

Strategy on track with better margin outlook

Rating	BUY	Maintain
Target Price	HKD 70.09	From: HK\$49.37
Current price	HKD 46.65	Upside: +50.3%

1H24 result strong beat mainly driven by volume and GM

Sunny's 1H24 result was ahead of market consensus, with revenue and net income came in at RMB14,279mn/1,079mn respectively (+32.1%/+147%Yoy), (12.4%/14.3% above consensus), Sunny's net income arrived at the high-end of the profit alert (+140-150% Yoy) in end-Jul. Sunny's 1H24 net profit reached 60% of our FY24E estimates. We attributed Sunny's result beat to the following factors: **i) smartphone end demand gradual recovery (esp. flagship models), which drove volume shipment, ASP and GM. Blended GM came in 17.2% (vs. 1H23 at 14.9% and 20bps higher than Bloomberg consensus), thanks to HLS and optoelectronics margin improvement; ii) lower effective tax rate offset higher interest cost.**

Slight uplift in HLS shipment guidance, with better GM outlook in HLS and HCM; Continue to focus on ASP & GM improvement

Handset related sales grew 34.5% Yoy to RMB13.0bn on the back of gradual smartphone end demand, while spec upgrade and lesser competition help both ASP and GM significantly improve. Optical components (mainly HLS) and optoelectronics (mostly HCM) shipment volume arrived at 634mn/289mn units (+23.7%/+13.5% Yoy) respectively.

Sunny's optical components and optoelectronics' GM each rebounded 5.8ppts/1.3 ppts Yoy to 31.8%/8.2%. Optical components' GM stayed above 30% level for the 2nd consecutive quarter, which we believe Sunny benefit from the recovery in premium smartphone market, which drove both ASP and GM, meanwhile improved yield rate also benefit HCM's GM. Management provided a better FY24E GM outlook vs. FY23 result, with HLS/VLS/HCM GM at ~20-25%/~40%/6-10% respectively (vs. ~20%/~40%/5-6% respectively).

Sunny's 1H24 high-end handset product shipment (i.e. 6P+ lens, periscopes and large image size modules) was back to growing trajectory Yoy, though the volume contribution was still largely stable HoH, its higher ASP play an important role in driving sales growth, we view this not as a sign of stabilization in high end product shipment, but also on the right track for Management's 'quality-growth' strategy:

- Sunny's high-end product contribution made good progress in recent years with increasing contribution from 6P+ lens (23.0%/24.7%/25.6%/32% in FY19-Y23). In 1H24, shipment grew 23.2% Yoy (vs. 1H23: -32.9% yoy) to 162mn units (25.6% contribution, vs. 25.7%/25.8% in 1H23/FY23).
- Periscopes and large image size (> 1/1.5") camera modules soared 66.5% Yoy (vs.10.9% in 1H23) to 15.0mn units and took up 7.6% of HCM shipment volume (vs. 6%/10.3%/6.7%/13.7%/7.6% in FY19-FY23). According to Management, high end HCM took up 20% of HCM revenue.

Sunny slightly raised its HLS shipment guidance from 10% to 10-15% Yoy, while leaving HCM flattish shipment guidance unchanged. Management would continue focus on improving product mix which would benefit both ASP and GM. Nevertheless, we still expect global smartphone shipment would gradually pick up in FY24E, mainly driven by top-tier clients' flagship model. We still expect Sunny's share gain in US smartphone client (HLS + potential CCM orders) and Samsung (supplying flagship HCM) is still on upward trajectory, which would provide support to both ASP and GM.

Result Takeaway

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Trading data

52-Week Range (HK\$)	76.35/33.30
3 Mth Avg Daily Vol (m)	12.79
No of Shares (m)	1,094.8
Market Cap (HK\$m)	50,689.2
Major Shareholders (%)	Wang Wenjian (38.5%)
Auditors	Deloitte
Result Due	FY24E: Mar 2025

Company description

Founded in 1984, Sunny Optical (SO) is a leading integrated optical products manufacturer mainly for digital camera and handset. The company dominates in China handset market with ~50% market share. It focuses heavily on domestic OEMs (Huawei, Vivo, Oppo, Xiaomi), with customers in Korea (Samsung) and Japan (Sony, Panasonic and Nikon).

We continue to expect the shipment pace would be similar to that in FY19-FY23, Sunny's YTD (7M24) HLS and HCM shipment reached ~58%/58% of latest guidance, both are still slightly ahead of guidance (vs. ~54%/55% on average in FY19-FY23). Management remains positive on long term prospects (incl. variable aperture, hybrid lens, OIS and sensor-shift stabilization), meanwhile AI technology and foldables would lead the growth of high-end smartphones and promote a new round of replacement cycle in the medium term.

XR is another bright spot in 1H24, with revenue rocketed 110% Yoy to ~RMB1bn and took up 5.3% of total revenue (vs. 1.6%/3.6%/6.2%/5.9% in FY20-FY23), as Sunny continued to provide various products (incl. SLAM modules and HD video see through camera modules) to its renowned customers. Meanwhile, Sunny has been actively developing the next generation of multi-sensing XR visual modules, they also has become the first manufacturer in the industry to mass produce MicroLed optical engines, hence deepening the co-operation with leading XR customers.

■ **Automotive products: Raised FY24E VLS shipment guidance, Strong CCM order book paves way for future growth; Continued R&D and comprehensive product offerings;**

Vehicle related products (incl. both VLS+ vehicle camera modules) sales rose 16.4% Yoy to RMB2,877mn and accounted for 15.3% of total revenue (vs. 5.0%/8.1%/10.2%/17.3%/16.6% in 1H20/1H21/1H22/1H23/FY23), on the back of VLS shipment grew 13.1% Yoy to 53.2mn units. Sunny guided up FY24E VLS shipment to grow 10-15% Yoy (vs. ~10% Yoy in FY23 result), and Sunny's 7M24 shipment arrived at ~62mn units (~60% of latest FY24E guidance vs. ~55% on average in FY19-FY23)

Sunny remains upbeat automotive business long term outlook, driven by project wins, and increasing no. of cam adoption accompanied by more compact design (e.g. COB packaging technology on automotive CCM) with added value (e.g. active defogging), pixel migration etc. Sunny maintained its **automotive CCM revenue growth target at 25% Yoy in FY24E, they also highlighted that the order book on hand has already reached RMB10bn (vs. FY23 revenue at RMB1.6bn), we believe the order book bodes well for Sunny's automotive CCM revenue growth in mid-long term.** Despite near term headwinds, we believe Sunny would continue to benefit from increasing automotive CCM, LiDAR and ADAS penetration, thanks to their leadership in VLS (No.1 with >30% global market share) and leading supplier in automotive CCM.

■ **Unchanged FY24E CAPEX guidance; Continue to pave way for long term growth**

Sunny continues to invest in product R&D and technology upgrades. R&D expense arrived at ~RMB1.47bn and accounted for 7.8% of total revenue (vs. 5.9%/6.6%/7.0%/8.4%/8.1% in FY19-FY23). We expect Sunny R&D expense would maintain at ~8% in FY24E/FY25E.

Sunny's 1H24 CAPEX was largely flattish Yoy at RMB1,046mn and maintained its FY24E CAPEX at ~RMB3.0bn (+20% Yoy, similar to FY22 level), in which ~40% would be used in XR and auto related segment (lens and CCM), while remaining will be allocated to HLS capacity expansion (for high-end clients) and development of motors in HCM, and expanding infrastructure in Vietnam (including new factories).

■ **Raise FY24E-26E EPS forecasts; Quality growth + diversification strategy well on track; Price correction overdone, Maintain BUY**

We raise Sunny's FY24E-26E net profit estimates by 35.8%/34.0%/31.7%, on the back of higher sales and GM forecast, we continue to expect a mild recovery in FY24E driven by top-tier smartphone clients. We still view Sunny's leadership in HLS and HCM remains intact, and their strategy to diversify away from smartphones is well on track, with non-smartphone revenue contribution (with auto+XR accounted for >60% of the non-smartphone sales) increased to >30% of total revenue in 1H24 vs. 15.5% in FY20. Market reacted positively after Sunny's 1H24 result and updated guidance outlook, and we viewed the price correction (due to soft shipment guidance, shareholder sell-off concern through setting up an equity collar option and market concerns on global smartphone market recovery pace) since FY23 result has been overdone.

Sunny is now trading at FY24E/25E 19.5x/16.0x PE (>1s.d. below Sunny's 10-year average), we expect FY24E-26E sales and net profit growth would accelerate to 10.7%/20.3% CAGR (vs. 8.4%/22.3% in our last update in Apr 24) on the back of **i) gradual global smartphone market recovery, ii) continued share gain in top-tier smartphone clients and iii) increasing non-smartphone contribution.** Our FY24E-26E net earnings estimates are 3.2%/2.4%/2.2% higher than Bloomberg median consensus. Sunny's clear mid-term product roadmap would continue to play a part in Sunny's new growth engine, we maintain Sunny's rating at BUY with new TP at HK\$70.09, which translates to FY25E 24.0x target PE (~15% discount to 10-year average). Sunny remains one of our sector top pick, we continue to advise investors to buy on dip and ride on smartphone market recovery.

Exhibit 1: Sunny Optical's shipment volume & sales breakdown (1H21-1H24)

Shipment Volume (Mn Units)	1H21	2H21	1H22	2H22	1H23	2H23	1H24	hoh	yoy
Optical components	825.0	838.1	769.8	669.5	603.8	759.4	738.3	-2.8%	22.3%
Spherical lenses	19.1	22.2	16.9	22.2	11.4	11.9	12.0	1.7%	5.6%
Handset lens sets	717.1	722.5	651.6	541.0	512.8	658.1	634.4	-3.6%	23.7%
Vehicle lens sets	37.3	30.7	37.6	41.3	47.1	43.7	53.2	21.7%	13.1%
Other lens sets	51.5	62.8	63.7	65.0	32.6	45.7	38.6	-15.6%	18.4%
Optoelectronic products	390.4	342.1	315.4	251.8	265.5	334.1	306.4	-8.3%	15.4%
Handset camera modules	361.2	312.5	288.7	228.0	254.6	312.9	289.0	-7.6%	13.5%
Others (incl. 3D sensing products such as structured light and ToF)	29.1	29.7	26.7	23.9	10.9	21.2	17.4	-17.8%	59.1%
Optical instruments	117.5	137.4	133.1	186.6	135.5	115.7	93.3	-19.4%	-31.2%
	117.5	137.4	133.1	186.6	135.5	115.7	93.3	-19.4%	-31.2%
Total	1,332.9	1,317.6	1,218.2	1,107.9	1,004.8	1,209.2	1,138.0	-5.9%	13.3%
Segment Revenue (RMB mn)	1H21	2H21	1H22	2H22	1H23	2H23	1H24	hoh	yoy
Optical components	4,343.9	4,432.2	4,399.0	5,068.5	4,317.9	5,237.2	5,480.4	-14.8%	-1.8%
Optoelectronic products	15,307.8	13,025.7	12,370.9	10,955.0	9,736.5	11,862.9	13,191.1	-11.1%	-21.3%
Optical instruments	181.7	205.6	201.8	201.6	224.1	302.6	188.7	11.1%	11.0%
Total	19,833.4	17,663.4	16,971.8	16,225.2	14,278.6	17,402.7	18,860.2	-12.0%	-15.9%
Growth (Yoy%)									
Optical components	12.4%	-16.7%	1.3%	14.4%	-1.8%	3.3%	26.9%		
Optoelectronic products	2.9%	-4.4%	-19.2%	-15.9%	-21.3%	8.3%	35.5%		
Optical instruments	43.7%	2.8%	11.1%	-1.9%	11.0%	50.1%	-15.8%		
Total	5.1%	-7.7%	-14.4%	-8.1%	-15.9%	7.3%	32.1%		
By product (RMB Mn)									
Handset	15,852	13,745	12,756	10,521	9,689	11,246	13,029		
Auto	1,614	1,347	1,725	2,383	2,471	2,812	2,877		
AR/XR	595	750	660	1,402	469	1,401	992		
Others	1,772	1,822	1,831	1,920	1,649	1,944	1,962		
Total	19,833	17,663	16,972	16,225	14,279	17,403	18,860		
Growth (Yoy%)									
Handset	-4.7%	-11.3%	-19.5%	-23.5%	-24.0%	6.9%	34.5%		
Auto	72.4%	-14.5%	6.9%	76.9%	43.3%	18.0%	16.4%		
AR/XR	425.7%	55.2%	10.9%	87.0%	-28.9%	-0.1%	111.4%		
Others	49.3%	14.7%	3.3%	5.4%	-9.9%	1.3%	19.0%		
Total	5.1%	-7.7%	-14.4%	-8.1%	-15.9%	7.3%	32.1%		

Source: Company data, CIRC

Exhibit 2: We revised up Sunny's FY24E-26E earnings on higher sales and GM assumption

	FY24E(old)	FY24E(new)	Diff	FY25E(old)	FY25E(new)	Diff	FY26E(old)	FY26E(new)	Diff
Revenue	33,970	37,356	10.0%	36,850	41,752	13.3%	39,913	45,851	14.9%
GM	15.9%	17.6%	+170bps	16.7%	18.1%	+140bps	17.5%	18.7%	+130bps
Operating profit	2,525	3,353	32.8%	3,026	3,938	30.1%	3,601	4,619	28.3%
Net Profit	1,789	2,430	35.8%	2,211	2,964	34.0%	2,676	3,521	31.6%
EPS (RMB)	1.63	2.22	35.8%	2.02	2.70	34.0%	2.44	3.21	31.7%

Source: CIRL estimates

Exhibit 3: Financial statement
Income statement

Year to Dec (RMB mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue	33,197	31,681	37,356	41,752	45,851
Gross profit (reported)	6,605	4,590	6,571	7,542	8,569
EBITDA	4,954	3,852	5,594	6,443	7,370
Depreciation	(1,941)	(2,067)	(2,241)	(2,505)	(2,751)
EBIT	3,014	1,785	3,353	3,938	4,619
Net interest income (exp.)	(293)	(449)	(511)	(472)	(452)
Associates	(6)	23	0	0	0
Exceptionals/others	0	0	0	0	0
Profit before tax	2,715	1,358	2,842	3,466	4,167
Tax expenses	(241)	(208)	(341)	(416)	(542)
Minority interest	(66)	(51)	(71)	(87)	(104)
Net profit	2,408	1,099	2,430	2,964	3,521
Dividends	-480	-218	-482	-589	-699

Balance sheet

Year to Dec (RMB mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Cash & equiv	15,784	22,744	14,114	15,966	18,360
Trade receivables	7,205	7,855	8,073	9,022	9,908
Other receivables	0	0	0	0	0
Inventories	4,721	5,137	5,629	6,276	6,939
Other current assets	1,729	1,729	1,729	1,729	1,729
Fixed assets	9,340	9,761	10,520	10,758	10,879
Intangible assets	0	0	0	0	0
Investment, associates etc	434	456	456	456	456
Total assets	39,213	47,682	40,520	44,208	48,272
Account payables	12,917	20,325	11,276	12,533	13,656
Other payables	0	0	0	0	0
Short-term debt	1,990	699	699	699	699
Other current liabs	707	674	807	882	1,008
Long-term debts	0	0	0	0	0
Deferred tax and others	1,482	3,231	3,231	3,231	3,231
Other long-term liabs	0	0	0	0	0
Total liabilities	17,096	24,929	16,013	17,345	18,594
Share capital	105	105	105	105	105
Reserves	21,733	22,318	24,001	26,270	28,981
Shareholders' equity	21,838	22,423	24,106	26,375	29,087
Minorities	279	330	401	488	592
Total equity	22,117	22,753	24,507	26,863	29,678
Net cash (debt)	13,794	22,045	13,415	15,267	17,661

Cash flow

Year to Dec (RMB mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Pre-tax profit	2,715	1,358	2,842	3,466	4,167
Taxes paid	(1,286)	1,509	(208)	(341)	(416)
Depreciation	1,941	2,067	2,241	2,505	2,751
Associates	6	(23)	(0)	(0)	(0)
CFO bef. WC change	3,375	4,911	4,875	5,630	6,502
Change in working cap	4,053	6,342	(9,758)	(340)	(427)
Cashflow from operation	7,428	11,253	(4,883)	5,291	6,076
CAPEX	(3,114)	(2,488)	(3,000)	(2,744)	(2,872)
Free cash flow	4,314	8,765	(7,883)	2,547	3,204
Dividends	(480)	(218)	(482)	(589)	(699)
Balance sheet adj.	(0)	0	0	0	(0)
Share issued	0	(0)	0	0	0
Others	(677)	(297)	(264)	(106)	(111)
Net cash flow	3,157	8,251	(8,630)	1,852	2,394
Net cash (debt) start	10,638	13,794	22,045	13,415	15,267
Net cash (debt) at year-end	13,794	22,045	13,415	15,267	17,661

Ratios

Year to Dec (RMB mn)	FY22A	FY23A	FY24E	FY25E	FY26E
Growth rate (%)					
Revenue	(11.5)	(4.6)	17.9	11.8	9.8
EBITDA	(34.9)	(22.3)	45.2	15.2	14.4
EBIT	(48.4)	(40.8)	87.8	17.5	17.3
Net profit	(51.7)	(54.3)	121.0	22.0	18.8
EPS	(51.7)	(54.3)	121.0	22.0	18.8
Margins (%)					
Gross margin (reported)	19.9	14.5	17.6	18.1	18.7
EBITDA	14.9	12.2	15.0	15.4	16.1
EBIT	9.1	5.6	9.0	9.4	10.1
Net margin	7.3	3.5	6.5	7.1	7.7
Other ratios					
ROE (%)	10.9	4.8	9.9	11.0	11.9
ROA (%)	6.1	2.3	6.0	6.7	7.3
Net gearing (%)	(62.4)	(96.9)	(54.7)	(56.8)	(59.5)
Interest coverage (x)	10.3	4.0	6.6	8.3	10.2
Receivables days	79.2	90.5	78.9	78.9	78.9
Payables days	177.3	273.8	133.7	133.7	133.7
Inventory days	64.8	69.2	66.7	67.0	67.9
Effective tax rate (%)	8.9	15.3	12.0	12.0	13.0

Source: Company data, CIRL estimates

Risk Factors

Downside risks include: 1) Prolonged upstream component supply shock; 2) Further slowdown in PRC customers' smartphone shipment ;3) Slower than expected multi-lens/HCM adoption in Android camp; 4) non-smartphone products' shipment/ sales disappoints, 5) pricing pressure arising from overseas players and domestic peers and 6) RMB depreciation

Rating Policy

	Rating	Definition
Stock Rating	Buy	Outperform HSI by 15%
	Neutral	Between -15% ~ 15% of the HSI
	Sell	Underperform HSI by -15%
Sector Rating	Accumulate	Outperform HSI by 10%
	Neutral	Between -10% ~ 10% of the HSI
	Reduce	Underperform HSI by -10%

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Analyst Certification

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