



SUNOTG 3.75% 01/23/23 (SUNOTG)

Intermediate-Term Carry (USD)

Marc Tan / 65 6202 1195 / marc.tan@kgi.com

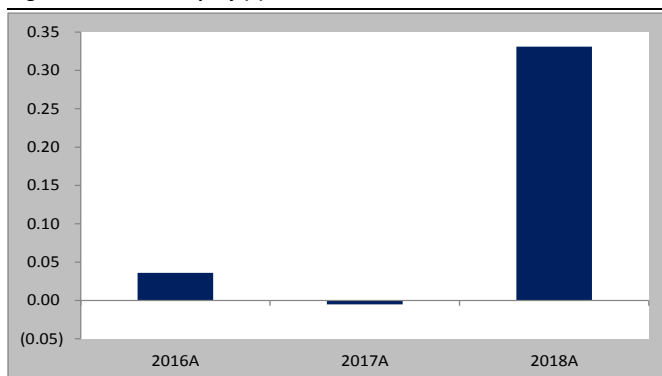
Company Background: Listed on the HKEx main board in 2007, Sunny Optical is an integrated optical device manufacturer and optical imaging system solutions provider. The company is one of the largest handset camera module suppliers in China, serving tier-one smartphone OEMs such as Huawei, Vivo, Oppo, Xiaomi and Meizu. Sunny Optical also manufactures lens sets for mobile devices, automotive lenses, spherical lenses and optical instruments. The company has five production sites in the Yangtze River Delta, Bohai Bay and Central Plains regions.

Credit Considerations:

2018 earnings hurt by renminbi depreciation & low utilization but balance sheet remains strong. The below-par revenue growth was primarily due to ASP decline in lens products (-7.7% YoY) and optoelectronic products (mainly CCM, -15.3% YoY), despite HLS and CCM shipments rising 56.4% and 30.3% YoY, respectively. Gross margin fell 2.5ppts YoY accordingly, and segment gross margin of CCM declined 4.7ppts to 8.4%, below our expectation of 9%. The company ascribed the fall to renminbi depreciation and the low utilization rate of its new production plant. Forex loss amounted to Rmb377.5mn in 2018 (2017: gain of Rmb42.8mn), primarily due to the US\$600mn bond issued in January 2018. Excluding the forex impact, adjusted operating profit grew 3.4% YoY to Rmb3.46bn in 2018.

Amid smartphone shipment slowdown, Sunny has given an aggressive capex budget of Rmb3bn (2018: Rmb2.6bn) but we believe the company is capable of meeting the capex plan without raising its gearing ratio given its annual operating cash inflow of over RMB 3bn (2018: RMB 3.6bn). For FY19, we expect net debt/equity to improve to 17.9% from 33.1% in FY18 and interest coverage ratio to improve to 21.2x from 15.1x in FY18.

Figure 2: Net Debt/Equity (x)

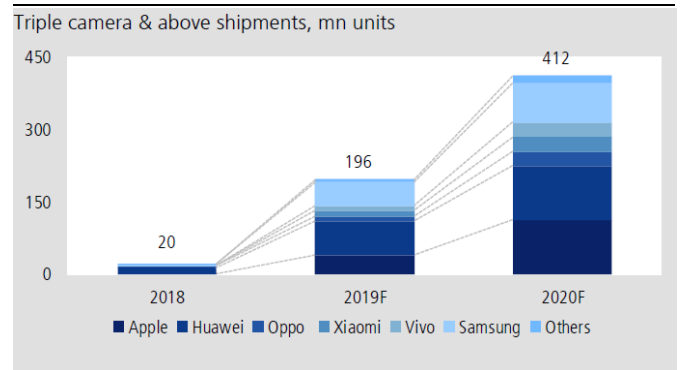


Source: Company Data, KGI Research

Market share expansion in handset lens continues with bullish guidance for 2019. While handset lens sets delivery declined 20% MoM for Feb 2019 due to the Spring Festival Holiday, deliveries grew by 19.5% YoY to 65.19 million as market share expansion continued. For FY19, Sunny has given bullish shipment guidance: HLS growth at 25-30% YoY, CCM growth at 20-25% YoY and vehicle lens set (VLS) growth at 25% YoY.

The growth will be bolstered by increasing multi-camera shipments, market share gains through high-end order wins (e.g. periscope camera on Huawei (CN) P30 Pro) and optimizing the cost structure for production automation. However, the company mentioned that gross margin of CCM is still under pressure in 1H19 on low production yield rates for some high-end products (one of which we believe is quadruple camera (periscope camera included) on P30 Pro) and production automation still underway, which will drag production efficiency.

Figure 2: Estimated shipments of tri-cameras and above



Source: KGI Research

Credit Recommendations:

In line with our defensive portfolio positioning, we add SUNOTG's 2023 to our defensive portfolio. The bond is currently trading at 99.4 with a YTW of 3.9% and duration of 3.5. The bond classifies as an Investment Grade issue with a Baa2 ratings by Moody's.

Subordination Risk - The 2023 is a senior unsecured note that was issued out of Sunny Optical's Holding Company while the majority of the group's claims are at its operating subsidiaries. As a result, recovery value for bondholders could be lower in a bankruptcy scenario.

Financials

FYE 31 December

INCOME STATEMENT (RMB mn)	2016A	2017A	2018A
Revenue	14,612.0	22,366.0	25,931.9
Operating Profit	1,475.0	3,383.0	3,077.2
EBITDA	1,738.0	3,797.0	3,731.0
Interest Expense	16.0	49.0	202.1
Profit Before Tax	1,446.0	3,318.0	2,851.3
Net Profit	1,271.0	2,902.0	2,491.0
BALANCE SHEET and CASH FLOW (RMB mn)	2016A	2017A	2018A
Cash & ST securities	2,768.0	3,341.0	7,342.0
Net Debt	177.0	(39.0)	3,073.0
Shareholders Equity	4,913.0	7,519.0	9,288.0
Total Assets	11,637.0	15,726.0	22,852.0
CFO	0.0	0.0	3,568.0
Capex (PPE)	(279.0)	(281.0)	(2,617.0)
Total Liabilities	6,723.0	8,207.0	13,564.0
Net Fixed Assets	1,794.0	2,586.0	4,523.0
Free Cash Flow	1,331.0	1,959.0	449.0
KEY RATIOS	2016A	2017A	2018A
EBITDA Margin (%)	11.9	17.0	14.4
Net Margin (%)	8.7	13.0	9.6
Net Debt to EBITDA (x)	0.1	(0.0)	0.8
Net Debt to Equity (x)	0.04	(0.01)	0.33
Net Debt to Total Assets (x)	0.0	(0.0)	0.1
EBITDA to Interest (x)	90.4	69.0	15.1

Source: Company Data, KGI Research

KGI's Ratings

Rating	Definition
	KGI Securities Research's recommendations are based on an Absolute Return rating system.
BUY	>10% total return over the next 12 months
HOLD	-10% to +10% total return over the next 12 months
SELL	<-10% total return over the next 12 months

Disclaimer

This report is provided for information only and is not an offer or a solicitation to deal in securities or to enter into any legal relations, nor an advice or a recommendation with respect to such securities. This report is prepared for general circulation. It does not have regard to the specific investment objectives, financial situation and the particular needs of any recipient hereof. You should independently evaluate particular investments and consult an independent financial adviser before dealing in any securities mentioned in this report.

This report is confidential. This report may not be published, circulated, reproduced or distributed and/or redistributed in whole or in part by any recipient of this report to any other person without the prior written consent of KGI Securities. This report is not intended for distribution and/or redistribution, publication to or use by any person in any jurisdiction outside Singapore or any other jurisdiction as KGI Securities may determine in its absolute discretion, where the distribution, publication or use of this report would be contrary to applicable law or would subject KGI Securities and its connected persons (as defined in the Financial Advisers Act, Chapter 110 of Singapore) to any registration, licensing or other requirements within such jurisdiction.

The information or views in the report ("Information") has been obtained or derived from sources believed by KGI Securities to be reliable. However, KGI Securities makes no representation as to the accuracy or completeness of such sources or the Information and KGI Securities accepts no liability whatsoever for any loss or damage arising from the use of or reliance on the Information. KGI Securities and its connected persons may have issued other reports expressing views different from the Information and all views expressed in all reports of KGI Securities and its connected persons are subject to change without notice. KGI Securities reserves the right to act upon or use the Information at any time, including before its publication herein.

Except as otherwise indicated below, (1) KGI Securities, its connected persons and its officers, employees and representatives may, to the extent permitted by law, transact with, perform or provide broking, underwriting, corporate finance-related or other services for or solicit business from, the subject corporation(s) referred to in this report; (2) KGI Securities, its connected persons and its officers, employees and representatives may also, to the extent permitted by law, transact with, perform or provide broking or other services for or solicit business from, other persons in respect of dealings in the securities referred to in this report or other investments related thereto; and (3) the officers, employees and representatives of KGI Securities may also serve on the board of directors or in trustee positions with the subject corporation(s) referred to in this report. (All of the foregoing is hereafter referred to as the "Subject Business".)

However, as of the date of this report, neither KGI Securities nor its representative(s) who produced this report (each a "research analyst"), has any proprietary position or material interest in, and KGI Securities does not make any market in, the securities which are recommended in this report.

Each research analyst of KGI Securities who produced this report hereby certifies that (1) the views expressed in this report accurately reflect his/her personal views about all of the subject corporation(s) and securities in this report; (2) the report was produced independently by him/her; (3) he/she does not carry out, whether for himself/herself or on behalf of KGI Securities or any other person, any of the Subject Business involving any of the subject corporation(s) or securities referred to in this report; and (4) he/she has not received and will not receive any compensation that is directly or indirectly related or linked to the recommendations or views expressed in this report or to any sales, trading, dealing or corporate finance advisory services or transaction in respect of the securities in this report. However, the compensation received by each such research analyst is based upon various factors, including KGI Securities' total revenues, a portion of which are generated from KGI Securities' business of dealing in securities.

Copyright 2019. KGI Securities (Singapore) Pte. Ltd. All rights reserved.