNYm)	11483
Index level	24,123	Free float (%)	55
RIC	2382.HK	Market cap (USDm)	1,902
Bloomberg	2382 HK	Market cap (HKDm)	14,766

Source: HSBC

Source: HSBC

## Financials & valuation

### Financial statements

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Profit &amp; loss summary (CNYm)</b>				
Revenue	5,813	8,426	12,149	14,276
EBITDA	659	846	1,191	1,434
Depreciation & amortisation	-148	-188	-228	-258
Operating profit/EBIT	511	658	963	1,177
Net interest	7	-14	-13	-13
PBT	504	634	950	1,163
HSBC PBT	504	634	950	1,163
Taxation	-64	-73	-142	-175
Net profit	440	566	807	989
HSBC net profit	440	566	807	989

### Cash flow summary (CNYm)

Cash flow from operations	668	-183	881	737
Capex	-217	-396	-400	-300
Cash flow from investment	-1,039	-459	-400	-300
Dividends	-105	-131	-167	-239
Change in net debt	-679	825	-314	-198
FCF equity	394	-666	326	249

### Balance sheet summary (CNYm)

Tangible fixed assets	785	1,035	1,208	1,250
Current assets	3,766	4,204	5,270	5,939
Cash & others	1,692	900	1,214	1,412
Total assets	9,217	10,887	13,300	14,732
Operating liabilities	1,316	1,822	2,419	2,381
Gross debt	489	522	522	522
Net debt	-1,203	-378	-692	-891
Shareholders funds	2,860	3,251	3,891	4,641
Invested capital	1,543	2,518	2,844	3,396

### Ratio, growth and per share analysis

Year to	12/2013a	12/2014e	12/2015e	12/2016e
<b>Y-o-y % change</b>				
Revenue	45.9	45.0	44.2	17.5
EBITDA	27.1	28.3	40.8	20.5
Operating profit	25.1	28.8	46.3	22.2
PBT	27.0	25.7	49.8	22.5
HSBC EPS	23.1	18.4	42.6	22.5

### Ratios (%)

Revenue/IC (x)	4.1	4.2	4.5	4.6
ROIC	31.2	28.7	30.5	32.1
ROE	18.4	18.5	22.6	23.2
ROA	5.8	5.6	6.7	7.1
EBITDA margin	11.3	10.0	9.8	10.0
Operating profit margin	8.8	7.8	7.9	8.2
EBITDA/net interest (x)		60.5	88.6	106.7
Net debt/equity	-42.1	-11.6	-17.8	-19.2
Net debt/EBITDA (x)	-1.8	-0.4	-0.6	-0.6

### Per share data (CNY)

EPS reported (fully diluted)	0.44	0.52	0.75	0.92
HSBC EPS (fully diluted)	0.44	0.52	0.75	0.92
DPS	0.12	0.16	0.22	0.27
Book value	2.88	3.01	3.60	4.30

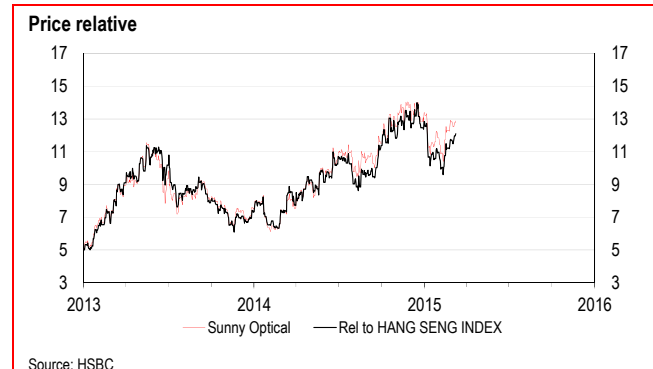
### Key forecast drivers

Year to	12/2013a	12/2014e	12/2015e	12/2016e
Handset related products	4,212	6,791	10,158	12,058
Digital camera lens	639	590	468	344
Vehicle lens sets	291	421	713	1,063
Optical Instruments	233	221	211	211
Other products	438	403	599	599
Total sales	5,813	8,426	12,149	14,276

### Valuation data

Year to	12/2013a	12/2014e	12/2015e	12/2016e
EV/sales	1.8	1.4	0.9	0.8
EV/EBITDA	16.3	13.6	9.4	7.7
EV/IC	6.9	4.6	3.9	3.2
PE*	24.5	20.7	14.5	11.9
P/Book value	3.8	3.6	3.0	2.5
FCF yield (%)	3.3	-5.6	2.7	2.1
Dividend yield (%)	1.1	1.4	2.0	2.5

Note: \* = Based on HSBC EPS (fully diluted)



Note: price at close of 10 Mar 2015

# Handset camera module business margin pressure remains

- ▶ Lower than we expected 2H14 earnings imply fierce competition at the low end
- ▶ Upbeat handset and vehicle lens guidance likely in the price
- ▶ Maintain Neutral (V) with TP of HKD14.1 (from HKD13.3)

**Lower than we expected 2H14 earnings imply fierce competition at the low end.** Net income came in at CNY309mn (EPS: CNY0.29, up 20% HoH and 19% YoY) on sales of CNY4.6bn (up 20% HoH and 52% YoY). Gross margin was up 1.2pts HoH to 15.9% (vs HSBCe/consensus 15.3%/16.0%) on increasing contribution of higher margin handset lens business. Operating margin was down 0.8pts HoH to 7.5% (vs HSBCe/consensus 7.6%/7.5%) on increasing R&D exp for high-end products (e.g. OIS, dual camera CCM, 10+MP lens, etc). 2H14 earnings were 5% below our estimates on faster handset camera module ASP erosion. 2H14 handset camera module blended ASP declined 7% HoH (vs. our estimate of flattish HoH) on fiercer than expected competition in the low-end. The Board of Directors proposed 2014 dividend of CNY15.5 cents per share. This implies 30% earnings payout ratio, in line with the company's 3-year historical average. Cash dividend yield based on today's closing price is 1.4%.

**Handset camera module business margin pressure remains.** For handset camera module (HCM) business, management guided for shipments to grow 20-30% YoY in 2015, in line with our estimates of China design/manufactured smartphone shipment growth of 26% YoY. The company indicated it has started shipping out high-end camera module with 20MP resolution, optical image stabilization (OIS) function, or dual cameras in 2014. However, we believe the yield rate of these high-end products still has room to improve. We also think that the company will continue to suffer from competition at the low end before the benefits of high-end products kick in and estimate handset camera module gross margin to decline 0.4pts YoY this year (c.55% of 2015e gross profit).

**Upbeat handset camera lens business guidance likely in the price.** During the analyst meeting, management guided for handset lens shipments to grow over 50% YoY in 2015 (in line with our estimate) driven by significant growth on 10MP and above lens shipments and continuous market share gain at a Korean client. As such, management indicated that the handset lens business gross margin will increase to 35-40% in 2015 (versus our estimate of 30-35%) from 30% in 2014. After acquiring a leading Japanese

lens manufacturer, Konica Minolta's handset lens factory in 2013, Sunny Optical has access to Konica Minolta's comprehensive patent portfolio and advanced production technology. With the patent portfolio, we believe Sunny Optical's lens design will be simpler than its competitors (except Largan) which should increase the yield rate. Sunny Optical has started mass production of the 13MP lens (2% of shipment last year vs. 0% in 2013) and finished the R&D process of its higher spec products such as lens for OIS, 16MP, 20MP. However, as the stock price has outperformed the HSI by 20% in the past one month, we believe this guidance could already be priced in.

**In-line vehicle lens business outlook.** Management expects vehicle lens business shipments to grow 40% YoY on increasing camera penetration in automotive industry (c.20-30% in 2014 on our estimates). This is in line with our and market's expectations. On 31 March 2014, the US National Highway Traffic Safety Administration (NHTSA) announced new vehicle safety standards mandating automakers to install back-up cameras in all vehicles sold in the US by 1 May 2018. In addition, Japan will mandate vehicle cameras in 2016 and in European market, a car will not be able to rate 4-star or above in 2017 without a pre-installed camera for active safety function, respectively.

**Valuation and risks:** We revised up our 2015e/2016e EPS by 6%/4% to CNY0.75/CNY0.92 to reflect the better than we expected handset camera lens business. Our target price of HKD14.1 (from HKD13.3) is based on 15x FY15e earnings; this multiple is the weighted average of the 13x assigned to camera module (c70% of profit), 20x to lenses (c30% of profit), which are the average trading multiples for these sectors.

Under our research model, for stocks with a volatility indicator, the Neutral band is 10ppts above and below the hurdle rate for Hong Kong stocks of 8.5%. Our target price implies a potential return of 6.2% (including forecast dividend yield), which is within the Neutral band; therefore, we are maintaining our Neutral (V) rating. Potential return equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated

**Key downside/upside risks** include slower/faster-than-expected China smartphone growth momentum; worse/better-than-expected product yield; shortage/good supply of high-end handset camera module components; and more severe/less severe-than-expected pricing pressure from competitors and handset OEMs.

**Sunny Optical: 2H14 results snapshot**

(CNYm)	2H14	1H14	H/H	2H13	Y/Y	HSBCe	Diff.	Cons	Diff.
Revenue	4,590	3,836	20%	3,027	52%	5,063	-9%	4,687	-2%
Gross Profit	728	562	30%	527	38%	773	-6%	750	-3%
GP Margin	15.9%	14.6%	1.2 pts	17.4%	-1.5 pts	15.3%	0.6 pts	16.0%	-0.1 pts
Operating Profit	342	316	8%	276	24%	383	-11%	353	-3%
OP Margin	7.5%	8.2%	-0.8 pts	9.1%	-1.7 pts	7.6%	-0.1 pts	7.5%	-0.1 pts
Non-Operating									
	(9)	(16)		(7)				10	
Pre-Tax Income	333	301	11%	269	24%	383	-13%	362	-8%
After-Tax Income	309	257	20%	244	27%	324	-5%	307	1%
EPS (RMB)	0.29	0.24	21%	0.24	19%	0.30	-5%	0.28	1%

Source: Company data, HSBC estimates, Bloomberg consensus

Sunny Optical: earnings revisions

(CNYm)	2014			2015e			2016e		
	HSBCe	Actual	% Change	Old	New	% Change	Old	New	% Change
Revenue	8,899	8,426	-5%	11,310	12,149	7%	13,690	14,276	4%
Gross Profit	1,334	1,289	-3%	1,761	1,899	8%	2,216	2,319	5%
Operating Income	700	658	-6%	894	963	8%	1,121	1,177	5%
Net Income	581	566	-3%	760	807	6%	953	989	4%
EPS (CNY)	0.54	0.52	-2%	0.70	0.75	6%	0.88	0.92	4%
Gross Margin	15.0%	15.3%	0 pts	15.6%	15.6%	0 pts	16.2%	16.2%	0 pts
Operating Margin	7.9%	7.8%	0 pts	7.9%	7.9%	0 pts	8.2%	8.2%	0 pts
Net Margin	6.5%	6.7%	0 pts	6.7%	6.6%	0 pts	7.0%	6.9%	0 pts

Source: Company data, HSBC estimates

## Sunny Optical: Semi-annual earnings forecast

(CNYm)	Fiscal 2010	Fiscal 2011		Fiscal 2011	Fiscal 2012		Fiscal 2012	Fiscal 2013		Fiscal 2013	Fiscal 2014		Fiscal 2014E	Fiscal 2015		Fiscal 2015E
		1H	2H		1H	2H		1H	2H		1H	2HE		1HE	2HE	
Sales	1,818	1,103	1,396	2,499	1,770	2,215	3,984	2,786	3,027	5,813	3,836	4,590	8,426	4,990	7,158	12,149
QoQ		12%	27%		27%	25%		26%	9%		27%	20%		9%	43%	
YoY	39%	32%	42%	37%	60%	59%	59%	57%	37%	46%	38%	52%	45%	30%	56%	44%
Cost of Goods	-1,426	-867	-1,109	-1,976	-1,430	-1,814	-3,243	-2,345	-2,500	-4,846	-3,275	-3,863	-7,137	-4,220	-6,029	-10,249
Percentage of Revenues	-78%	-79%	-79%	-79%	-81%	-82%	-81%	-84%	-83%	-83%	-85%	-84%	-85%	-85%	-84%	-84%
Gross profit	392	236	287	523	340	401	741	440	527	967	562	728	1,289	770	1,129	1,899
GM	21.6%	21.4%	20.6%	20.9%	19.2%	18.1%	18.6%	15.8%	17.4%	16.6%	14.6%	15.9%	15.3%	15.4%	15.8%	15.6%
Operating Income	182	129	150	278	189	220	409	235	276	511	316	342	658	391	572	963
OPM	10.0%	11.7%	10.7%	11.1%	10.7%	9.9%	10.3%	8.4%	9.1%	8.8%	8.2%	7.5%	7.8%	7.8%	8.0%	7.9%
Pre-tax Income	165	110	129	240	188	210	397	235	269	504	301	333	634	384	565	950
PBT margin	9%	10%	9%	10%	11%	9%	10%	8%	9%	9%	8%	7%	8%	8%	8%	8%
Net Profit	144	92	124	215	157	190	346	197	244	440	257	309	566	327	481	807
NM	8%	8%	9%	9%	9%	9%	9%	7%	8%	8%	7%	7%	7%	7%	7%	7%
QoQ		3%	35%		26%	21%		4%	24%		5%	20%		6%	47%	
YoY	56%	67%	39%	50%	71%	53%	61%	26%	28%	27%	30%	27%	29%	27%	55%	43%
EPS (CNY)	0.15	0.09	0.13	0.22	0.16	0.19	0.35	0.20	0.24	0.44	0.24	0.29	0.52	0.30	0.45	0.75
QoQ		3%	35%		26%	21%		3%	21%		-1%	21%		6%	47%	
YoY	61%	67%	39%	50%	71%	53%	60%	24%	24%	23%	19%	19%	20%	27%	55%	43%

Source: Company data, HSBC estimates

# Disclosure appendix

## Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Joyce Chen and Yolanda Wang

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For each stock we set a required rate of return calculated from the cost of equity for that stock's domestic or, as appropriate, regional market established by our strategy team. The price target for a stock represents the value the analyst expects the stock to reach over our performance horizon. The performance horizon is 12 months. For a stock to be classified as Overweight, the potential return, which equals the percentage difference between the current share price and the target price, including the forecast dividend yield when indicated, must exceed the required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile\*). For a stock to be classified as Underweight, the stock must be expected to underperform its required return by at least 5 percentage points over the next 12 months (or 10 percentage points for a stock classified as Volatile\*). Stocks between these bands are classified as Neutral.

Our ratings are re-calibrated against these bands at the time of any 'material change' (initiation of coverage, change of volatility status or change in price target). Notwithstanding this, and although ratings are subject to ongoing management review, expected returns will be permitted to move outside the bands as a result of normal share price fluctuations without necessarily triggering a rating change.

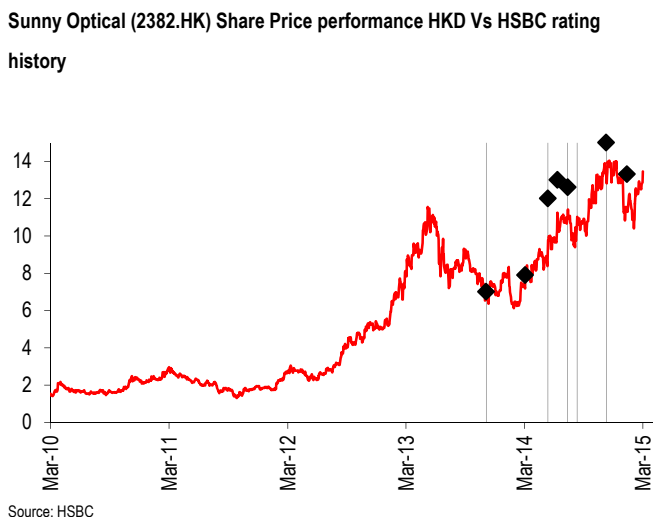
\*A stock will be classified as volatile if its historical volatility has exceeded 40%, if the stock has been listed for less than 12 months (unless it is in an industry or sector where volatility is low) or if the analyst expects significant volatility. However, stocks which we do not consider volatile may in fact also behave in such a way. Historical volatility is defined as the past month's average of the daily 365-day moving average volatilities. In order to avoid misleadingly frequent changes in rating, however, volatility has to move 2.5 percentage points past the 40% benchmark in either direction for a stock's status to change.

## Rating distribution for long-term investment opportunities

As of 10 March 2015, the distribution of all ratings published is as follows:

<b>Overweight (Buy)</b>	42%	(30% of these provided with Investment Banking Services)
<b>Neutral (Hold)</b>	39%	(28% of these provided with Investment Banking Services)
<b>Underweight (Sell)</b>	19%	(20% of these provided with Investment Banking Services)

## Share price and rating changes for long-term investment opportunities



### Recommendation & price target history

From	To	Date
N/A	Neutral (V)	11 November 2013
Neutral (V)	Overweight (V)	21 May 2014
Overweight (V)	Neutral (V)	21 July 2014
Neutral (V)	Overweight (V)	18 August 2014
Overweight (V)	Neutral (V)	17 November 2014
Target Price	Value	Date
Price 1	7.00	11 November 2013
Price 2	7.90	12 March 2014
Price 3	12.00	21 May 2014
Price 4	13.00	20 June 2014
Price 5	12.60	21 July 2014
Price 6	15.00	17 November 2014
Price 7	13.30	20 January 2015

Source: HSBC



## HSBC & Analyst disclosures

### Disclosure checklist

Company	Ticker	Recent price	Price Date	Disclosure
SUNNY OPTICAL	2382.HK	13.46	10-Mar-2015	6, 7

Source: HSBC

- 1 HSBC has managed or co-managed a public offering of securities for this company within the past 12 months.
- 2 HSBC expects to receive or intends to seek compensation for investment banking services from this company in the next 3 months.
- 3 At the time of publication of this report, HSBC Securities (USA) Inc. is a Market Maker in securities issued by this company.
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- 8 A covering analyst/s has received compensation from this company in the past 12 months.
- 9 A covering analyst/s or a member of his/her household has a financial interest in the securities of this company, as detailed below.
- 10 A covering analyst/s or a member of his/her household is an officer, director or supervisory board member of this company, as detailed below.
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### Additional disclosures

- 1 This report is dated as at 10 March 2015.
- 2 All market data included in this report are dated as at close 10 March 2015, unless otherwise indicated in the report.
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