

Sector Update

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■ AT A GLANCE

Jahwa Electronics (033240 KS, KRW19,950)

SELL HOLD BUY **KRW26,000**(+30%)
Target price

Sekonix (053450 KS, KRW23,150)

SELL HOLD BUY **KRW28,000**(+21%)
Target price

Digital Optics (106520 KS, KRW18,800)

Not rated n/a

Electronic Products & Components (OVERWEIGHT)

13MP cameras to focus attention on optical component makers

WHAT'S THE STORY?

Event: We maintain our upbeat 2013 outlook on smartphone camera parts makers—particularly those in the Samsung Electronics (SEC) value chain—and initiate coverage of Jahwa Electronics and Sekonix at BUY.

Impact: We are OVERWEIGHT on handset camera parts firms, as smartphone and tablet PC shipments at SEC are expected to rise 55% and 185%, respectively in 2013, and camera demand has expanded to other mobile devices, including notebooks and portable game players. With SEC reportedly planning to equip its into its next flagship smartphone with a 13 megapixel camera, we expect: 1) parts suppliers for high megapixel cameras to enjoy sustained earnings growth; and 2) Korean optical part makers to become more competitive globally by mass producing 13M products. Also, as camera specs should remain a key battleground for handset makers looking to differentiate their smartphones, the market is likely to maintain its focus on the camera value chain this year.

Action: We believe major beneficiaries of this focus will include Jahwa Electronics and Sekonix, for which we set our 12-month target prices at KRW26,000 and KRW28,000, respectively.

THE QUICK VIEW

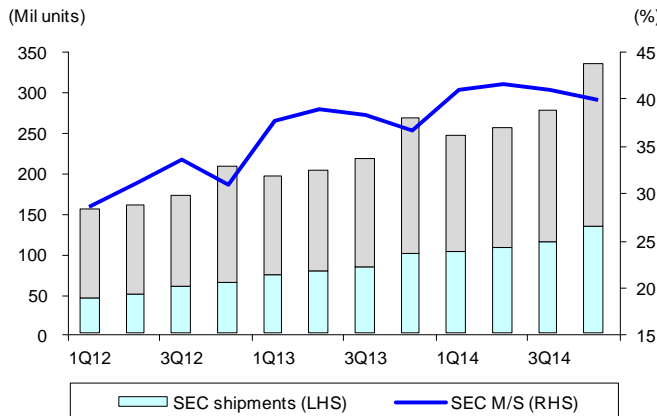
SEC to cement dominance of smartphone market: The smartphone and tablet-PC markets should boast another year of solid growth in 2013 on the back of steadily rising demand for high-end handsets and increased penetration in emerging markets. In particular, as Apple has seen its market share whittled away, Samsung Electronics should consolidate its dominance of the smartphone market this year, backed by aggressive new product launches. Our handset analyst forecasts that SEC will ship 330m smartphones this year, up 50% y-y.

More mobile devices to come with cameras; more to sport dual cameras: In addition to increasing smart device shipments, the portions of devices equipped with one and two cameras should remain high this year. Front-facing cameras are being adopted mainly for video calls. All of SEC's tablets came equipped with front- and rear-facing cameras in 2012, while all of its smartphones came equipped with a least 1 camera and 73% came with 2.

New SEC phone to have 13MP camera; high-MP cameras to become ubiquitous: With SEC planning to launch a new flagship smartphone with a 13MP camera and mid-range smartphones with 8MP cameras, Korean firms supplying high-MP camera parts should see their earnings grow and global competitiveness improve this year. In 2012, firms supplying 8MP camera parts failed to respond quickly to a surge in demand, and thus have focused on expanding capacity this year. In addition, more suppliers have entered the 8MP camera module market.

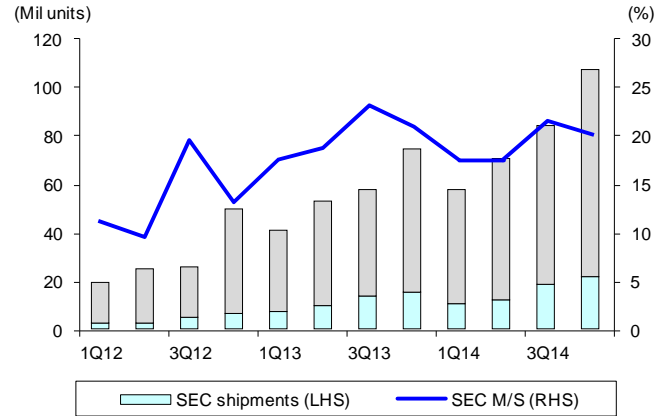
Focus on firms supplying SEC with high-MP camera parts: We remain positive on firms supplying SEC with high-MP camera parts. We expect handset makers to continue to use high-MP cameras to differentiate their smart devices, drawing attention to suppliers in the process. Although some set makers, including ZTE and LG Electronics, have already released smartphones with 13MP cameras, Apple is known to be planning to use an 8MP camera in its next model. Domestic parts suppliers will likely strive to enhance their technological power by mass producing 13MP camera parts for SEC's next flagship phone. We expect earnings growth at: 1) Jahwa Electronics, which makes auto-focusing actuators; 2) Sekonix and Digital Optics, which make lenses; 3) Optrontec, which manufactures blue filters; and 4) CammSys, which makes camera modules.

Chart 1. SEC: Smartphone shipment trends and forecasts vs M/S



Source: Samsung Securities estimates

Chart 2. SEC: Tablet-PC shipment trends and forecasts vs M/S



Source: Samsung Securities estimates




Table 1. Comparison of SEC smart devices released in 2012

	Smartphones	Tablet PCs	Feature phones
Total models	52	12	18
With camera	52	12	16
Portion w/ camera (%)	100	100	89
With dual cameras (%)	38	12	0
Below 3MP*	11	7	16
Dual camera	4	7	0
5MP*	22	5	0
Dual camera	19	5	0
8MP*	16	0	0
Dual camera	15	0	0

Note: * Rear camera

Source: GSM arena, Samsung Securities

Table 2. SEC smartphone lineup in 1H: Ultra-high pixel, high-end products vs high pixel, low-end products

	High-end Galaxy S4*	Low-end		
		Galaxy Discover*	Galaxy Grand	Galaxy Premier*
	n/a			
CPU	Octa 1.8GHz	Dual 1.2GHz	Quad 1.4GHz	Quad 1.4GHz
Display	Super AMOLED	Super AMOLED	AMOLED	AMOLED
Size (inches)	4.99	4.5	5	8.9
Camera (MP)	13 / 2 full HD	5/ 1.3	8 / 2	8 / 2
Resolution	1920x1080	480 x 800	800 x 480	1280x720
OS	Android 4.1	Android 4.1	Android 4.1	Android 4.1

Note: * Not yet released

Source: GSM Arena, industry news



Table 3. Flagship smartphone cameras: Pixel count trends

	2008	2009	2010	2011	2012	2013E
Samsung			Galaxy S	Galaxy S2	Galaxy S3	Galaxy S4*
Front			-	2MP	1.9MP FHD	2MP FHD
Rear			5MP	8MP	8MP	13MP
Apple	iPhone 3G	iPhone 3GS	iPhone 4	iPhone 4S	iPhone 5	iPhone 5S*
Front			VGA	VGA	1.2MP	Unknown
Rear	2MP	3MP	5MP	8MP	8MP	*8MP
Nokia	N97	5800	N8	N9	Lumia 920	Lumia EOS*
Front	VGA	VGA	VGA	VGA	VGA	Unknown
Rear	5MP	3.15MP	12MP	8MP	8.7MP	41MP
ZTE		Smooth	Blade	Blade 2	Blade 3	Grand S
Front		-	-	-	-	2MP
Rear		1.9MP	5MP	5MP	5MP	13MP
HTC	G1	Dream	Droid	EVO 3D	One X	One M7*
Front	-	-	1.3MP	1.3MP	1.3MP	2.1MP
Rear	3.2MP	3.15MP	8MP	5MP	8MP	Ultra pixel 4MP
LGE			Optimus Z	Optimus LTE	Optimus G	Optimus G pro
Front			-	1.3MP	2MP FHD	2.1MP FHD
Rear			5MP	8MP	13MP	8MP

Note: * Not yet released

Source: Industry news, Samsung Securities

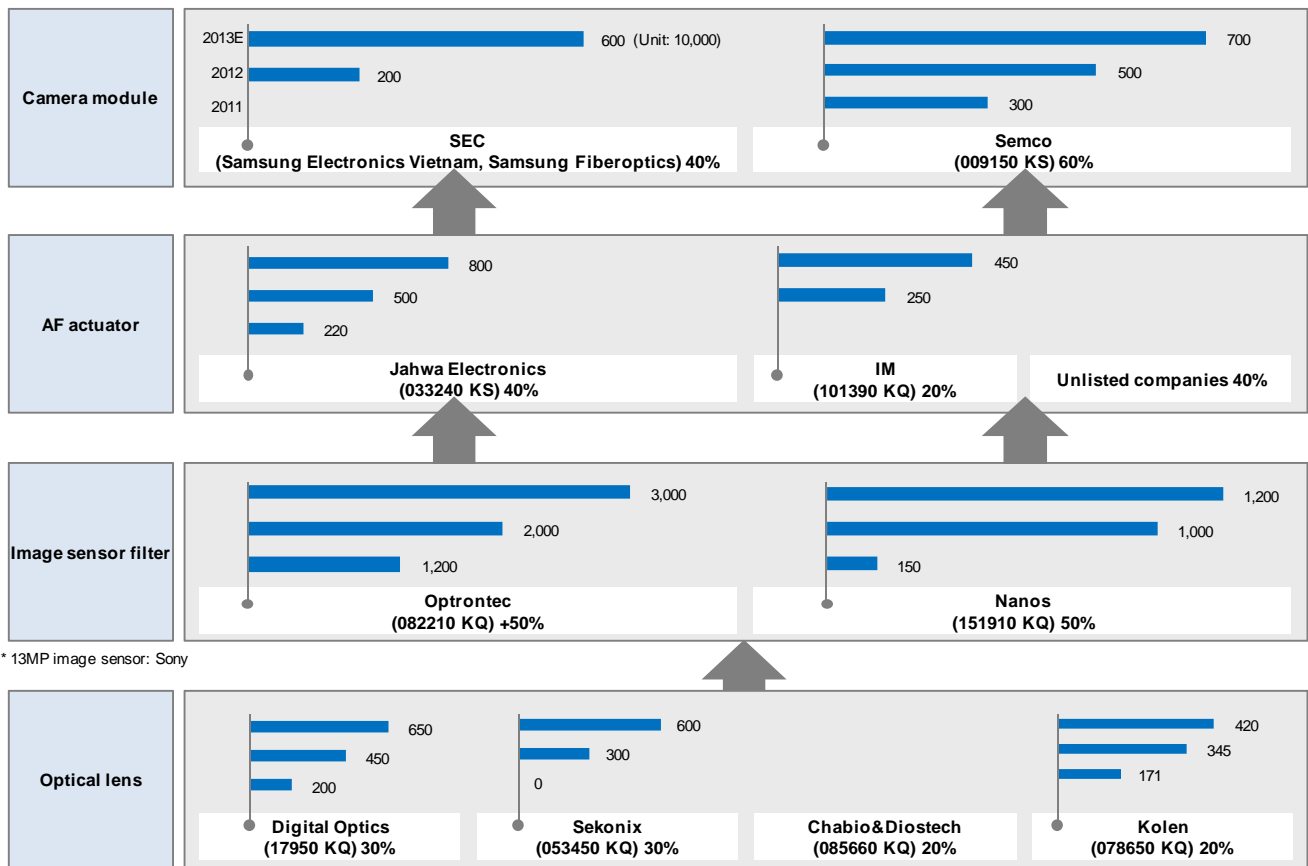
Table 4. Key smartphone lineup in 2013: Camera still a differentiating factor

Manufacturer	LG	HTC	Nokia
Model	Optimus G pro	One	Lumia EOS*
			n/a
Camera (MP)	13 / 2.1	4.3 / 2	41
Camera characteristics	<ul style="list-style-type: none"> Dual recording: Able to record video using front and rear cameras simultaneously VR Panorama: Can take 360 degree panorama pictures Tracking focus: Able to maintain focus on moving objects 	<ul style="list-style-type: none"> Ultra pixel: Combines three 4.3MP sensors, absorbing 3 times more light than a normal smartphone camera Full HD video recording 	<ul style="list-style-type: none"> 808 PureView sequel Carl Zeiss lens Optical image stabilization

Note: * Name unconfirmed

Source: Industry news

Chart 3. Galaxy S4 13MP camera value chain: M/S and capacity* trends



* 13MP image sensor: Sony

Note: * Based on capacity for 8MP camera components and above
 Source: Company data, Samsung Securities estimates

Company Update

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■ AT A GLANCE

SELL HOLD **BUY**

Target price	KRW26,000 (30%)		
Current price	KRW19,950		
Bloomberg code	033240 KS		
Market cap	KRW355.5b/USD327.7m		
Shares (float)	17,820,000 (58.1%)		
52-week high/low	KRW20,300/KRW9,330		
Average daily trading value (60-day)	KRW 4.33b/USD 3.99m		
One-year performance	1M	6M	12M
Jahwa Electronics (%)	+5.8	+61.5	+83.9
Vs Kospi (%pts)	+4.7	+57.2	+84.4

■ KEY CHANGES

(KRW)	New	Old	Diff
Recommendation	BUY		
Target price	26,000	-	-
2012E EPS	1,378	-	-
2013E EPS	1,869	-	-
2014E EPS	2,046	-	-

Jahwa Electronics (033240)

13MP actuators to drive growth

WHAT'S THE STORY?

Event: We believe camera auto focus actuator (AFA) maker, Jahwa Electronics, will see handset-use AFA sales grow more than 39% in 2013, as AFA demand from Samsung Electronics (SEC) is spurred on by: 1) rising shipments of smartphones and tablet PCs; and 2) a growing portion of phones shipped featuring high-megapixel camera modules. SEC in Dec 2012 acquired Jahwa's key client Samsung Fiberoptics and has since ramped up 13MP camera module capacity at its Vietnam plant. In turn, Jahwa has increased 13MP AFA capacity at its own Vietnam plant. Meanwhile, Jahwa has added to its client list several overseas camera module suppliers, which it should begin supplying in 1Q. With 8MP camera modules in short supply, Jahwa may also enter the module business.

Impact: Expecting robust AFA shipment growth, we forecast that sales and operating profit will rise 23% and 25%, respectively in 2013, to KRW362b and KRW38b (or KRW416b and KRW48b on a consolidated basis).

Action: Shares in Jahwa are trading at 8x 2013 consolidated P/E(10.7x on a parent basis)—undervalued relative to the global optical parts maker average (13.8x). We initiate coverage at BUY with a 12-month target price of KRW26,000, which offers 30% upside.

THE QUICK VIEW

Initiating coverage at BUY with KRW26,000 target: Jahwa Electronics ships all of its auto focus actuators (AFAs) to Samsung Electronics, either through mobile phone camera module supplier CammSys or directly (to a recently acquired division formerly called Samsung Fiberoptics). The AFAs are generally mounted on camera modules of 5 megapixels (5MP) and higher, which are increasingly featured in smart devices. We expect Jahwa to enjoy another year of strong earnings growth in 2013, especially considering the upcoming launch of a new flagship smartphone by SEC.

Investment points: We expect Jahwa's earnings to grow this year, backed by: 1) growth in smart device markets; 2) a timely 13MP AFA capacity expansion at its Vietnamese subsidiary, made to meet SEC's growing AFA needs; and 3) the addition of overseas suppliers to its client list.

Risks: Jahwa faces a number of risks. First, with high-megapixel AFAs in short supply, the market could be tempting for new entrants. Second, Jahwa's profitability could suffer if initial 13MP lens production yields are poor. Third, the firm may come under greater pressure from handset makers to cut prices, as it is required to publish consolidated results on a quarterly basis from this year, which should highlight robust earnings at its Vietnamese subsidiary. Fourth, camera module production may shift to the wafer level in the long term.

Consolidated earnings to highlight attractive valuation: We estimate 2013 consolidated sales and operating profit at KRW416b and KRW48b, respectively. With Jahwa trading at just 8x 2013 consolidated P/E—below the global optical parts maker average of 13.8x—we believe the stock is undervalued.

■ SUMMARY FINANCIAL DATA

	2011	2012E	2013E	2014E
Revenue (KRWb)	177.9	294.8	362.4	404.1
Net profit (adj) (KRWb)	10.6	24.5	33.3	36.5
EPS (adj) (KRW)	494	1,378	1,869	2,046
EPS (adj) growth (%)	2,359.6	178.7	35.7	9.5
EBITDA margin (%)	9.6	11.6	11.7	10.7
ROE (%)	7.8	16.3	18.9	17.6
P/E (adj) (x)	40.4	14.5	10.7	9.7
P/B (x)	2.2	2.0	1.7	1.5
EV/EBITDA (x)	17.8	8.1	5.9	5.0
Dividend yield (%)	1.0	1.0	1.0	1.0

Source: Company data, Samsung Securities estimates

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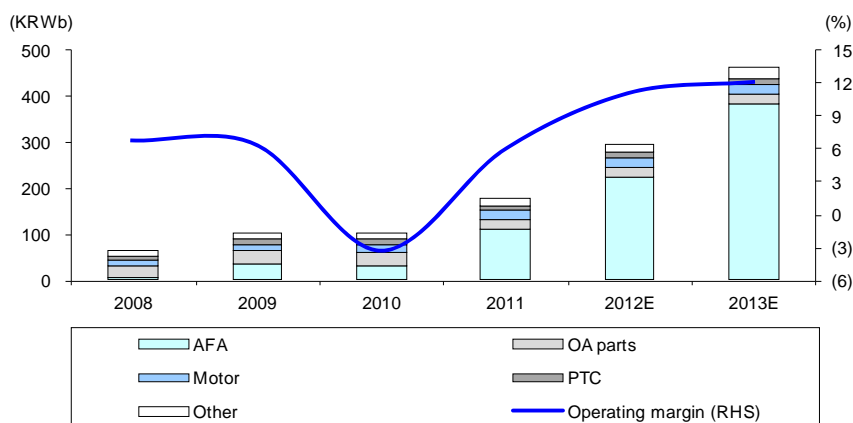
1. Valuation and investment points

Initiating coverage at BUY with KRW26,000 target

We initiate coverage of Jahwa Electronics at BUY with a 12-month target price of KRW26,000. Established in 1981, the firm manufactures magnetic products such as auto focus actuators (AFAs), purity convergence magnets (PCMs), and coin-type vibration motors. On a parent basis, the firm generated 80.9% of its 2012 sales from AFAs and vibration motors and the remaining 19.1% from OA parts and other items. We are bullish on Jahwa's key AFA module business for four reasons.

- **Growth of downstream industry:** We expect smartphone and tablet-PC shipments at Samsung Electronics (SEC) to increase this year, in turn boosting the electronics giant's high-megapixel (ie, 5MP and above) portion of camera module usage—and thus AFA demand. We estimate that Jahwa's handset-use AFA sales will grow more than 39% in 2013 (vs growth of 106% in 2012).
- **13MP module capacity ramp-up at SEC subsidiary:** SEC acquired Samsung Fiberoptics, Jahwa's key AFA module client, in Dec 2012, and has since ramped up its 8MP and 13MP camera module process lines at its Vietnamese subsidiary, SEV. To meet soaring demand, Jahwa has responded by increasing AFA capacity at its own Vietnamese subsidiary.
- **Client base expansion:** Jahwa last year added to its client list (that includes Samsung Fiberoptics and CammSys) several overseas camera module suppliers, which it should begin supplying in 1Q. With 8MP camera modules in short supply, Jahwa may also enter the module business.
- **AFA shipments growing:** Led by AFA shipment growth, sales and operating profit at Jahwa likely rose 66% and 217% y-y, respectively, to KRW295b and KRW30b. With SEC likely to increase its dominance of the market this year, we expect sales and operating profit at Jahwa in 2013 to grow 23% and 25%, respectively, to KRW362b and KRW38b.

Chart 1. Annual earnings trends and forecasts



Source: Company data, Samsung Securities estimates

Our 12-month target price of KRW26,000 offers 30% upside, and is derived by applying a peer average P/E multiple of 13.8x to our K-IFRS parent 2013 EPS estimate of KRW1,869. Earnings should continue to grow quickly this year, backed by SEC's growing dominance of the smartphone and tablet-PC markets

Table 1. Target price calculation

(KRW)	2013E
EPS	1,869
Target P/E multiple (x)	13.8
Target price	26,000
Current price	19,950
Upside (%)	30.3

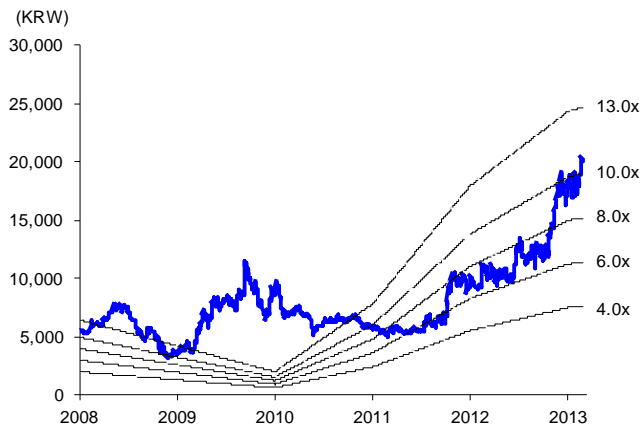
Source: Samsung Securities estimates

Table 2. Camera component makers peer valuation

Company	Component	P/E (x)		P/B (x)		EV/EBITDA (x)		Operating margin (%)		ROE (%)		EPS growth (%)	
		2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Jahwa Electronics*	AF actuator	10.7	9.7	1.7	1.5	5.9	5.0	10.5	9.9	18.9	17.6	35.7	9.5
Domestic firms													
Sekonix*	Optical lens	7.3	5.7	1.6	1.3	5.5	4.2	12.4	12.6	24.6	24.4	58.1	26.8
Patron*	Camera module	8.2	6.3	2.9	2.0	4.7	3.5	10.8	10.8	42.1	37.8	64.6	29.7
Digital Optics	Optical lens	7.3	5.8	2.2	1.5	n/a	n/a	14.7	14.3	38.3	37.8	71.9	26.5
Optrontec	IR filter	10.0	7.6	2.5	1.9	8.4	6.8	19.2	19.4	28.7	28.1	198.9	32.6
Nanos	IR filter	19.6	9.2	5.1	n/a	n/a	n/a	9.4	9.5	43.7	47.8	(2.3)	112.2
Foreign firms													
Largan Precision	Optical lens	14.5	12.6	7.1	n/a	n/a	n/a	n/a	n/a	29.3	25.2	34.8	14.8
Genius	Optical lens	22.4	18.2	n/a	n/a	n/a	n/a	n/a	n/a	12.5	13.8	(12.7)	23.6
Kinko optical	Optical lens	13.2	11.7	n/a	n/a	n/a	n/a	n/a	n/a	10.4	11.6	18.1	13.2
Sunny Optical	Camera module	21.7	16.5	3.8	3.2	14.6	11.0	9.8	9.9	18.3	21.0	52.0	31.6
Average		13.8	10.4	3.6	2.0	8.3	6.4	12.7	12.7	27.5	27.5	53.7	34.6

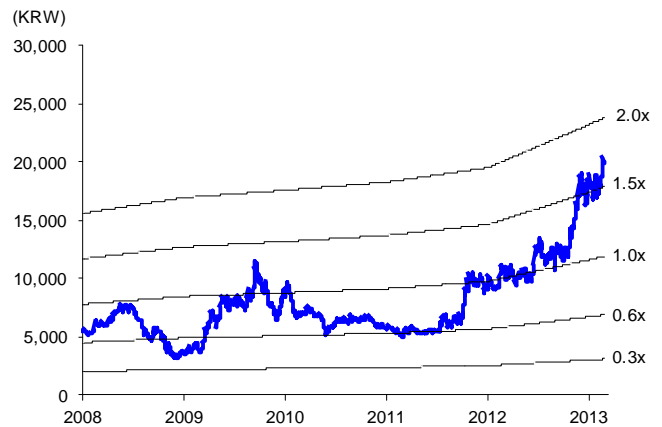
Note: K-IFRS basis; * Samsung estimates; Based on Feb 22 closing prices
Source: Bloomberg, Samsung Securities

Chart 2. Jahwa Electronics: Rolling P/E band



Source: Samsung Securities estimates

Chart 3. Jahwa Electronics: Rolling P/B band



Source: Samsung Securities estimates

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2. Business analysis

AFA sales to Samsung to surge again this year

Jahwa primarily manufactures AFAs that are mounted on camera modules for mobile phones. AFAs account for 20% of camera module costs and are generally found in camera modules of 3 megapixels and higher—modules of 2 megapixels and lower are usually fixed focus modules. Jahwa currently supplies all of its auto focus actuators (AFAs) to SEC, either through camera module supplier CammSys or directly (to a Vietnamese subsidiary or to a recently acquired division formerly called Samsung Fiberoptics). We estimate that Jahwa last year supplied SEC with 30-35% of AFAs used in 8MP modules in its high-end smartphones.

Chart 4. Camera module and AFA

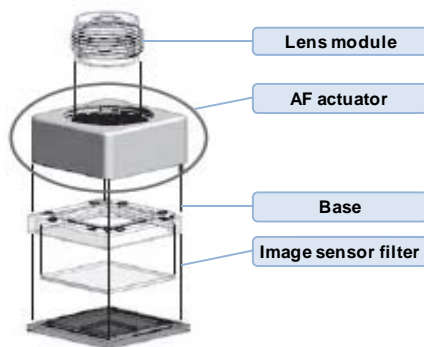


Table 3. Camera module and AFA manufacturers

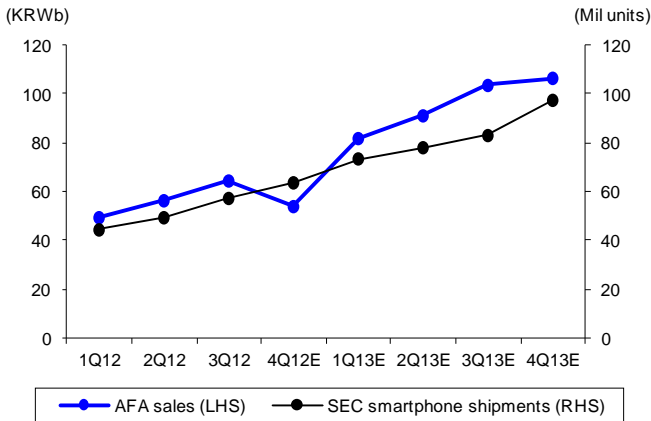
Set company	Camera module	Actuators
Samsung	SEC (Samsung Fiberoptics), Semco, CammSys, Patron, Truly, Lite-On	Jahwa Electronics, Semco(OEM), Hysonic, Patron
Nokia	Sharp, Toshiba, STM, Hon Hai, KM, Fujinon	Shicoh, Nidec-Sankyo, Mitsumi
Apple	LG Innotek, Hon Hai, Primax, VistaPoint	Nidec-Sankyo, Shicoh, Alps, Mitsumi
LG	LG Innotek, Hansung Elcomtec, Cowell, Sony, Sharp	LG Innotek, Sony
HTC	Lite-On, Hon Hai, Primax	TDK
RIM	STM, Semco	Semco
Moto	Hon Hai, VistaPoint, Lite-On, DIS	Shicoh

Source: Industry news

Sales of AFAs, which Jahwa began manufacturing in 2008, have grown more than 200% pa to contribute 75% to 1Q-3Q12 sales. Such rapid growth in sales and the portion of Samsung demand the firm meets have been possible because of: 1) surging smartphone penetration; and 2) Jahwa's superiority in magnetic engineering technology. Jahwa's in-house developed encoder-type actuator has proven highly efficient in 8MP camera modules, thus garnering interest from smartphone makers competing to use fewer and lighter components. Jahwa's AFA sales should remain strong this year as SEC sees rises in: 1) smartphone and tablet-PC shipments; and 2) its proportion of smart devices with cameras of 8 megapixels and higher.

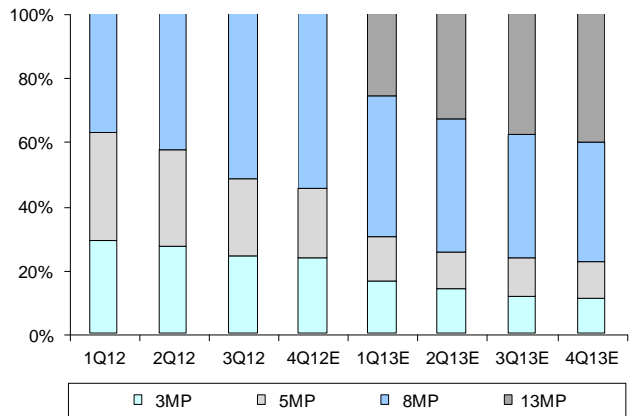
Meanwhile, SEC's next flagship model (due out in early 2Q13) will reportedly come equipped with a 13MP camera. Last year, SEC built a high-resolution camera module production line (for R&D purposes) in Vietnam. Recently, the firm is reported to have expanded its 13MP module line, sourcing all of its AFA needs from Jahwa's Vietnamese subsidiary. The 13MP module line will initially have a monthly capacity of 3m units, but that figure should jump to 5m units in 1H given SEC's aggressive shipment volume target for the tentatively named Galaxy S4 (as calculated through channel checks). Provided other camera parts do not suffer yield problems, Jahwa should sell a substantial number of 13MP AFAs in 2013.

Chart 5. Jahwa AFA sales vs SEC smartphone shipments



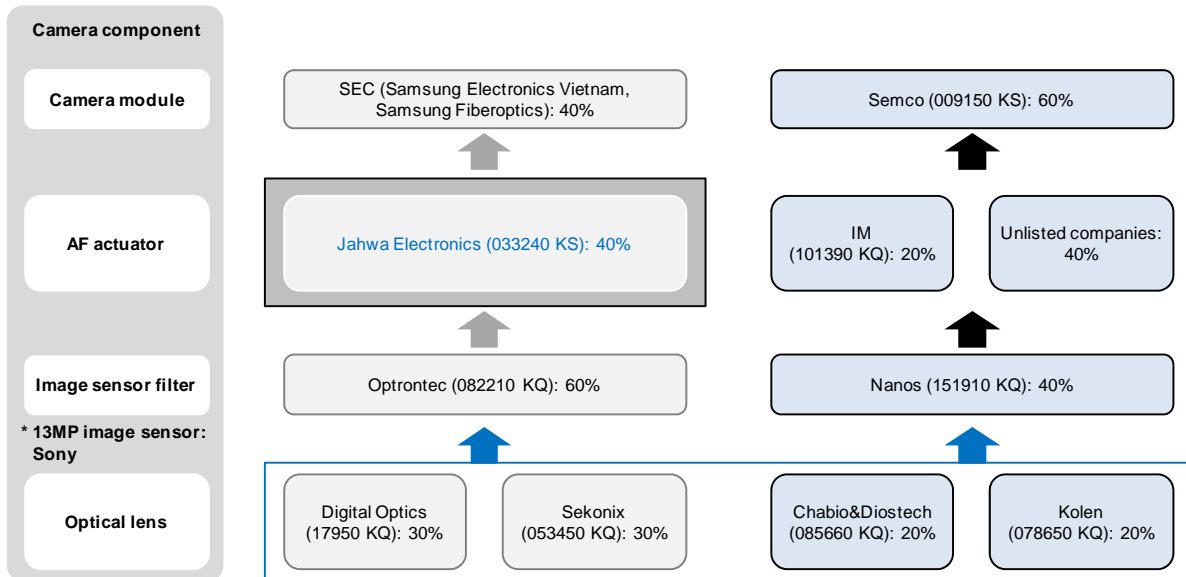
Source: Company data, Samsung Securities

Chart 6. Jahwa: Breakdown of AFA sales by resolution



Source: Company data, Samsung Securities

Chart 7. Galaxy S4 :13MP camera component value chain



Source: Samsung Securities

AFAs evolving

The launch of 13MP camera smartphones should mark the height of pixel competition. As smartphone cameras already produce images at a similar resolution to many standalone digital cameras, raising the pixel count to 20MP would be largely meaningless to consumers. After all, without zooming in or enlarging an image, the naked eye can only distinguish between pictures taken by cameras up to 10MP, and pixel count is just one factor that determines image quality. Looking ahead, camera modules will likely employ AFAs with optical image stabilizers (OIS) or cutting-edge image sensors (such as Sony's sensors with RGBW coding). AFAs with OIS are integral to improving video quality on smartphones, which currently lag far behind camcorders, and thus would command a higher ASP.

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3. Risk factors

Short-term risks

New entrants: Jahwa supplies AFAs to all of SEC's high-resolution camera module suppliers except Samsung Electro-Mechanics. If rivals enter the market, attracted by an AFA shortage and SEC's strategy of supplier diversification, Jahwa's AFA shipments and ASPs could take a hit. That said, we believe Partron's case offers a good example for Jahwa: Partron meets 60-70% of SEC's front-facing camera module needs and has sustained its share of SEC demand thanks to economies of scale and cost cutting. Likewise, we expect Jahwa to secure cost competitiveness by boosting shipments and responding swiftly to camera-module line expansions at SEC's Vietnam plant.

Concern over 13MP lens production yield

Last year, the launch of the Galaxy S3 was delayed due to poor initial production yields of several handset parts. Ahead of the release of the Galaxy S4, the market is now concerned over the possibility of poor 13MP lens production yields. Earnings at players in the value chain will be affected by initial production yields.

ASP cut pressure

Jahwa may come under greater pressure from handset makers to cut prices, as it is required to publish consolidated results on a quarterly basis from this year, which should highlight robust earnings at its Vietnamese subsidiary.

Long-term risks

Next-generation technology: Camera module technology is evolving. The stepper motor method—widely used in digital cameras—is difficult to replicate in smaller devices. Thus, smartphones typically use VCM-type AFAs, as they can be miniaturized and mass produced. At a wafer level, however, micro-electro-mechanical systems (MEMS) is superior in terms of making products smaller, lighter, and more energy efficient—and the development of such technology is now underway. This technological evolution poses a long-term risk to actuator makers, such as Jahwa.

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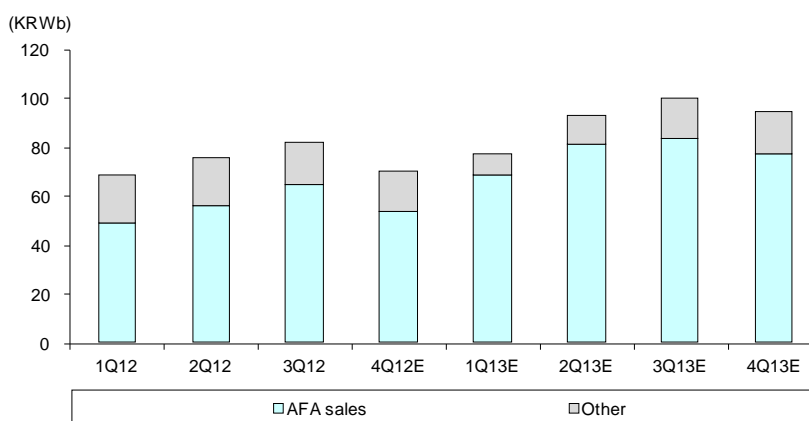
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4. Earnings forecasts

4Q12 and 2013 earnings forecasts

We estimate that 4Q sales and operating profit at Jahwa rose 11% and 64% y-y, respectively, to hit KRW69.5b and KRW7.7b. We believe full-year sales and operating profit grew 66% and 217%, respectively, mainly thanks to: 1) smart device shipment growth at SEC; and 2) a trend towards higher resolution cameras. SEC is expected to launch a new flagship smartphone in early 2Q13, and if Jahwa starts supplying 13MP AFAs in late 1Q13, its ASP should rise and it should enjoy strong y-y growth in 1Q13. As it will likely take 1-2 months to establish solid 13MP AFA production yields, we expect significant improvement to profitability from 2Q13. On the back of a new product and an expansion of its production of technologically superior products, we expect Jahwa to boast 2013 sales and operating profit of KRW362.4b and KRW38b, respectively.

Chart 8. Quarterly earnings trends and forecasts



Source: Company data, Samsung Securities estimates

Table 4. Quarterly earnings trends and forecasts

(KRWb)	1Q12	2Q12	3Q12	4Q12E	1Q13E	2Q13E	3Q13E	4Q13E	2011	2012E	2013E
Sales	68.1	75.5	81.7	69.5	76.7	92.3	99.3	94.2	177.9	294.8	362.4
AFA	49.0	55.9	64.0	53.5	68.3	80.6	83.2	76.5	107.7	222.5	308.7
Other	19.1	19.6	17.7	15.9	8.3	11.7	16.1	17.6	70.2	72.3	53.7
Operating profit	5.2	7.4	10.1	7.7	5.4	9.1	13.0	10.5	10	30	38
Operating margin (%)	7.6	9.8	12.4	11.1	7.0	9.8	13.1	11.2	5.39	10.31	10.5

Source: Company data, Samsung Securities estimates

Income statement

Year-end Dec 31 (KRWb)	2011	2012E	2013E
Sales	178	295	362
Cost of goods sold	150	239	290
Gross profit	28	56	72
Gross margin (%)	16	19	20
SG&A expenses	18	26	34
Operating profit	10	30	38
Operating margin (%)	5.39	10.31	10.5
Net interest income	2	2	3
Net forex-related gains	0	-2	0
Net equity-method gains	0	0	0
Other	2	-0	0
Pre-tax profit	13	31	41
Taxes	3	6	8
Effective tax rate (%)	20	20	20
Net profit	11	25	33
Net margin (%)	6	8	9
Operating net profit*	9	25	33
Operating net margin (%)	5	8	9
EBITDA	17	34	42
EBITDA margin (%)	10	12	12
Reported EPS (KRW)	597	1,378	1,869
Adjusted EPS (KRW)**	494	1,378	1,869
DPS (common, KRW)	200	200	200
DPS (preferred, KRW)	0	0	0
Dividend payout ratio (%)	28	13	10

Cash flow statement

Year-end Dec 31 (KRWb)	2011	2012E	2013E
Cash flow from operations	19	28	27
Net profit	11	25	33
Depreciation & amortization	5	6	4
Net forex-translation income	0	1	0
Net equity-method income	0	0	0
Gross cash flow	14	29	34
(-) Change in working capital	3	(1)	(8)
Other	2	0	0
Cash flow from investments	(15)	(24)	(23)
Capex	(3)	0	0
Free cash flow	16	28	27
Change in investment assets	(1)	(2)	(5)
Dividends***			
Other	(11)	(22)	(18)
Cash flow from financing	2	6	9
Change in debt	3	2	2
Change in equity	0	0	0
Dividends	(2)	(3)	(3)
Other	(0)	7	11
Change in cash	6	11	13
Cash at beginning of year	8	13	24
Cash at end of year	13	24	37

Note: K-IFRS parent basis

* Excluding one off items

** Fully diluted, excluding one-off items

*** From companies subject to equity-method valuation

Source: Company data, Samsung Securities estimates

Balance sheet

Year-end Dec 31 (KRWb)	2011	2012E	2013E
Current assets	123	178	231
Cash & equivalents	13	24	37
Accounts receivable	32	48	59
Inventories	17	25	35
Other current assets	60	81	99
Fixed assets	82	77	77
Investment assets	55	56	61
Equity in affiliated companies	48	48	48
Tangible assets	25	20	16
Intangible assets	2	1	1
Other long-term assets	0	0	0
Total assets	204	256	308
Current liabilities	62	91	114
Accounts payable	35	59	72
Short-term debt	16	17	20
Other current liabilities	10	15	22
Long-term liabilities	3	3	3
Bond & long-term debt	1	1	1
Other long-term liabilities	2	2	2
Total liabilities	65	95	117
Capital stock	9	9	9
Capital surplus	19	19	19
Retained earnings	131	152	182
Other	(19)	(19)	(19)
Total equity	140	161	191
Net debt	(53)	(79)	(107)
Book value per share (KRW)	9,143	9,759	11,610

Financial ratios

Year-end Dec 31	2011	2012E	2013E
Growth (%)			
Sales	79.0	65.7	22.9
Operating profit	Turned pos	217.1	25.2
Pre-tax profit	759.2	130.6	35.3
Net profit	292.9	130.6	35.7
Operating net profit*	2,359.6	178.7	35.7
EBITDA	Turned pos	101.3	24.0
Adjusted EPS**	2,359.6	178.7	35.7
Ratios			
ROE (%)	7.8	16.3	18.9
ROA (%)	5.7	10.7	11.8
ROIC (%)	5.5	15.1	16.0
Net debt to equity (%)	(37.6)	(49.3)	(56.0)
Interest coverage (x)	51.5	105.0	128.8
Receivables turnover (days)	52.9	49.7	54.1
Payables turnover (days)	49.5	58.3	65.9
Inventory turnover (days)	27.5	26.0	30.5
Valuations (x)			
P/E	40.4	14.5	10.7
P/B	2.2	2.0	1.7
EV/EBITDA	17.8	8.1	5.9
EV/EBIT	25.8	9.8	6.5
Dividend yield (common, %)	1.0	1.0	1.0

Company Update

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■ AT A GLANCE

SELL HOLD **BUY**

Target price	KRW28,000 (21%)		
Current price	KRW23,150		
Bloomberg code	053450 KS		
Market cap	KRW164.7b/USD151.8m		
Shares (float)	7,327,343 (79.3%)		
52-week high/low	KRW23,650/KRW8,732		
Average daily trading value (60-day)	KRW 4.00b/USD 3.69m		
One-year performance	1M	6M	12M
Sekonix (%)	+17.5	+96.8	+170.2
Vs Kosdaq (%pts)	+15.2	+89.6	+173.1

■ KEY CHANGES

(KRW)	New	Old	Diff (%)
Recommendation	BUY		
Target price	28,000		
2012E EPS	2,019		
2013E EPS	3,193		
2014E EPS	4,048		

Sekonix (053450)

To take off with 13MP lenses

WHAT'S THE STORY?

Event: Optical lens manufacturer Sekonix has supplied Samsung Electronics with 8 megapixel (8MP) lenses since 3Q12, and is scheduled to be mass producing 13MP lenses—to be used in its client's next flagship smartphone—in 1Q13.

Impact: Sekonix's smartphone camera lens shipments and ASP should both continue to grow well this year, and we forecast that sales and operating profit will climb 53% and 91%, respectively, to KRW226b and KRW28b, with q-q earnings improvements adding fuel to a share-price rally. The firm's auto-use camera lens/module operation and its pico projector business should emerge as new growth drivers.

Action: We initiate coverage of Sekonix at BUY with a 12-month target price of KRW28,000, which offers 21% upside. Trading at 7.3x 2013 P/E—discounted 44% to the global optical parts maker average of 13x—we believe the stock is undervalued given that the firm's high-end portion of lens shipment volume looks set to rise to 30% this year.

THE QUICK VIEW

Initiating coverage at BUY with KRW28,000 target: Optical parts developer and manufacturer, Sekonix, supplies Samsung Electronics (SEC) with smartphone-use camera modules, mainly via Samsung Electro-Mechanics (Semco). Originally supplying 2 megapixel (2MP) and VGA lenses, the firm traded at discounts to its peers that were focused on high-end components. However, Sekonix has established a solid track record, supplying 8MP lenses for use in SEC's Galaxy S3 from 3Q12, and now plans to mass-produce 13MP lenses this year. Thus, we expect the firm to enjoy solid earnings momentum based on growing 8MP product shipments and shipments of its new product. We initiate coverage of Sekonix at BUY with a 12-month target price of KRW28,000 (based on 9x 2013 P/E and offering 21% upside).

Shares to rerate this year on supply of 13MP lenses to SEC: Sekonix's lucrative smartphone camera lens business should enjoy another year of strong growth in 2013, on: 1) increasing smartphone shipments at its clients; and 2) an ASP hike thanks to the launch of a 13-megapixel (MP) lens. The firm's auto-use camera business has grown more than 30% *pa* since its first year and now dominates domestically, controlling over 90% of the lens market and 20-30% of the module market. The business is in prime position to benefit from a blossoming of the market—*ie*, when cameras become mandatory on all new cars. Sekonix reported that sales and operating profit rose 74% and 376% y-y, respectively, to KRW147.9b and KRW14.7b, backed by growth in smartphone shipments at SEC. With smartphone giant likely to increase its dominance of the market this year, we expect sales and operating profit at Sekonix in 2013 to grow 53% and 91%, respectively, to KRW226b and KRW28b.

Risk factor—timing of yield normalization for 13MP lenses: In our view, the timing of yield normalization for the production of 13MP lenses is key to 2013 earnings. Last year, profitability at suppliers producing 8MP lenses for the Galaxy S3 suffered deteriorated due to poor production yields—to the extent that the very launch of the Galaxy S3 was delayed. With this in mind, concerns over production yields for new lenses linger. We, however, remain bullish on Sekonix, as: 1) it enjoys a higher 8MP lens production yield than its rivals do; and 2) handset makers are positive on the firm thanks to its stable high-megapixel lens supply last year.

■ SUMMARY FINANCIAL DATA

	2011	2012E	2013E	2014E
Revenue (KRWb)	85.1	147.9	226.0	282.2
Net profit (adj) (KRWb)	1.4	15.1	23.4	29.7
EPS (adj) (KRW)	252	2,019	3,193	4,048
EPS (adj) growth (%)	(79.8)	700.7	58.1	26.8
EBITDA margin (%)	7.9	17.2	17.4	17.4
ROE (%)	2.4	20.9	24.6	24.4
P/E (adj) (x)	91.8	11.5	7.3	5.7
P/B (x)	2.7	2.1	1.6	1.3
EV/EBITDA (x)	28.3	8.0	5.5	4.2
Dividend yield (%)	0.0	0.0	0.0	0.0

Source: Company data, Samsung Securities estimates

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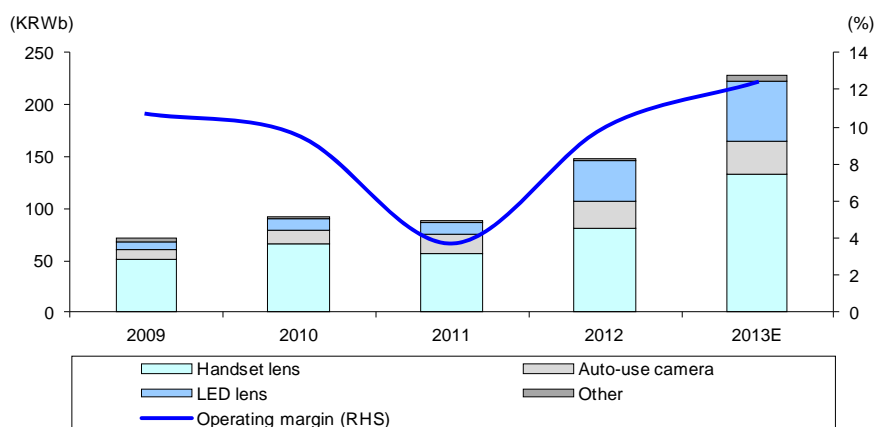
1. Valuation and investment points

Initiating coverage at BUY with KRW28,000 target

We initiate coverage of Sekonix at BUY with a 12-month target price of KRW28,000. The firm produces camera lenses for smartphones (54% of estimated 2012 sales), camera lenses and modules for autos (17%), and other parts such as projectors, LED lenses, and optical film (29%). We see four investment points for the firm.

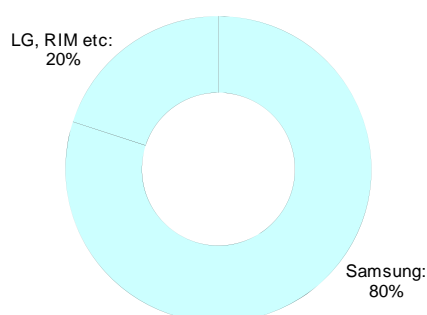
- The firm's lucrative smartphone camera lens business should enjoy another year of strong growth in 2013, on: 1) increasing smartphone shipments at its clients; and 2) an ASP hike thanks to the launch of a 13 megapixel (13MP) lens.
- The firm's auto-use camera business has grown more than 30% pa since its first year, and now dominates domestically, controlling 90% of the lens market and 20-30% of the module market. The business is in prime position to benefit from a blossoming of the market—ie, when cameras become mandatory on all new cars.
- Sekonix reported that 2012 sales and operating profit rose 74% and 376% y-y, respectively, to KRW147.9b and KRW14.7b, backed by growth in smartphone shipments at SEC. With smartphone giant likely to increase its dominance of the market this year, we expect sales and operating profit at Sekonix in 2013 to grow 53% and 91%, respectively, to KRW226b and KRW28b.
- Sekonix has traded at discounts to its peers due to a perception that it is a low-end lens maker. We, however, find the firm attractively valued in light of its success supplying 8MP lenses to SEC last year, which we believe will lead to jump in orders for 8MP lenses this year. We also note that it has won a contract to supply SEC with 13MP lenses this year. Thus, Sekonix should narrow the valuation gap with its peers as its 8MP-and-higher portion of lens sales rises.

Chart 1. Annual earnings trends and forecast



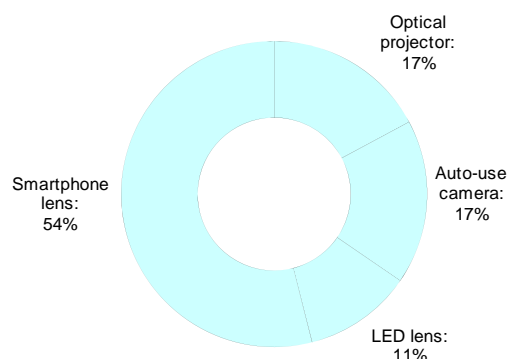
Source: Company data, Samsung Securities estimates

Chart 2. 2012 sales breakdown, by customer



Source: Samsung Securities

Chart 3. 2012 sales breakdown, by product



Source: Samsung Securities

Our 12-month target price of KRW28,000, derived by applying a peer average P/E multiple of 9x to our 2013 EPS estimate of KRW3,193, offers 21% upside. Earnings at Sekonix should grow dramatically again this year, given its clients' increasing need for high-end lenses and the firm's new product launch. We believe the firm will shed its valuation discount, as it not only boasts efficiency in the production of low-end lenses, but it is also set to raise its 8MP-and-higher portion of lens shipment volume from 10% last year to 30% this year.

Table 1. Target price calculation

(KRW)	2013E
EPS	3,193
Target P/E multiple (x)	9
Target price	28,000
Current price	23,150
Upside (%)	20

Source: Samsung Securities estimates

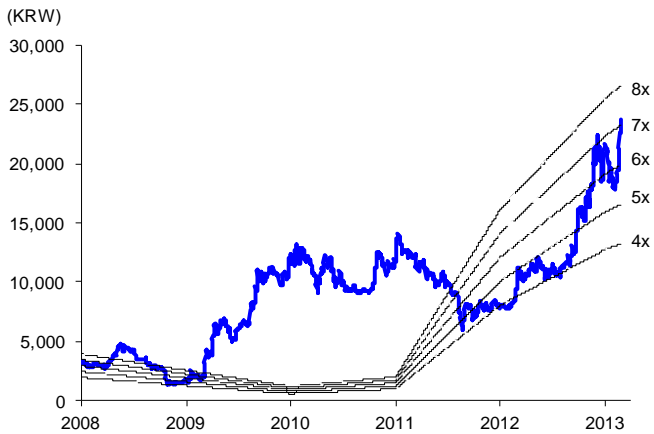
Table 2. Camera component makers: Valuation matrix

Company	Component	P/E (x)		P/B (x)		EV/EBITDA (x)		Operating margin (%)		ROE (%)		EPS growth (%)	
		2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E	2013E	2014E
Sekonix*	Optical lens	7.3	5.7	1.6	1.3	5.5	4.2	12.4	12.6	24.6	24.4	58.1	26.8
Domestic firms													
Jahwa Electronics*	AF actuator	10.7	9.7	1.7	1.5	5.9	5.0	10.5	9.9	18.9	17.6	35.7	9.5
Patron*	Camera module	8.2	6.3	2.9	2.0	4.7	3.5	10.8	10.8	42.1	37.8	64.6	29.7
Digital Optics	Optical lens	7.3	5.8	2.2	1.5	n/a	n/a	14.7	14.3	38.3	37.8	71.9	26.5
Optrontec	IR filter	10.0	7.6	2.5	1.9	8.4	6.8	19.2	19.4	28.7	28.1	198.9	32.6
Domestic average		8.7	7.0	2.2	1.6	6.1	4.9	13.5	13.4	30.5	29.1	85.8	25.0
Foreign firms													
Largan Precision	Optical lens	14.5	12.6	7.1	n/a	n/a	n/a	n/a	n/a	29.3	25.2	34.8	14.8
Genius	Optical lens	22.4	18.2	n/a	n/a	n/a	n/a	n/a	n/a	12.5	13.8	(12.7)	23.6
Kinko optical	Optical lens	13.2	11.7	n/a	n/a	n/a	n/a	n/a	n/a	10.4	11.6	18.1	13.2
Sunny Optical	Camera module	21.7	16.5	3.8	3.2	14.6	11.0	9.8	9.9	18.3	21.0	52.0	31.6
Average		13.8	10.4	3.6	2.0	8.3	6.4	12.7	12.7	27.5	27.5	53.7	34.6

Note: K-IFRS basis; *Samsung estimates; Based on Feb 22 closing prices

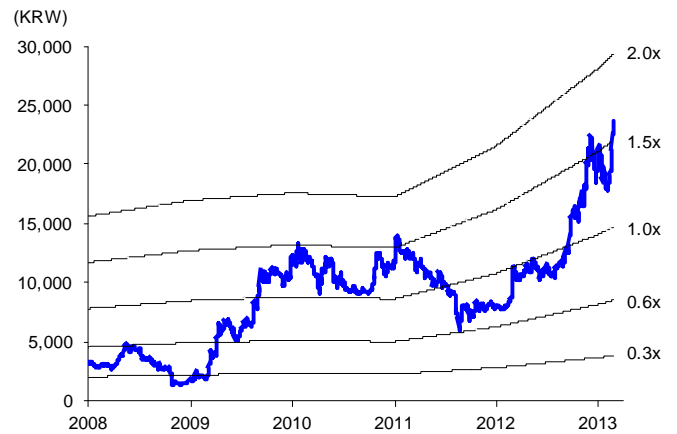
Source: Bloomberg, Samsung Securities

Chart 4. Sekonix: Rolling P/E band



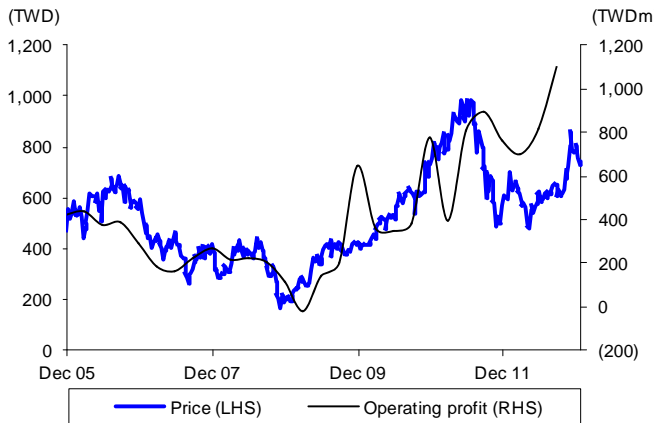
Source: Samsung Securities estimates

Chart 5. Sekonix: Rolling P/B band



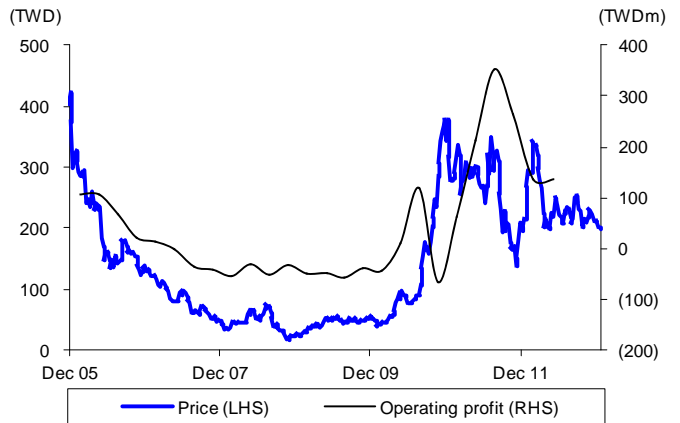
Source: Samsung Securities estimates

Chart 6. Largan (supplies Apple with high-pixel lenses)



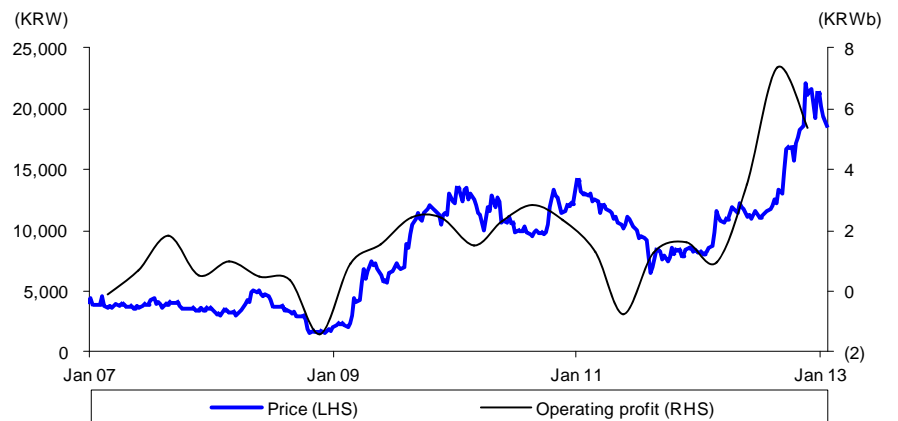
Source: Samsung Securities

**Chart 7. Genius (supplies Apple with low-pixel lenses):
Stock price precedes operating profit**



Source: Samsung Securities

Chart 8. Sekonix: Operating profit precedes stock price



Source: Samsung Securities

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2. Business overview

Smartphone camera lens shipments to grow; 13MP products to hit market

Several other companies—eg, Digital Optics, Kolen, Dios Tech, Changwon Optic, and Bangjoo Optical—supply SEC with handset-use camera lenses. The lenses are made of plastic and each camera module houses several lenses (which account for 10% of module costs). In terms of lens shipment volume, Sekonix meets 30% of SEC’s needs.

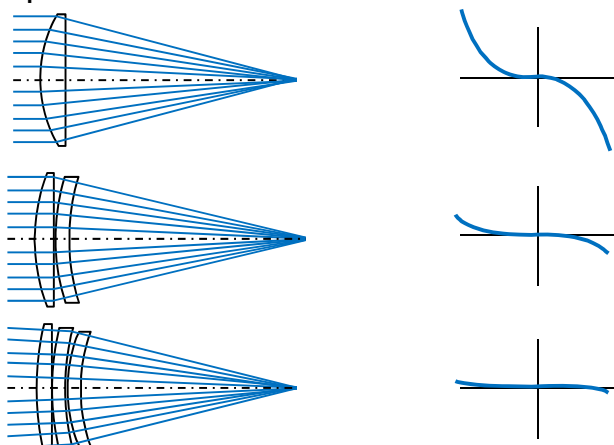
Table 3. camera module companies and lens suppliers

Camera module	Camera lens
Hon Hai	Largan, Genius, Hon Hai, Newmax
Toshiba	Anteryon, Ether, Fujinon
ST Micro	Heptagon, Largan, Ethers, KonicaMinolta
Sharp	Kantatsu, Fujinon
Samsung Fiberoptics	Sekonix, Dios Tech, Kolen
LG Innotek	Largan, Genius, Kolen, Sekonix Dios Tech
Semco	Bangjoo Optical, Haesung Optics, Sekonix Digital Optics, Dios Tech
CammSys	Sekonix, Dios Tech
Lite-On	Dios Tech, Largan
Patron	Sekonix, Dios Tech

Source: Samsung Securities

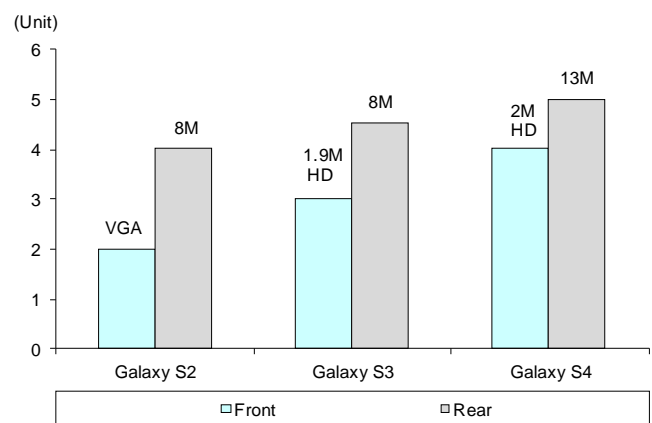
SEC’s lens suppliers have enjoyed solid earnings momentum with the advent of smart devices. First, camera modules are in increasingly greater demand due to growing shipments of smartphones, tablet PCs, and notebook computers. Second, the portion of devices with front-facing cameras is trending up thanks to a rise in the popularity of video calls. Third, the trend toward premium cameras and HD lenses has produced a surge in the number of lenses required per module, but high-end lenses are in supply shortages as suppliers have been slow to add capacity.

Chart 9. High-MP cameras have more lenses, so focusing error is improved



Source: Industry news, Samsung Securities

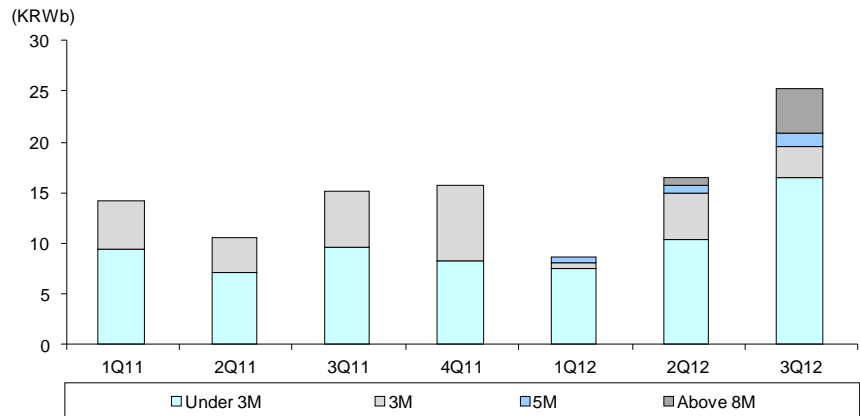
Chart 10. Number of lenses, by Galaxy model



Source: Industry news, Samsung Securities

In accordance with its aggressive 1H13 shipment target for the Galaxy S3, SEC estimated its monthly demand for 8MP lenses at 7m units in 2Q12, but the electronics giant suffered supply disruptions due to low production yields at lens makers in the early stages of mass-production. This experience prompted SEC to step up its efforts towards vendor diversification, and Sekonix signed a contract to make 8MP lenses from 3Q12. The lens maker has since established a solid track record, shipping 6m units on 2012. We forecast that Sekonix's 8MP lens shipments will grow 222% in 2013 and mass-production of its 13MP lenses will begin, together driving up the high-end portion of its lens shipments to 30% (vs 10% in 2012).

Chart 11. Sekonix: Sales trends and forecast, by pixel count



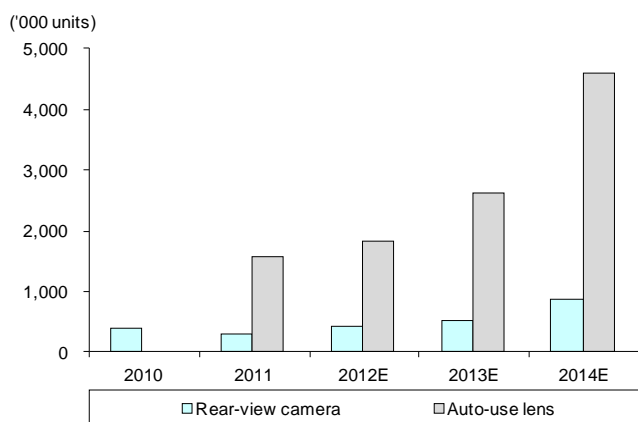
Source: Company data, Samsung Securities estimates

New growth drivers: Auto-use camera lens/module and PICO projector

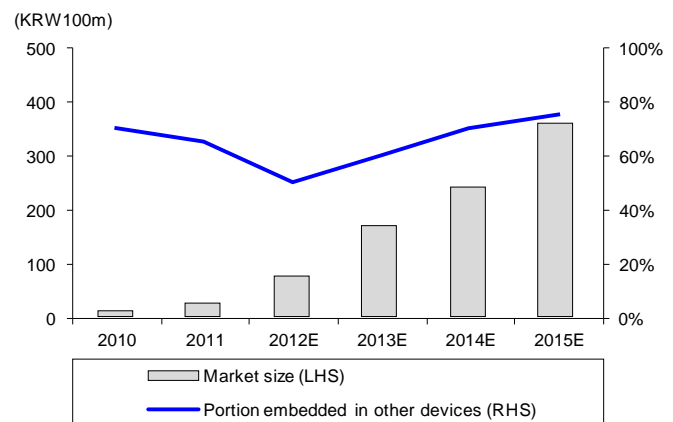
While explosive demand for smartphone camera lenses drove Sekonix’s earnings in 2012, the firm’s auto-use camera lens/module business also contributed greatly. Sekonix dominates Korea’s auto-use camera lens market with a 90% share. The firm ships all of its rear camera modules to the Hyundai Motor Group, and is the group’s second largest supplier (after MCNex), meeting 20-30% of its demand. The auto-use camera lens operation should further fuel Sekonix’s growth, as autos are increasingly adopting electronic parts and cameras will become mandatory on all new cars.

As for the pico projector business, Sekonix makes lenses and other products for SEC and LG Electronics—for instance, it has supplied projector modules for SEC’s Galaxy Beam. Although module demand has yet to rise visibly, demand from set makers should increase when pico projector quality improves—ie, in terms of brightness and definition.

Chart 12. Sekonix: Rear-view camera vs auto-use lens shipments **Chart 13. Pico projector market trends and forecasts**



Source: Company data, Samsung Securities



Source: Nikkei Electronics, Samsung Securities

Short-term risk factors—timing of yield normalization for 13MP lenses: Profitability at firms producing high-megapixel lenses depends on their technological capabilities. With suppliers likely to begin mass producing 13MP lenses in February, their earnings should vary according to their initial production yields. We expect Sekonix to meet handset makers’ demand easily this year, as it: 1) enjoys higher margins than its rivals do for 8MP lenses—a market it entered as a secondary vendor last year; and 2) has rich in-house molding technology and has garnered production yield knowhow over the past few years.

Long-term risk factor: If sales of the Galaxy S4 fall short of expectations, earnings at related component makers will likely follow suit.

Next-generation technology: While camera lenses are currently manufactured using plastic moldings, technology is being developed to manufacture thousands of lenses on a wafer. As the new microelectromechanical systems technology—if it materializes—should result in smaller, lighter, more energy efficient products, it poses a long-term risk to optical parts suppliers, such as Sekonix.

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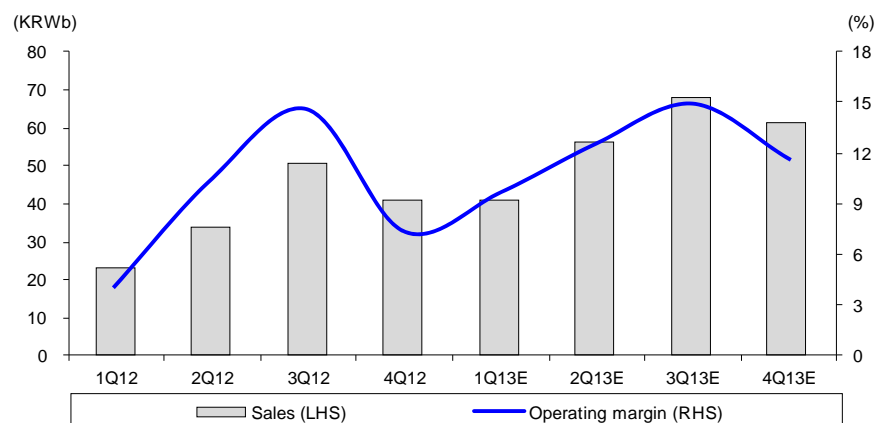
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3. Earnings forecasts

1Q13 earnings forecasts

Sekonix reported that its 2012 sales and operating profit rose 74% and 376% y-y, respectively, to hit KRW147.9b and KRW14.7b. We attribute such high growth mainly to: 1) smartphones shipment growth at its client; and 2) its client's difficulties in diversifying its high MP lens suppliers due to a lack of companies with requisite technological capabilities and experience. Nonetheless, 4Q results fell slightly short of market expectations, as the firm: 1) made bonus payments of approximately KRW1.5b; and 2) reflected pico projector inventory adjustments. We believe earnings will come back on track in 1Q—and surge in 2Q—amid rising pico projector demand and better production yields. We forecast that sales will rise 77% y-y in 1Q—led mainly by a strong performance from the lens division—but that profitability will not be especially high due to 13MP lens yield issues. We believe profitability will start improving in 2Q when yields stabilize.

Chart 14. Quarterly earnings trends and forecasts



Source: Company data, Samsung Securities estimates

Table 4. Quarterly earnings trends and forecasts

(KRWb)	1Q12	2Q12	3Q12	4Q12A	1Q13E	2Q13E	3Q13E	4Q13E	2011	2012A	2013E
Sales	22.9	33.7	50.5	40.7	40.7	56.2	67.8	61.3	85	147.9	226.0
Handset lens	13.6	16.5	25.2	24.4	30.3	36.1	39.4	33.6	79	139	167
LED lens	3.2	10.8	18.3	9.7	3.3	11.8	18.9	16.5	10	42	50
Auto-use camera	6.1	6.4	6.9	6.4	7.1	8.2	8.9	8.2	19	26	32
Operating profit	0.9	3.5	7.3	3.0	3.9	7.0	10.1	7.1	3	14.7	28
Operating margin (%)	4.0	10.3	14.5	7.3	9.6	12.5	14.8	11.6	4	10	12

Source: Company data, Samsung Securities estimates

Sekonix

Income statement

Year-end Dec 31 (KRWb)	2011	2012E	2013E
Sales	85	147.9	226.0
Cost of goods sold	67	114	173
Gross profit	18	34	53
Gross margin (%)	21	23	24
SG&A expenses	15	19	25
Operating profit	3	14.7	28
Operating margin (%)	4	10	12
Net interest income	(1)	(1)	(2)
Net forex-related gains	0	0	0
Net equity-method gains	0	0	0
Other	(1)	3	(0)
Pre-tax profit	1	16	26
Taxes	(0)	1	3
Effective tax rate (%)	(6)	6	10
Net profit	1	15	23
Net margin (%)	2	10	10
Operating net profit*	2	15	23
Operating net margin (%)	2	10	10
EBITDA	7	25	39
EBITDA margin (%)	8	17	17
Reported EPS (KRW)	201	2,094	3,193
Adjusted EPS (KRW)**	252	2,019	3,193
DPS (common, KRW)	10	10	10
DPS (preferred, KRW)	0	0	0
Dividend payout ratio (%)	0	0	0

Cash flow statement

Year-end Dec 31 (KRWb)	2011	2012E	2013E
Cash flow from operations	1	6	16
Net profit	1	15	23
Depreciation & amortization	5	8	11
Net forex-translation income	1	0	0
Net equity-method income	0	0	0
Gross cash flow	9	21	43
(-) Change in working capital	(7)	(15)	(21)
Other	(0)	(0)	0
Cash flow from investments	(18)	(29)	(31)
Capex	(16)	(25)	(30)
Free cash flow	(15)	(19)	(14)
Change in investment assets	(1)	0	0
Dividends***			
Other	(2)	(4)	(1)
Cash flow from financing	19	24	13
Change in debt	19	13	13
Change in equity	0	0	0
Dividends	(0)	0	(0)
Other	0	10	0
Change in cash	1	1	(1)
Cash at beginning of year	3	4	5
Cash at end of year	4	5	4

Note: K-IFRS parent basis

* Excluding one off items

** Fully diluted, excluding one-off items

*** From companies subject to equity-method valuation

Source: Company data, Samsung Securities estimates

Balance sheet

Year-end Dec 31 (KRWb)	2011	2012E	2013E
Current assets	36	58	85
Cash & equivalents	4	5	4
Accounts receivable	21	36	56
Inventories	9	15	23
Other current assets	2	1	2
Fixed assets	70	91	110
Investment assets	28	28	28
Equity in affiliated companies	27	27	27
Tangible assets	34	52	71
Intangible assets	5	4	4
Other long-term assets	2	7	7
Total assets	106	150	195
Current liabilities	35	44	66
Accounts payable	7	13	19
Short-term debt	23	25	38
Other current liabilities	5	6	9
Long-term liabilities	10	22	22
Bond & long-term debt	8	19	19
Other long-term liabilities	3	3	3
Total liabilities	45	66	88
Capital stock	3	4	4
Capital surplus	22	22	22
Retained earnings	43	58	82
Other	(7)	0	0
Total equity	61	83	107
Net debt	25	39	53
Book value per share (KRW)	8,618	10,782	14,072

Financial ratios

Year-end Dec 31	2011	2012E	2013E
Growth (%)			
Sales	(5)	74	53
Operating profit	(64)	376	91
Pre-tax profit	(87)	1,095	61
Net profit	(85)	953	55
Operating net profit*	(80)	708	61
EBITDA	(58)	279	55
Adjusted EPS**	(80)	701	58
Ratios			
ROE (%)	2	21	25
ROA (%)	1	12	14
ROIC (%)	4	11	16
Net debt to equity (%)	42	47	50
Interest coverage (x)	2	11	13
Receivables turnover (days)	84	71	74
Payables turnover (days)	30	24	26
Inventory turnover (days)	30	30	31
Valuations (x)			
P/E	92	11	7.3
P/B	3	2	2
EV/EBITDA	28	8	6
EV/EBIT	86	12	8
Dividend yield (common, %)	0	0	0

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■ AT A GLANCE

not rated

Target price	n/a		
Current price	KRW18,800		
Bloomberg code	106520 KS		
Market cap	KRW100.6b/USD92.6m		
Shares (float)	5,453,177 (53.5%)		
52-week high/low	KRW19,150/KRW11,200		
Average daily trading value (60-day)	KRW 2.16b/USD 1.99m		
One-year performance	1M	6M	12M
Digital Optics (%)	+13.6	+49.2	0.0
Vs Kosdaq (%pts)	+11.3	+42.0	0.0

Digital Optics (106520KS)

Specialist in high-megapixel lenses

WHAT'S THE STORY?

Event: We visited Digital Optics, a specialist in handset-use high-megapixel (MP) lenses, to check on its operations ahead of new product launches by handset makers. The firm listed in Jul 2012.

Impact: We remain bullish on Digital Optics, as: 1) it plans to begin mass producing 13MP lenses for Samsung Electronics [SEC] at end-1Q, which should lead to an ASP hike and shipment growth; 2) we forecast that shipments of its existing flagship 8MP lenses will grow more than 30% this year on a surge in demand in end industries; and 3) the firm's product mix should improve further this year, boosting profitability. The company guidance is that it will post a K-IFRS parent-based 2013 operating margin of 14%.

Action: In 2012, Digital Optics saw its K-IFRS parent-based sales and operating profit grow 43% and 36%, respectively, thanks to robust sales of 8M lenses amid a surge in smartphone shipments at SEC. We believe Digital Optics will continue to enjoy growth momentum this year on launch of its new 13MP lenses and SEC's growing smartphone market dominance. Company guidance puts its K-IFRS parent-based 2013 sales and operating margin at KRW120b and 14%, respectively, and the stock is trading at 7.4x 2013 consensus P/E.

THE QUICK VIEW

2012 review: In 2012, Digital Optics saw its K-IFRS parent-based sales and operating profit grow 43% and 36%, respectively, which we attribute to a surge in demand for high-megapixel camera modules.

Earnings momentum to gather pace in 2013: We remain bullish on Digital Optics in 2013 for three reasons. First, it should begin mass producing 13MP lenses at end-1Q, leading to a higher ASP and shipments. Prices for 13MP lenses are known to be 20% higher than initial prices for 8MP lenses (USD1.50), and Digital Optics expects to ship far more lenses for the Galaxy S4 than it did for the Galaxy S3. Second, demand for its existing product—8MP lenses—should rise steadily this year, leading to product mix improvement and a resultant rise in overall profitability. Third, the firm's auto-use camera lens business, based on a partnership with Samsung Electro-Mechanics, is a potential growth driver, as auto-use cameras are gaining popularity.

Risk factors: Optical lens makers struggled to stabilize their production yields in the first two months of mass production for the Galaxy S3 last year—leading to a supply shortage. As low yields can wreak havoc on profitability at parts suppliers, some in the market are concerned over yields ahead of the start of mass production of 13MP lenses.

Valuation: Company guidance puts its K-IFRS parent-based 2013 sales and operating margin at KRW120b and 14%, respectively, and the stock is trading at 7.4x 2013 consensus P/E—discounted to the global peer average.

■ SUMMARY FINANCIAL DATA

	2009	2010	2011
Revenue (KRWb)	11.8	26.7	58.4
Net profit (adj) (KRWb)	0.5	1.9	6.0
EPS (adj) (KRW)	-	-	-
EPS (adj) growth (%)	-	-	-
EBITDA margin (%)	25.4	15.1	18.5
ROE (%)	(5.7)	15.4	36.2
P/E (adj) (x)	-	-	-
P/B (x)	-	-	-
EV/EBITDA (x)	-	-	-
Dividend yield (%)	-	-	-

Source: Company data, Samsung Securities

Income statement

Year-end Dec 31 (KRWb)	2009	2010	2011
Sales	11.8	26.7	58.4
Cost of goods sold	10.0	22.4	47.2
Gross profit	1.8	4.3	11.2
SG&A expenses	1.4	1.7	2.1
Labor costs	0.5	0.7	0.8
Selling expenses	0.2	0.3	0.4
Other	0.7	0.8	0.9
Other operating profit (losses)	0.0	0.0	(0.5)
Operating profit	0.4	2.6	8.6
Financial income	0.7	0.3	0.3
Interest income	0.3	0.3	0.1
Other	0.5	0.1	0.3
Financial costs	0.5	0.6	1.5
Interest expenses	0.5	0.5	0.6
Other	0.0	0.1	0.9
Non-operating income	0.7	0.6	0.0
Non-operating expenses	1.0	1.1	0.0
Other	0.0	0.0	0.0
Pre-tax profit	0.3	1.8	7.4
Taxes	(0.2)	(0.1)	1.4
Extraordinary income	0.0	0.0	0.0
Extraordinary expenses	0.0	0.0	0.0
Net profit	0.5	1.9	6.0
EBITDA	3.0	4.0	10.8
EPS (KRW)*	(56)	167	497

Cash flow

Year-end Dec 31 (KRWb)	2009	2010	2011
Operating cash flow	4.4	3.4	6.6
Net profit	0.5	1.9	6.0
Depreciation	2.4	1.3	1.9
Severance payments	0.3	0.3	0.4
Forex losses (gains)	(0.2)	0.2	0.1
Associate losses (gains)	0.0	0.0	0.0
Chg in working capital	0.9	(1.1)	(4.7)
Other	0.6	0.9	2.9
Investment cash flow	(6.2)	(9.3)	(4.5)
Capex	1.9	7.2	2.8
Chg in investment assets	(2.0)	(1.7)	(0.0)
Other	(6.1)	(14.8)	(7.3)
Financing cash flow	0.8	5.6	0.2
Chg in short-term debt	0.4	0.5	(0.2)
Chg in long-term debt	0.0	5.0	0.0
Chg in bonds	0.0	0.0	0.0
Chg in current maturities	(0.4)	(0.6)	0.0
Dividends	0.0	0.0	0.0
Rights issues	0.0	0.0	0.0
Other	0.7	0.7	0.4
Cash flow from other	0.0	0.0	0.0
Chg in cash	(1.0)	(0.3)	2.3
Cash at beg of year	3.1	2.1	1.9
Cash at end of year	2.1	1.9	4.1

Note: * Fully diluted, excluding one-off items; K-IFRS adopted from 2011

Source: Company data, Samsung Securities estimates

Balance sheet

Year-end Dec 31 (KRWb)	2009	2010	2011
Current assets	10.2	14.3	29.7
Cash & equivalents	2.1	1.9	4.1
Financial goods	2.1	2.4	2.1
Marketable securities	1.5	0.0	1.8
Accounts receivable	3.1	7.3	15.8
Inventories	1.1	2.0	3.8
Other	0.4	0.7	2.1
Non-current assets	15.4	23.7	22.8
Investment assets	4.7	7.0	5.0
Tangible assets	7.9	13.8	14.2
Intangible assets	2.8	2.9	3.7
Other	0.0	0.0	0.0
Total assets	25.6	38.0	52.6
Current liabilities	8.1	15.1	24.7
Accounts payable	3.3	7.0	13.1
Short-term borrowings	3.9	4.4	6.4
Current portion of long-term debt	0.6	2.0	1.0
Other	0.3	1.7	4.3
Non-current liabilities	4.5	7.6	7.3
Bonds	1.0	0.0	0.0
Long-term debt	2.5	6.4	5.4
Other	1.0	1.2	1.9
Total liabilities	12.6	22.8	32.1
Capital stock	2.0	2.0	2.0
Capital surplus	4.9	5.0	5.0
Capital adjustments	0.2	0.3	0.4
Retained earnings	6.1	8.0	13.2
Other	(0.3)	(0.0)	(0.0)
Total equity	13.0	15.2	20.5

Financial ratios

Year-end Dec 31	2009	2010	2011
Growth (% y-y)			
Sales	3.8	127.2	118.4
Operating profit	(62.1)	576.5	232.7
Pre-tax profit	185.5	546.3	313.7
Net profit	486.1	284.0	218.2
EBITDA	4.0	35.3	166.9
EPS*	(202.1)	(400.0)	197.4
Margins (%)			
Operating profit	3.2	9.6	14.7
Pre-tax profit	2.4	6.7	12.7
Net profit	4.2	7.0	10.3
EBITDA	25.4	15.1	18.5
ROE	(5.7)	15.4	36.2
ROA	2.0	5.9	13.2
Ratios			
Net debt/equity (%)	17.5	56.5	23.0
Liabilities/equity (%)	96.9	149.5	156.3
Interest coverage (x)	1.9	10.5	15.6
Receivables turnover (x)	3.8	3.6	3.7
Per share data (KRW)			
Sales	905	2,056	4,491
Book value	972	1,086	1,374
Dividend	0	0	0
EBITDA	230	311	830

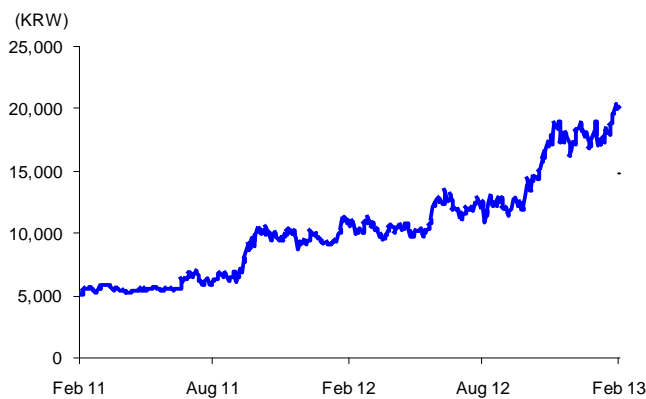
Electronic Products & Components

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■ Target price changes in past two years

Jahwa Electronics



Sekonix



Digital Optics



Electronic Products & Components

■ Rating changes in past two years

Jahwa Electronics

Date 2013/02/25
 Recommendation BUY
 Target price (KRW) 27,000

Sekonix

Date 2013/02/25
 Recommendation BUY
 Target price (KRW) 23,000

Digital Optics

Date 2013/02/25
 Recommendation not rated
 Target price (KRW) n/a

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