

JPM-pp1

Asia Pacific Equity Research

20 June 2015

Skyworth Digital Holdings (751 HK)

Overweight

Price: HK\$7.47

19 Jun 2015

Price Target: HK\$9.50

PT End Date: 31 Dec 2015

FY15 results - first take

Skyworth is the largest branded TV maker in the China domestic market. The shares are up 26% over the past three months (HSCEI Index up 9% over the same period). The company reported FY15 (Mar) results with EBIT and net profit beating our expectations by 16% and 3%, respectively (before impact of property gains).

Skyworth results announced after trading on 19 June:

<http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0619/LTN20150619824.pdf>

- **Sales of TVs were quite strong.** Sales of TVs for FY15 of HK\$30.1bn (up 2% Y/Y) was about 2% higher than our expectation. Sales of set-top boxes and other products were more or less in line with expectations.
- **Weakness in white goods.** Overall sales of HK\$40.1bn were HK\$1.6bn lower than our estimate mainly due to a drop in sales of white appliances (mainly refrigerators). Exports of white goods fell 39% Y/Y but we note that this is a low-margin business and not impactful to overall earnings. Domestic white goods sales grew by just 7% Y/Y in FY15 (we expected 30% growth) but this is a minor negative as it is just a small (5%) part of overall sales.
- **GPM much higher than we expected.** The key positive was that despite an 11-12% drop in ASP for its TV sales during the fiscal year, GPM actually rose to 20.0% for FY15 compared to 19.3% in FY14 and our estimate of 19.4% for FY15. ASP declines have moderated in recent months, which may help margins in FY16, in our view.
- **Cost controls pretty good.** Selling and administrative costs fell 2% to HK\$4835m, which is pretty good given the competitive environment during FY15. As a percentage of sales, it fell from 12.5% in FY14 to 12.0% in FY15.
- **Major gain on property.** Skyworth reported a HK\$1.7bn gain (~HK\$1.3bn after taxes) related to the property sales in Shenzhen, which compared to our expectations of an after-tax gain of HK\$1.1bn.
- **Recurrent profits beat slightly.** The net profit of the company (excluding property-related gains) was about 2% higher than our estimate and 4-5% higher than consensus (Bloomberg).
- **More info after analyst briefing Monday (22 June morning):** Some key topics of discussion:
 - 1) Impact of new UDTV (4k definition) on FY16 ASP and margins
 - 2) Impact of domestic sourcing of LED TV panels on tax savings and margins

3) Progress on new white goods initiatives (air conditioners and air purifiers) in FY16

4) New online advertising and ecommerce fulfillment potential longer term

FY15 results

Year to Mar (HKMM)	FY14A	FY15A	Growth	FY15E	Var	FY15 cons
Turnover	39,480	40,135	1.7%	41,754	-3.9%	41,738
Gross profit	7,629	8,023	5.2%	8,098	-0.9%	8,181
GPM	19.3%	20.0%		19.4%		19.6%
EBIT	1,884	2,582	37.0%	2,212	16.7%	2,066
NP (ex gains)	1,254	1,595	27.2%	1,559	2.3%	1,504
EPS (HK\$)	0.446	1.100	146.7%	0.910	20.9%	0.539

Source : Company data, J.P. Morgan estimates.

Latest monthly statistics show continued recovery

May statistics released by Skyworth (after close of trading 8 June) shows continued recovery after March 2015.

(see filing : <http://www.hkexnews.hk/listedco/listconews/SEHK/2015/0608/LTN20150608335.pdf>)

The Y/Y domestic unit sales growth of 7% was in line with our expectations (FY16 Y/Y unit growth of 8%) but the performance is much better than the 1.5% drop in sales by rival TCLM in the month of May. We believe that Skyworth is taking market share from TCLM in rural areas as it has been quicker to offer higher-end UDTVs as well as reasonably priced newer entry models than TCLM.

Another positive surprise is that the ASP for domestic sales in the month of May was down just 1% Y/Y, which is much better than the April ASP decline of 10% (the average ASP decline over the past 12 months was 11%). The decline in the month of May was in line with our expectations of a 3% ASP decline in FY16. We see the ASP for TVs for Skyworth bottoming out with upside coming from higher UDTV sales in the upcoming months.

Price, valuation and risks. Skyworth trades at 9.8x CY16E P/E. Our PT (Dec-15, DCF-derived; WACC: 12%; terminal growth of 3%) of HK\$9.5 implies a forward P/BV of 1.9x and forward P/E of 12.5x CY16E). Key risks to our PT are: the timing of the commencement of government incentive /subsidy schemes for TVs, and a higher cost of components cutting into margins.

Please refer to our latest Note, "[Skyworth Digital: Raising PT to HK\\$9.5 - Including hidden value from online content](#)" dated Apr 13, 2015 for detail.

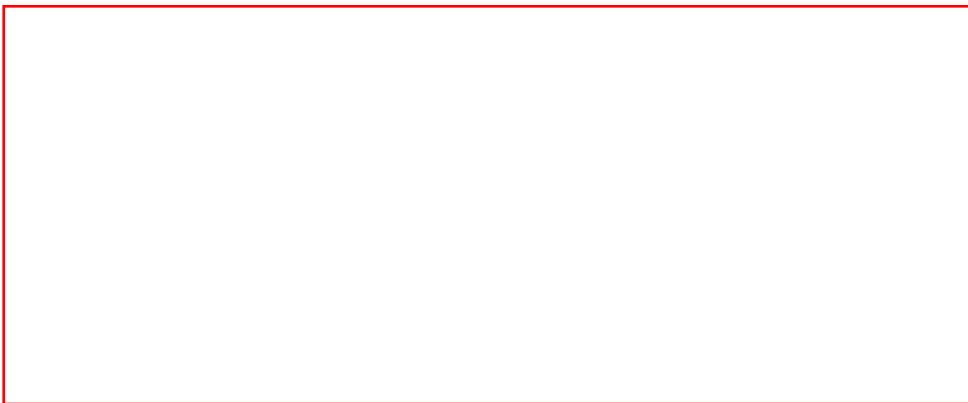
Table 1: Detailed Statistics for May 2015

Unit sales (000)	14-Nov	14-Dec	15-Jan	15-Feb	Mar-15	Apr-15	May-15
Domestic							
Flat TV	912	1,103	1,284	514	605	771	547
Y/Y domestic LCD	3%	9%	39%	78%	-2%	14%	7%
M/M total gth	28%	21%	16%	-60%	18%	27%	-29%
Y/Y flat panel	3%	9%	39%	78%	-2%	14%	7%
Domestic ASP change	-11%	-8%	-7%	2%	-3%	-10%	-1%
Cloud	261	384	477	215	234	275	220
4K	130	197	257	47	75	143	101
4K + Cloud	391	580	733	262	309	418	321
3D + Cloud / Total	43%	53%	57%	51%	51%	54%	59%

Exports	411	333	299	244	306	381	371
Total Flat TV	1,323	1,436	1,583	758	911	1,152	918
Flat TV (Y/Y growth)	18%	9%	29%	80%	8%	28%	21%

Source: Company reports.

Figure 1: Total TV Unit Sales



Source: Company reports.

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. We see Skyworth taking market share in the rural market from peers (especially TCLM) as Skyworth has a strong line-up of higher-end TVs and the best high-end brand in lower-tier cities.

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 10-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 19 June 2015)

TCL Multimedia (1070.HK/HK\$5.66/Neutral)

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Date	Rating	Share Price (HK\$)	Price Target (HK\$)
19-May-10	OW	6.03	10.00
06-Jul-10	OW	4.92	8.40
03-Aug-10	OW	5.61	9.20
27-Aug-10	OW	4.19	8.00
13-Oct-10	OW	5.28	7.50
01-Dec-10	OW	4.12	6.50
17-Jan-11	OW	4.70	7.00
18-Oct-11	OW	3.44	6.00
25-Nov-11	OW	3.17	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	5.16	7.90
08-Mar-13	OW	5.33	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	3.49	4.70
15-Aug-14	OW	4.00	5.60
25-Nov-14	OW	4.23	6.30
26-Jan-15	OW	4.23	6.50
09-Feb-15	OW	4.97	7.00
06-Mar-15	OW	5.50	8.20
13-Apr-15	OW	6.73	9.50

<http://gps-app.amer.jpmchase.net:6080/server/console/chart/?shareClassId=1003078&shareClassServerId=4&chartDesignation=1&actionType=C>

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