

JPM-pp1

Asia Pacific Equity Research

05 March 2015

Skyworth Digital Holdings (751 HK)

Overweight

Price: HK\$5.36

04 Mar 2015

Price Target: HK\$7.00

PT End Date: 31 Dec 2015

Buy on weakness due to industry jitters

Skyworth is the largest branded TV maker in the China domestic market. We see any weakness in the share price resulting from the lower than expected (versus consensus) 2014 results, or at rival TCLM, as a good buying opportunity for Skyworth, our preferred China TV play. Our positive view on Skyworth's TV operations is reinforced after our finds from meetings this week with TCLM during their post results road show.

Furthermore, we see any concerns over February sales for the Chinese TV market as another buying opportunity as Skyworth is mainly selling into the less developed rural market and should experience sales growth that is faster than the overall industry. Also, we believe that Skyworth has been taking market share from the other major rural supplier, TCLM based on figures over the past few months and our conversations with the two companies' managements regarding the recent sales trends.

We see upside to the industry and to Skyworth from any additional details regarding the upcoming TV and appliance energy savings subsidies (we expect a detailed announcement in March), which stipulates the start date as well as the overall budget. Currently, the subsidy reported by local press amounted to only approx. Rmb2.5bn for the 2015 subsidy for TVs, but we see risk that the budget can be considerably higher.

The non-TV business supports further upside, in our view. Our latest sum of the parts valuation of HK\$9.0 shows that the TV business is currently valued at less than zero at the current share price. This valuation does not factor in upside from the new air conditioning business or e-commerce fulfillment businesses, which can be substantial. Additionally, Skyworth is earning internet advertising and content revenue from its smart TVs and we see the large active subscriber base has the potential to be the largest and most valuable part of Skyworth longer term (but again valued at zero in our current SOTP).

In our latest note, we revised up SOTP value to HK\$9.0, which is about 29% higher than the DCF based valuation, where we look at the company as a whole. We note that the entire TV / Module business is only 24% of the total SOTP value but the uncertainty and negative news that is coming from this operation has had a disproportionate drag on the company's share price.

Table 1: Estimation of Sum or the parts Value

	HK\$m	% NAV	Methodology
Cash	3,023		
Pledged deposits	1,572		
Investments	691		
Long term debt	(547)		
Short term debt	(5,156)		
Bills Receivables	10,061		
Bills Payables	(4,094)		
Cash receipt for land	1,470		Cash receipt net of taxes
Total monetary items	7,020	27%	Book value
Skyworth Digital technologies	6,156	24%	20% discount to shr price
White goods	1591	6%	15x PE multiple with 20% discount
Office buildings	5429	21%	Rmb 25k psm - 178k sm area

LCD JV	1123	4%	Book value with 20% discount
TV / modules / others	4,226	17%	6x PE multiple
Total SOTP value	25,546		
Shares	2,847		
Per share	9.0		

Source: Company reports

The key issues / assumptions that impact on the SOTP valuation are as follows:

- **Treatment of bills receivables / payables.** We have assumed that the net bills receivables less payables are monetary (near cash) items and have included these in the SOTP at book value. Essentially bills receivables are payments by customers for goods that have been delivered and guaranteed by major banks. Payment typically is made in cash in 3-6 months. As a check, we made sure that net working capital (excluding bills receivables and payables) is positive (receivables + inventories > payables) .
- **Head office buildings.** Skyworth has two large office buildings in Shenzhen (Nanshan Tech Park) which generate significant rental income. The new building is a 124,000 sm grade A office building that has recently generated rental income. The older building is 54,000 sm and has been generating some minor rental income for a number of years. We have assumed an average of Rmb25,000 psm which is the market price for comparable buildings in the area.
- **Multiples for non TV business.** We have assumed a 20% discount to the stake (290m shares) in A-share listed Skyworth Digital, which is a set top box maker that was spun off in ct 2014. The shares trade on the domestic A-share market with a current price of Rmb20.18. We have also assumed a 15x P/E for the white goods (mostly refrigerators) business, similar to HK listed peers.
- **Multiple for TV/Modules business.** We use the TV and module assembly business for multiples, as historically these have been the core business, which are currently under a great deal of pressure (esp. the TV operations). We have assumed a 6x PE multiple, which is a 15% discount to what Skyworth is currently trading at, and at the low end of PE multiples for industrial SMID-Caps.
- **Cash to be received for property already sold.** In Oct 2013, a piece of land was sold in Shenzhen for a total consideration of HK\$2.1bn. The cash is scheduled to be received in FY15. We have included the cash receipt less any applicable taxes in the SOTP calculation. We understand that the company has other factories and plants that may be closed and sold for other uses (and presumably at a gain) but we have not included the value of these properties in this calculation.
- **Some upside to value that we don't factor in.** We have not factored in any SOTP value regarding the new air conditioning business, the new third party logistics business or any excess in market value for rental properties over the current book value in the accounts, leaving room for further upside.

Price, valuation and risk. Our PT (Dec-15, DCF-derived; WACC: 12%; terminal growth of 3%) of HK\$7.0 implies a forward P/BV of 1.4x and forward P/E of 10.7x CY16E). Key risks to our PT are: the timing of the commencement of government incentive /subsidy schemes for TVs, and the higher cost of components cutting into margins.

Please refer to our latest note, “Skyworth [Digital: Lifting PT to HK\\$7 - Strong Jan sales and hidden value in no-core assets](#)” dated Feb 09, 2014 for detail.

Investment Thesis

Skyworth is China's largest flat-panel TV brand by unit sales and is a leader in the fast-growing rural market. We believe that the flat panel TV market in China is entering a favourable period of growth and margin expansion due to the migration of 3D TVs into the mass market. There may be lower marketing expenses as a proportion of sales revenues as the company improves its distribution network with newly introduced specialty stores.

Valuation

Our Dec-15 price target is based on a DCF valuation that assumes a market risk premium of 6.0% and a risk-free rate of 4.2% (yield

on ten-year government notes in China). We assume a beta of 1.3, and accordingly, we assume a WACC of 12.0%.

Risks to Rating and Price Target

Key risks to our rating and price target include the higher cost of components and higher-than-expected selling expenses that could cut into margins.

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Other Companies Discussed in This Report (all prices in this report as of market close on 04 March 2015)

TCL Multimedia (1070.HK/HK\$4.37/Neutral)

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
19-May-10	OW	5.78	10.00
06-Jul-10	OW	4.92	8.40
03-Aug-10	OW	5.61	9.20
27-Aug-10	OW	4.69	8.00
13-Oct-10	OW	5.28	7.50
01-Dec-10	OW	4.10	6.50
17-Jan-11	OW	4.70	7.00
18-Oct-11	OW	3.44	6.00
25-Nov-11	OW	3.54	4.00
09-Feb-12	OW	3.81	4.70
24-Oct-12	OW	4.34	6.00
07-Feb-13	OW	4.67	6.70
04-Mar-13	OW	5.29	7.90
08-Mar-13	OW	5.22	9.00
27-Jun-13	OW	4.00	7.50
11-Oct-13	OW	3.66	6.70
26-Nov-13	OW	4.19	6.80
11-Mar-14	OW	3.86	5.60
23-May-14	OW	3.60	4.70
15-Aug-14	OW	3.97	5.60
25-Nov-14	OW	4.19	6.30
26-Jan-15	OW	4.22	6.50
09-Feb-15	OW	4.71	7.00

<http://gfd-app.emea.jpmchase.net:6080/server/console/chart/?shareClassId=500279&shareClassServerId=4&chartDesignation=1&actionType=C>

Date	Rating	Share Price (HK\$)	Price Target (HK\$)
19-May-10	OW	4.87	8.00
27-Aug-10	OW	2.49	3.40
13-Oct-10	N	3.43	3.20
01-Nov-11	N	2.36	2.70
28-Feb-12	N	3.58	3.20
02-May-12	OW	4.41	5.30
18-Feb-13	OW	6.20	7.50
29-Aug-13	N	3.52	4.40
28-Apr-14	N	2.88	3.00
03-Mar-15	N	4.31	3.50

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