

Equity Research | China | Technology

22 June 2018

Intensifying competition weighs on gross margin

- A mixed set of takeaways from SunnyOp's Reverse Roadshow at its Yuyao headquarters reaffirm our concerns over GM pressure amid intensifying competition in the CCM market.
- Management expects a YoY decline in GPM in 1H18, primarily dragged by lower CCM GPM, but see potential HoH improvement in 2H18 to be driven by rising mass shipments of triple cam and 3D sensing (ToF and Structured Light).
- We trimmed our FY18E/FY19E revenue and profit estimates by 2.5%/1.3% and 9.7%/0.4% respectively and lowered our DCF-based price target to HKD132 (from HKD135). Maintain Hold.

CCM margin pressure to persist in FY18E and FY19E. As well expected, SunnyOp guided a CCM gross margin squeeze in 1H18 in the face of an increasingly competitive industry due to 1) COB overcapacity, 2) enhanced APU computing power leads to an industry-wide dual-cam margin contraction (lower precision requirement), and 3) uptick in component (lens, VCM, CMOS sensor) prices due to shortage. In addition, Korean competitors, SEMCO and LG Innotek, have made inroads into the Chinese Android supply chain. Looking forward, we see SunnyOp to buck the industry with a rapidly expanding CCM capacity (from 55KK to 65KK per month by end-18) to entrench its leading position and utilise a variety of cutting-edge technologies (e.g., Wafer Level Testing, IR Cut On Chip Packaging, ('IOC') and next-gen AA) to sustain a margin gap with its competitors. We foresee a more competitive CCM industry across-the-board in both FY18E and FY19E which bodes badly for SunnyOp's CCM ASP and GPM.

HLS to benefit from next wave of optical spec upgrades. SunnyOp's HLS business growth is well-on track (shipment grew by 47.0% YoY during Jan-May 2018) and management guided a margin expansion in 1H18 thanks to its rising penetration into Android flagship's front cam (including Samsung's S9, Huawei's P20/P20 Pro, OPPO's R15 and vivo's X21). SunnyOp is also expanding its HLS capacity to 90KK from 70KK by end-18. Looking forward, management expects a more widespread adoption of periscope-style triple-cam for high-factor optical zoom (5-10X) from 2019 onwards, which will likely further drive SunnyOp's HLS volume growth and ASP expansion, given its strong suit in telephoto lens and periscope camera, and support HCM segment ASP/GPM from 2H19, in our view.

Automotive business, a long-term growth driver. Besides establishing an industry-leading position in VLS, SunnyOp has ramped up efforts in automotive sensing, including vehicle cam module, Head-Up Displays ('HUD') and light detection and ranging ('Lidar'), which could benefit SunnyOp in terms of proliferation of ADAS and autonomous driving from 2020E onwards, in our view.

Industry headwind clouds near-term growth outlook. We trimmed our FY18E/FY19E revenue and profit estimates by 2.5%/1.3% and 9.7%/0.4% respectively and lowered our DCF-based price target to HKD132 (from HKD135). Maintain Hold.

Sunny Optical (2382 HK)

Hold

(unchanged)

Price Target	HK\$132
(Revision)	(-2.2%)
(downside)	(9.5%)

EPS revision	2017E	2018E
	-9.7%	-0.4%

Close price	HKD145.9
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Market cap.	USD20,401mn
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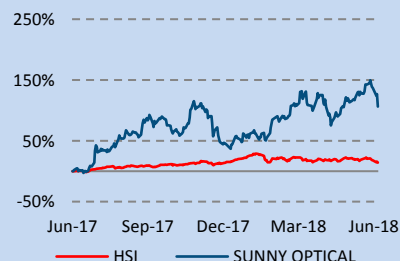
Free float	61.1%
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52-week range	HKD67.0 – 174.9
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3-mth ave. T/O	HKD1,142mn
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Price as of 22-June-2018

Stock rel HSI performance (%)


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Income statement (RMBmn)

Year end: Dec	2016	2017E	2018E	2019E	2020E
Revenue	14,612	22,366	27,207	32,771	39,279
COGS	(11,932)	(17,563)	(21,542)	(25,398)	(29,721)
Gross profit	2,680	4,803	5,665	7,373	9,557
Selling and marketing	(154)	(205)	(244)	(283)	(311)
R&D	(694)	(1,168)	(1,367)	(1,695)	(1,983)
Admin	(331)	(389)	(447)	(501)	(551)
Operating profit	1,501	3,041	3,607	4,894	6,712
Other income, net	73	125	110	115	121
EBIT	1,574	3,166	3,717	5,010	6,833
Net interest	30	32	23	49	75
Associates and JVs	(12)	(16)	(17)	(18)	(19)
Exceptional items	(145)	136	118	104	113
Pretax profit	1,446	3,318	3,841	5,145	7,002
Taxation	(175)	(404)	(510)	(724)	(1,044)
Net profit	1,272	2,914	3,331	4,421	5,958
Non controlling interests	(1)	(13)	(13)	(14)	(15)
Net profit for parent	1,271	2,902	3,318	4,407	5,943
Basic, basic (RMB)	1.18	2.67	3.02	4.02	5.42
Basic, diluted (RMB)	1.17	2.66	3.02	4.01	5.41
DPS (RMB)	0.29	0.66	0.76	1.00	1.35

Balance sheet (RMBmn)

Year end: Dec	2016	2017E	2018E	2019E	2020E
Cash	467	1,227	1,504	2,141	4,916
Short term investments	2,201	1,973	1,935	1,898	1,862
Accounts receivables	3,716	5,666	6,346	6,980	7,678
Inventory	2,828	2,622	3,015	3,347	3,715
Other current assets	106	148	159	175	192
Total current assets	9,318	11,635	12,959	14,541	18,363
PP&E	1,794	2,586	4,033	5,525	6,746
Intangible Assets	0	392	392	392	392
Associates and JVs	100	125	141	159	178
Other long term assets	425	988	1,092	1,194	1,308
Total long term assets	2,319	4,091	5,659	7,270	8,625
TOTAL ASSETS	11,637	15,726	18,618	21,812	26,988
Short term debt	904	1,348	1,078	216	43
Accounts payables	5,573	6,183	6,677	7,078	7,503
Other current liabilities	181	175	187	199	212
Total current liabilities	6,658	7,705	7,942	7,493	7,758
Long term debt	-	-	-	-	-
Deferred tax	34	107	118	129	142
Other long term liabilities	31	395	416	438	462
Total long term liabilities	65	502	533	567	604
TOTAL LIABILITIES	6,723	8,207	8,476	8,060	8,362
Shareholders' funds	4,895	7,489	10,082	13,659	18,500
Minority Interests	18	31	44	58	72
TOTAL LIAB AND EQUITY	11,637	15,726	18,601	21,777	26,935
Net cash / (debt)	(437)	(121)	426	1,926	4,873

Cash flow statement (RMBmn)

Year end: Dec	2016	2017E	2018E	2019E	2020E
EBIT	1,574	3,166	3,717	5,010	6,833
Depreciation & amortisation	317	491	553	608	669
Net interest	30	32	23	49	75
Taxes paid	(175)	(404)	(510)	(724)	(1,044)
Changes in working capital	(142)	(1,126)	(613)	(600)	(687)
Others	12	277	118	104	113
Cash flow from operations	1,616	2,436	3,288	4,447	5,959
Capex	(792)	(1,142)	(2,000)	(2,100)	(1,890)
Acquisitions	-	(27)	-	-	-
Disposals	10	13	-	-	-
Others	(478)	(531)	(16)	(18)	(20)
Cash flow from investing	(1,260)	(1,686)	(2,016)	(2,118)	(1,910)
Dividends	(228)	(318)	(725)	(830)	(1,102)
Issue of shares	-	-	-	-	-
Change in debt	221	444	(270)	(863)	(173)
Others	(68)	(115)	-	-	-
Cash flow from financing	(76)	10	(995)	(1,692)	(1,274)
Change in cash	280	760	277	637	2,775
Free cash flow	356	750	1,272	2,329	4,049

Key ratios

Year end: Dec	2016	2017E	2018E	2019E	2020E
Operating ratios					
Gross margin (%)	18.3	21.5	20.8	22.5	24.3
Net margin (%)	8.7	13.0	12.2	13.4	15.1
Effective tax rate (%)	12.1	12.2	13.3	14.1	14.9
Revenue growth (%)	36.6	53.1	21.6	20.5	19.9
Net income growth (%)	66.8	128.3	14.4	32.8	34.8
EPS growth adj (%)	66.8	128.3	14.4	32.8	34.8
DPS growth (%)	39.4	127.9	14.4	32.8	34.8
Efficiency ratios					
ROE (%)	26.0	38.7	32.9	32.3	32.1
ROCE (%)	31.6	39.5	34.8	35.0	35.5
Asset turnover (x)	1.3	1.4	1.5	1.5	1.5
Op cash / EBIT (x)	1.0	0.8	0.9	0.9	0.9
Depreciation / CAPEX (x)	0.4	0.4	0.3	0.3	0.4
Accounts receivable days	83.9	76.6	80.6	74.2	68.1
Accounts payable days	129.8	122.1	108.9	98.8	89.5
Leverage ratios					
Net gearing (%)	8.9	1.6	(4.2)	(14.0)	(26.2)
Net debt / EBITDA (x)	(0.2)	(0.0)	0.1	0.4	0.7
Interest cover (x)	97.3	64.9	72.4	187.3	1,309.1
Current ratio (x)	1.4	1.5	1.6	1.9	2.4
Valuation					
PER (x)	112.0	44.7	39.1	29.3	21.6
EV/EBITDA (x)	72.2	37.6	32.0	23.6	17.0
PBR (x)	29.0	17.3	12.8	9.4	6.9
Dividend yield (x)	0.2	0.6	0.6	0.9	1.2

Source: Company, Bloomberg, CSCI Research estimates

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Company Rating Definition

The Benchmark: Hong Kong Hang Seng Index; Time Horizon: 12 months

Buy	12-month absolute total return: $\geq 10\%$
Hold	12-month absolute total return: $> -10\%$ but $< 10\%$
Sell	12-month absolute total return: $\leq -10\%$

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