

Skyworth Digital Holdings

New HK\$11 target price - rural dominance is the key

Skyworth is the largest branded TV maker in the China domestic market. Overall, FY15 results were better than expected, with higher GPM on TVs and lower selling costs being the key positive surprise. We are lifting our PT to HK \$11.0 and maintaining OW rating.

- FY15 results show the strength of the sales network.** FY15 was a challenging year for the TV industry but Skyworth managed to lift its unit sales in China by 10% in FY15 and took rural market share from rival TCLM. The increase in China TV GPM to a near record 22.0% (20.8% in FY14) was a positive surprise given ASPs fell by more than 10% Y/Y. Selling costs as a proportion of sales also fell by 0.4% to 12.0% in FY15. In the first two months of FY16, we have already seen a strong 9% Y/Y unit sales growth in China and the minus 1% ASP in the month of May was the lowest Y/Y decline in more than 1.5 years. Over 50% of TVs in China are still old CRT (mostly rural) which should support a strong replacement cycle and benefit rural TV brand leader Skyworth for the next 3 years.
- Earnings and PT adjustment.** We have adjusted our sales forecast for FY16 down by 3.5% to reflect lower sales of white goods appliances. We factored in lower SGA costs in FY16 and FY17 after seeing better than expected cost controls in FY15. Overall, we lifted NP for both FY16 and FY17 by 6.8% and 10.4% respectively. Our EPS estimate for FY16 and FY17 is 21% and 29% higher than consensus. We are comfortable with this positive variance as the FY15 actual EBIT (excluding gains) is about 17% higher than consensus. We set a new Dec 16 PT of HK\$11 (previously a Dec 15 PT of HK\$9.5). The increase in PT is due to HK\$0.50 from the earnings revision and HK\$1.0 due to the rollover to a later target price date.
- Price, valuation and risk.** Skyworth trades at 9.5x FY16E P/E. Our PT (Dec-16, DCF-derived; WACC: 12%; terminal growth of 3%) of HK\$11 implies a forward P/BV of 1.8x and forward P/E of 11.9x 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.

Skyworth Digital Holdings (Reuters: 0751.HK, Bloomberg: 751 HK)

HK\$ in mn, year-end Mar	FY12A	FY13A	FY14A	FY15A	FY16E
Revenue (HK\$ mn)	28,137	37,824	39,480	40,135	46,505
Net Profit (HK\$ mn)	1,252	1,501	1,254	3,128	2,237
EPS (HK\$)	0.46	0.54	0.45	1.10	0.78
DPS (HK\$)	0.15	0.17	0.15	0.24	0.17
Revenue growth (%)	15.6%	34.4%	4.4%	1.7%	15.9%
EPS growth (%)	12.0%	17.4%	(18.0%)	147.8%	(29.2%)
ROCE	10.9%	12.0%	9.8%	10.2%	14.7%
ROE	16.1%	16.3%	12.1%	11.0%	15.3%
P/E (x)	16.1	13.7	16.8	6.8	9.5
P/BV (x)	2.4	2.1	2.0	1.5	1.4
EV/EBITDA (x)	6.6	5.8	5.7	3.4	3.4
Dividend Yield	1.9%	2.3%	2.0%	3.3%	2.3%

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

Overweight

0751.HK, 751 HK

Price: HK\$7.47

▲ Price Target: HK\$11.00
Previous: HK\$9.50



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Price Performance



Company Data

Shares O/S (mn)	2,830
Market Cap (HK\$ mn)	21,140
Market Cap (\$ mn)	2,727
Price (HK\$)	7.47
Date Of Price	19 Jun 15
Free Float(%)	63.1%
3M - Avg daily vol (mn)	14.15
3M - Avg daily val (HK\$ mn)	98.37
3M - Avg daily val (\$ mn)	12.7
HSCEI	1,3186.05
Exchange Rate	7.75
Price Target End Date	31-Dec-16
Price Target (HK\$)	11.00

See page 14 for analyst certification and important disclosures, including non-US analyst disclosures.

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<p>Key catalysts for the stock price:</p> <ul style="list-style-type: none"> • New subsidies or incentives to stimulate appliance demand from the govt. • More sales from new white goods business • Higher proportion of sales through dedicated Skyworth retail outlets 	<p>Upside risks to our view:</p> <ul style="list-style-type: none"> • More demand for TVs as a result of the end of analog broadcasting in Dec 2015 • Higher demand for TVs and easier comparable numbers once consumers stop waiting for government incentives • More content related revenues from smart TVs 	<p>Downside risks to our view:</p> <ul style="list-style-type: none"> • Margins coming down as competition picks up from internet content providers selling cheap TVs • Margin on high end Ultra-High definition TVs comes down as product matures • Poor sales for TVs as property market softens under a tight credit environment
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Key financial metrics	FY13	FY14	FY15E	FY16E
Revenues (LC)	37,824	39,480	40,135	46,505
Revenue growth (%)	-25.6%	4.4%	1.7%	15.9%
EBITDA (LC)	2,366	2,336	3,136	3,644
EBITDA margin (%)	6.3%	5.9%	7.8%	7.8%
Tax rate (%)	17%	16%	20%	16%
Net profit (LC)	1,501	1,254	3,128	2,237
EPS (LC)	0.544	0.446	1.105	0.782
EPS growth (%)	17.4%	82.0%	247.8%	70.8%
DPS (LC)	0.17	0.15	0.24	0.17
BVPS (LC)	3.56	3.82	4.82	5.38
Operating cash flow (LC mn)	(391)	3,900	4,588	1,139
Free cash flow (LC mn)	(894)	1,668	1,235	(566)
Interest cover (x)	18	14	19	51
Net margin (%)	4.0%	3.2%	7.8%	4.8%
Sales/assets (X)	1.47	1.29	1.23	1.33
Debt/equity (%)	56.7%	50.3%	17.0%	13.9%
Net debt/equity (%)	34.2%	23.6%	-4.8%	3.9%
ROE (%)	16%	12%	11%	15%

Key model assumptions	FY13	FY14	FY15E	FY16E
CRT (000 units sold)	490	212	0	0
LED (000 units sold)	8779	11108	12719	14372
LED (GPM %)	19%	19%	20%	21%

Source: Company and J.P. Morgan estimates.

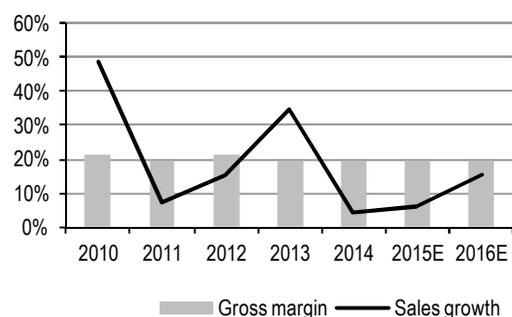
Sensitivity analysis	EBITDA		EPS	
Sensitivity to	FY15E	FY16E	FY15E	FY16E
Panel prices (5% drop)	9%	18%	18%	18%
Domestic LCD sales (5%)	6%	11%	11%	11%
1% change in GPM	11%	10%	18%	18%

Source: J.P. Morgan estimates.

Valuation and price target basis

Our Dec-16 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%. Our Beta is 1.3, and accordingly, we assume a WACC of 12.0%.

Sales growth vs GPM trends



Source: Company, J.P. Morgan estimates.

JPM vs. consensus, change in estimates

EPS (LC)-Excluding Gain	FY15E	FY16E
JPM old	0.720	0.790
JPM new	0.782	0.887
% chg	9%	12%
Consensus	0.648	0.688

Source: Bloomberg, J.P. Morgan estimates.

Peer comparison – Consumer electronic companies in China

Companies	Ticker	LC, (PT)	MCAP US\$mn	Vol US\$mn	1W chg	3M chg	CY14E P/E (x)	CY15E P/E(x)	ROE	PB	Yld (%)	ND/E (%)
SKYWORTH (OW)*	751 HK	7.47 (11)	2,730	13.0	(2.2)	25.8	15.9	7.9	14.8	2.4	1.9	23.9
TCL MULTIMEDIA (OW)*	1070 HK	5.66 (6.8)	974	5.9	(4.9)	(1.0)	(61.2)	30.6	19.9	1.6	3.5	(52.0)
HAIER ELECTRONIC (NC)	1169 HK	21.20	7,641	14.6	(3.4)	5.7	16.1	14.0	22.1	4.0	0.6	(74.0)
HISENSE ELEC-A (NC)	600060 CH	28.23	5,683	149.2	(17.3)	27.3	23.2	21.0	13.3	3.3	1.3	(18.7)
Average					(7.0)	14.4	(1.5)	18.4	17.5	2.8	1.5	(30.2)

Source: Bloomberg, J.P. Morgan estimates (*). Bloomberg estimates for NC companies. Share prices are as of June 19, 2015

Highlights from analysts briefing

- **UDTV growth helps TV margins.** The demand for ultra high definition TV (UDTV) has continued to grow in FY15 to over 20% of unit sales in recent months. Margin for UDTV was 30.4 % in FY15 or nearly double that of a normal LED TV. Management expects 2.5m units of UDTV domestic sales for FY16
- **Online revenues take off.** Activated smart TV users reach 7.6m at the end of May (adding around 10,000 daily). We believe that an activated user number of over 5m users was a threshold where Skyworth would start charging for online advertising and other services (not much revenue sharing when active users below 5m). As such online advertising revenue was minimal in FY15 (just reached 5m users late in FY15). Management expects Rmb 80m of online sales (advertising ,content and others) for FY16 (we estimate Rmb about Y 75 million for FY16)
- **New air conditioning starting in FY16.** One of the newest businesses for Skyworth is the air conditioning business under the Skyworth brand. The company believes that it can use its strong brand and sales network to be able to sell air cons profitably. Over 3 to 4 years management targets 3m units of air con sales. For FY16, management targets 600k in unit sales (we currently EST. 500k). By FY18, we expect about 15% of overall sales to come from air conditioning.

Still compelling value with many engines of growth

We continue to view Skyworth as a company that can leverage from its strong TV brand and network into a number of new areas. The one we focus on this time is the online business, which is currently a very small sales generator but with exceptional growth. We also see upside from the relatively new appliance business (refrigerators, air conditioners, clothes washers and air purifiers). One major initiative that we have not been able to value is the new third party e-commerce fulfillment operations, where Skyworth can generate a portion of the online sales for other company/brand's electronics and appliance online sales. Skyworth is in a good position to provide logistics, installation and repair services to other companies without such an extensive network of outlets, warehouses and repairmen. We believe the majority of the FY16 sales and net profit will still be from the TV hardware business and PE of 9-10x CY15 for the company as a whole is much lower than other peers listed in the A-share Shenzhen exchange with smaller sales and market share. An example is Bloomberg consensus 38x CY15E PE for the set top box subsidiary Skyworth Digital - A (000810 CH). We should see sustained interest from domestic investors as the Shenzhen market is trading at a CY15 PE of over 30x.

FY15 results beat on better margins

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%	2,206
NP (ex gains)	1,254	1,766	40.8%	1,559	13.3%	1,504
EPS (HK\$)	0.446	1.100	146.7%	0.910	20.9%	0.539

Source: Company reports; J.P. Morgan estimates

- **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).

FY16 Net profit lifted by 7% and net PT of HK\$11

Earnings changes

(HK\$m)	----- New -----		----- Old -----		----- Change -----	
Year to Mar	FY15E	FY16E	FY15E	FY16E	FY15E	FY16E
Turnover	46,505	55,825	48,208	56,318	-3.5%	-0.9%
Gross profit	9,300	10,939	9,477	10,871	-1.9%	0.6%
EBIT	2,989	3,395	2,834	3,106	5.4%	9.3%
Net profit	2,237	2,572	2,096	2,329	6.8%	10.4%
EPS (HKD)	0.78	0.89	0.72	0.79	8.6%	12.3%
Assumptions						
Gross margin	20.0%	19.6%	19.7%	19.3%	0.3%	0.3%

Source: J.P. Morgan estimates

We adjusted our sales for FY16 down by 3.5% to reflect the lower sales of white goods appliances. The decline in exports of appliances was not anticipated but in our opinion is not that negative as exports tend to be very low margin. For TV sales we have assumed total TV sales of 14.4m units in FY16 compared to 15.0unit target by management. We note that this is conservative given that the unit sales in FY15 of 13.2m units exceeded the target of 12m units set at the beginning of FY15.

We factored in lower SGA costs in FY16 and FY17 after seeing better than expected cost control in FY15. Overall, we lifted NP for both FY16 and FY17 by 6.8% and 10.4% respectively. Our EPS estimate for FY16 and FY17 is 21% and 29% higher than consensus. We are comfortable with this positive variance as the FY15 actual EBIT (excluding gains) is about 17% higher than consensus. We set a new Dec 16 PT of HK\$11 (previously a Dec 15 PT of HK\$9.5). The increase in PT is due to

HK\$0.50 from the earnings revision and HK\$1.0 due to the rollover to a later target price date.

Sum of the parts value up to HK\$14

We maintain our sum of the parts (SOTP) valuation at HK\$14.0 as the increase in the value of the core TV operations (following strong FY15 results) was entirely offset by the roughly 5% drop in the share price of listed A-share subsidiary Skyworth Digital (000810 CH). Despite the recent rise in the share price of Skyworth, our SOTP analysis still assigns a value of negative HK\$1.4 to the TV business (including the new online value), which we believe is unfair given that TV sales are improving and Skyworth is in a great position to participate in future online revenues from its large subscriber base. This HK\$14 sotp value does not include any value for the upcoming e-commerce logistics and fulfillment business that is commencing in late FY16.

Estimation of Sum or the part value

	HK\$m	% NAV	Methodology
Cash	3,317		
Pledged deposits	423		
Investments	1,424		
Long term debt	(1,312)		
Short term debt	(1,274)		
Bills Receivables	7,297		
Bills Payables	(4,835)		
Cash receipt for land	1,470		Cash receipt net of taxes
Total monetary items	6,510	16%	Book value
Skyworth Digital technologies	8,507	21%	20% discount to shr price
White goods	3,409	9%	15x 16e PE multiple with 20% discount
Office buildings	5,429	14%	Rmb 25k psm - 178k sm area
LCD JV	1,404	4%	Book value
	10,423	26%	8x 16e PE multiple
TV / modules / others	8,507	21%	20% discount to shr price
Internet content	4,256	11%	DCF value (12% WACC; 4% term gth)
Total SOTP value	39,937		
	2,851		
Shares	14.0		
Per share	4,256		

Source: Company reports; J.P. Morgan estimates

March units sales better than expected

Skyworth reported strong figures for May (announced 8 June) with Y/Y domestic unit sales growth of 7% is 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. The shares of Skyworth are down 5% today (vs HSCEI up 1.5%) in part we believe due to weak May unit sales by TCLM (announced 5th June). We believe the latest May statistics released by Skyworth (after close of trading 8th June) should lift sentiment.

(See filing :

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

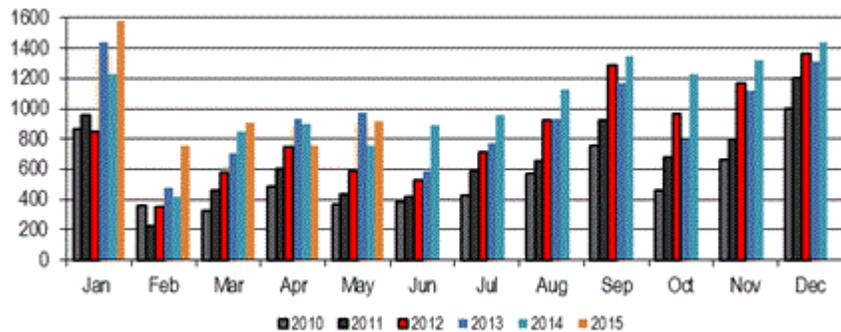
Another positive surprise is that the ASP for domestic sales in the month of May was down just 1% Y/Y, which is much better than the April ASP decline of 10% (the average ASP decline over the past 12 months was 11%). The decline in the month of May is in line with our expectation of a 3% ASP decline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

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.

Valuation and share price analysis

DCF valuation

Our Dec-16 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. Our Beta is 1.3, and accordingly, we assume a WACC of 12.0%. We estimate free cash flow for Skyworth until 2020 and assume a terminal growth rate of 3.0%. The terminal growth is based on the annual growth rate expected in 2015 (the final year of the estimate period) subject to a minimum of 3% and a maximum of 6%, depending on the nature of the industry and the level of maturity in China.

Table 4: Base-case DCF analysis

HK\$ mn	2013	2014E	2015E	2016E	2017E	2018E	2019E	Terminal
Cash flow estimates								
Sales	37,824	39,480	40,135	46,505	55,825	65,736	74,241	84,131
EBIT	2,069	1,883	2,555	2,989	3,395	3,977	4,494	5,145
NOPAT	1,613	1,459	2,044	2,290	2,751	3,222	3,640	4,170
Capex, net	(950)	(2,079)	(1,948)	(1,757)	(1,852)	(1,345)	(1,386)	(961)
Depreciation	297	453	581	655	777	863	914	937
Change in working capital	(2,449)	1,896	1,719	(1,679)	(2,015)	(2,075)	(1,609)	(462)
Free CF (excl. non-core)	(1,489)	1,729	2,395	(491)	(338)	666	1,562	3,688
DCF Parameters								
Liabilities as a % of EV	0%	Assumptions			Terminal growth			
WACC	12.0%	Risk-free rate			3.0%			
		Market risk			4.2%			
		Beta			6.0%			
Enterprise NPV (10-16E)	26,584	Cost of debt			1.30			
+ Net cash (debt), current	(664)	Implied exit P/E multiple (x)			10x			
- Minorities (Market value)	(641)							
+/- Other items	5,967							
= Equity value	31,246							
/ Number of shares (m)	2,851							
= Equity value per share (HK\$)	11.0							

Source Company data, J.P. Morgan estimates.

We also analyze the DCF price sensitivity to WACC, and the terminal multiple.

Table 5: Sensitivity analysis based on WACC and perpetual terminal growth rate

		Terminal growth rate						
		1.5%	2.0%	2.5%	3.0%	3.5%	4.0%	4.5%
WACC	10.5%	12.1	12.5	12.9	13.4	13.9	14.6	15.3
	11.0%	11.4	11.7	12.1	12.5	12.9	13.5	14.1
	11.5%	10.7	11	11.3	11.7	12.1	12.5	13
	12.0%	10.2	10.4	10.7	11	11.3	11.7	12.1
	12.5%	9.7	9.9	10.1	10.3	10.6	10.9	11.3
	13.0%	9.2	9.4	9.6	9.8	10	10.3	10.6
	13.5%	8.7	8.9	9.1	9.3	9.5	9.7	9.9

Source: J.P. Morgan estimates

Table 6: SD – Revenue mix

HK\$ mn, year-end March	2013	2014	2015E
LCD	5,481	-	-
YoY	-34.2%	-100.0%	-
% of total	14.5%	0.0%	0.0%
CRT	218	85	-
YoY	-62.9%	-61.0%	-100.0%
% of total	0.6%	0.2%	0.0%
LED	24,555	29,205	30,095
YoY	63.4%	18.9%	3.0%
% of total	64.9%	74.0%	75.0%
Set top box	3,906	4,162	4,376
YoY	19.4%	6.6%	5.1%
% of total	10.3%	10.5%	10.9%
Others	1,691	2,532	2,358
YoY	-	49.7%	-6.9%
% of total	4.5%	6.4%	5.9%
Total	37,824	39,480	40,135
YoY	34.4%	4.4%	1.7%

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

Table 7: SD – P&L statement

HK\$ mn, year-end March	2012	2013	2014	2015E	2016E
Total Revenues	28,137	37,824	39,480	40,135	46,505
YoY change (%)	15.6%	34.4%	4.4%	1.7%	15.9%
Cost of Goods Sold	(22,181)	(30,418)	(31,851)	(32,112)	(37,205)
YoY change (%)	12.7%	37.1%	4.7%	0.8%	15.9%
Gross Profit	5,956	7,406	7,629	8,023	9,300
YoY change (%)	27.7%	24.3%	3.0%	5.2%	15.9%
Gross Margin	21.2%	19.6%	19.3%	20.0%	20.0%
SGA	(4,765)	(5,942)	(6,570)	(6,571)	(7,548)
YoY change (%)	31.4%	24.7%	10.6%	0.0%	14.9%
Other Income/(Expenses)	444	605	824	1,103	1,237
Operating profit	1,635	2,069	1,883	2,555	2,989
EBITDA	1,879	2,366	2,336	3,136	3,644
EBITDA margin	6.7%	6.3%	5.9%	7.8%	7.8%
Depreciation & Amortization	(245)	(297)	(453)	(581)	(655)
YoY change (%)	22.5%	21.3%	52.5%	28.5%	12.7%
EBIT	1,723	2,069	1,883	2,555	2,989
EBIT margin	6.1%	5.5%	4.8%	6.4%	6.4%
Net Interest Expense	(177)	(133)	(163)	(161)	(71)
Exceptional item	0	0	0	1,780	0
Associates	30	(10)	(20)	2	42
Gains/losses	0	0	0	0	0
Net Income Before Taxes	1,576	1,926	1,700	4,176	2,960
YoY change (%)	11.2%	22.2%	-11.7%	145.6%	-29.1%
Tax	(308)	(332)	(267)	(826)	(465)
Effective Tax rate	19.5%	17.2%	15.7%	19.8%	15.7%
Minority Interests	(16)	(93)	(179)	(222)	(257)
Net Income	1,252	1,501	1,254	3,128	2,237
YoY change (%)	14.1%	19.9%	-16.5%	149.4%	-28.5%
Net margin	4.3%	4.0%	3.2%	7.8%	4.7%

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

Table 8: Interim estimates

HK\$ mn, year-end March	1H13	2H13	1H14	2H14	1H15	2H15E
Total Revenues	16,389	21,435	20,022	19,458	18,478	21,657
Gross Profit	3,301	4,105	3,833	3,796	3,612	4,411
EBIT	844	1,225	1,056	827	1,184	1,371
Net Income Before Taxes	774	1,152	973	727	1,099	3,077
Net Income	618	883	719	535	824	2,304
Diluted EPS (HK\$)	0.224	0.32	0.256	0.19	0.291	0.81
Ratios						
Revenue split	43.3%	56.7%	50.7%	49.3%	46.0%	54.0%
GPM	20.1%	19.2%	19.1%	19.5%	19.5%	20.4%
EBIT margin	5.1%	5.7%	5.3%	4.3%	6.4%	6.3%
NPM	3.8%	4.1%	3.6%	2.7%	4.5%	10.6%
YoY						
Revenue	25.4%	42.3%	22.2%	-9.2%	-7.7%	11.3%
GP	19.1%	28.9%	16.1%	-7.5%	-5.8%	16.2%
EBIT	22.7%	18.4%	25.1%	-32.5%	12.1%	65.8%
NP	34.1%	11.6%	16.3%	-39.4%	14.6%	330.7%

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

Table 9: SD – Balance sheet

HK\$ mn, year-end March	2012	2013	2014	2015E	2016E
Cash and Cash Equivalents	2,164	2,301	3,023	3,317	1,722
Inventories	3,151	5,109	4,188	4,342	5,031
Accounts receivable	11,623	15,986	15,848	14,597	16,914
Other Current Assets	2,002	1,237	3,121	2,805	3,634
Total Current Assets	18,940	24,633	26,180	25,061	27,301
Intangible Assets	0	0	0	0	0
Property and Equipment, Net	2,328	3,192	4,436	5,223	6,313
Other Assets	956	1,238	1,528	3,038	3,046
Non-Current assets	3,284	4,430	5,964	8,261	9,359
Total Assets	22,224	29,063	32,144	33,322	36,660
Accounts Payable	7,107	9,586	9,241	9,154	10,607
Other Accrued Expenses	1,248	2,321	4,979	5,193	5,637
Taxes Payable	198	190	125	448	87
ST and current LT debts	3,568	5,581	5,156	1,274	1,175
Total Current Liabilities	12,121	17,678	19,501	16,069	17,506
Long-term Debt	715	225	547	1,312	1,211
Other Noncurrent Liability	720	924	748	738	738
Noncurrent liabilities	1,435	1,149	1,295	2,050	1,949
Total Liabilities	13,556	18,827	20,796	18,119	19,455
Share capital	269	280	283	285	285
Reserves and Surplus	8,200	9,689	10,539	13,454	15,199
Total Shareholders' Equity	8,469	9,969	10,822	13,739	15,484
Minority Interest	199	267	526	1,464	1,721
Total Shareholders' Equity	8,668	10,236	11,348	15,203	17,206
Total Liabilities and Equity	22,224	29,063	32,144	33,322	36,660

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

Table 10: SD – Cash flow statement

HK\$ mn, year-end March	2012	2013	2014	2015E	2016E
EBIT	1,723	2,069	1,883	2,555	2,989
Depreciation and Amortization	245	297	453	581	655
Working Capital Changes	(348)	(2,449)	1,896	1,719	(1,679)
Tax Paid	(244)	(308)	(332)	(267)	(826)
Cash Flow From Operations	1,376	(524)	3,737	4,427	1,068
Capital expenditures	(720)	(950)	(2,079)	(1,948)	(1,757)
Investments and others	(408)	286	(390)	(1,620)	(116)
Net Interest	(177)	(133)	(163)	(161)	(71)
Cash Flow from Investing	(1,305)	(328)	(2,858)	(5,188)	(1,989)
Free Cash Flow	71	(1,137)	1,268	859	(805)
Dividends	(199)	(177)	(443)	(555)	(590)
Common issue	0	0	0	0	0
Debt	(322)	1,727	(103)	(10)	(200)
Other Financing	0	(309)	0	0	0
Cash Flow from financing	(521)	1,241	(546)	(565)	(790)
Change in cash	(450)	104	722	294	(1,595)
Cash beginning	2,524	2,164	2,301	3,023	3,317
Foreign exchange changes	90	33	0	0	0
Cash at end	2,164	2,301	3,023	3,317	1,722

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

Investment Thesis, Valuation and Risks

Skyworth Digital Holdings *(Overweight; Price Target: HK\$11.00)*

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-16 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.

Skyworth Digital Holdings: Summary of Financials

Income Statement						Cash flow statement					
HK\$ in millions, year end Mar	FY14	FY15	FY16E	FY17E	FY18E	HK\$ in millions, year end Mar	FY14	FY15	FY16E	FY17E	FY18E
Revenues	39,480	40,135	46,505	55,825	65,736	EBIT	1,883	2,555	2,989	3,395	3,977
% change Y/Y	4.4%	1.7%	15.9%	20.0%	17.8%	Depr. & amortization	453	581	655	777	863
Gross Profit	7,629	8,023	9,300	10,939	12,882	Change in working capital	1,896	1,719	(1,679)	(2,015)	(2,075)
% change Y/Y	3.0%	5.2%	15.9%	17.6%	17.8%	Taxes	(332)	(267)	(826)	(465)	(537)
EBITDA	2,336	3,136	3,644	4,173	4,840	Cash flow from operations	3,900	4,588	1,139	1,693	2,228
% change Y/Y	(1.3%)	34.3%	16.2%	14.5%	16.0%	Capex	(2,079)	(1,948)	(1,757)	(1,852)	(1,345)
EBIT	1,883	2,555	2,989	3,395	3,977	Net Interest	(163)	(161)	(71)	(65)	(59)
% change Y/Y	(9.0%)	35.7%	17.0%	13.6%	17.1%	Other	(100)	(110)	(108)	(111)	(131)
EBIT Margin	4.8%	6.4%	6.4%	6.1%	6.1%	Free cash flow	1,668	1,235	(566)	(122)	913
Net Interest	(163)	(161)	(71)	(65)	(59)	Equity raised/(repaid)	0	0	0	0	0
Earnings before tax	1,700	4,176	2,960	3,417	4,020	Debt raised/(repaid)	(103)	(10)	(200)	(200)	(200)
% change Y/Y	(11.7%)	145.6%	(29.1%)	15.5%	17.6%	Other	0	0	0	0	0
Tax	(267)	(826)	(465)	(537)	(631)	Dividends paid	(443)	(555)	(590)	(528)	(613)
as % of EBT	15.7%	19.8%	15.7%	15.7%	15.7%	Beginning cash	2,301	3,023	3,317	1,722	641
Net income (reported)	1,254	3,128	2,237	2,572	3,025	Ending cash	3,023	3,317	1,722	641	501
% change Y/Y	(16.5%)	149.4%	(28.5%)	14.9%	17.6%	DPS	0.15	0.24	0.17	0.20	0.23
Shares outstanding	2,813	2,832	2,860	2,899	2,899						
EPS (reported)	0.45	1.10	0.78	0.89	1.04						
% change Y/Y	(18.0%)	147.8%	(29.2%)	13.4%	17.6%						
Balance sheet						Ratio Analysis					
HK\$ in millions, year end Mar	FY14	FY15	FY16E	FY17E	FY18E	HK\$ in millions, year end Mar	FY14	FY15	FY16E	FY17E	FY18E
Cash and cash equivalents	3,023	3,317	1,722	641	501	Gross margin	19.3%	20.0%	20.0%	19.6%	19.6%
Accounts receivable	15,848	14,597	16,914	20,303	23,908	EBITDA margin	5.9%	7.8%	7.8%	7.5%	7.4%
Inventories	4,188	4,342	5,031	6,039	7,112	Operating margin	4.8%	6.4%	6.4%	6.1%	6.1%
Others	3,121	2,805	3,634	4,044	4,474	Net margin	3.2%	3.4%	4.8%	4.6%	4.6%
Current assets	26,180	25,061	27,301	31,028	35,995	Sales per share growth	2.4%	1.0%	14.7%	18.5%	17.8%
LT investments	1,528	3,038	3,046	3,064	3,084	Sales growth	4.4%	1.7%	15.9%	20.0%	17.8%
Net fixed assets	4,436	5,223	6,313	7,373	7,838	Net profit growth	(16.5%)	149.4%	(28.5%)	14.9%	17.6%
Total Assets	32,144	33,322	36,660	41,465	46,917	EPS growth	(18.0%)	147.8%	(29.2%)	13.4%	17.6%
Liabilities						Interest coverage (x)	14.3	19.5	51.4	64.1	81.4
Short-term loans	5,156	1,274	1,175	1,077	978	Net debt to equity	23.6%	(4.8%)	3.9%	7.9%	6.7%
Payables	9,241	9,154	10,607	12,733	14,993	Working Capital to Sales	0.2	0.2	0.2	0.2	0.2
Others	5,104	5,641	5,724	6,285	6,951	Sales/assets	1.3	1.2	1.3	1.4	1.5
Total current liabilities	19,501	16,069	17,506	20,095	22,922	Assets/equity	2.9	2.7	2.4	2.4	2.4
Long-term debt	547	1,312	1,211	1,109	1,008	ROE	12.1%	11.0%	15.3%	15.6%	16.2%
Other liabilities	748	738	738	738	738	ROCE	9.8%	10.2%	14.7%	15.2%	16.1%
Total Liabilities	20,796	18,119	19,455	21,942	24,668						
Shareholders' equity	11,348	15,203	17,206	19,523	22,249						
BVPS	3.82	4.82	5.38	6.08	6.90						

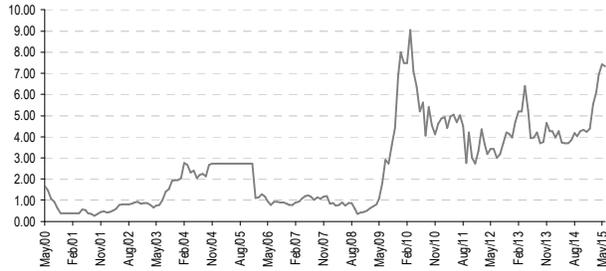
Source: Company reports and J.P. Morgan estimates.

JPM Q-Profile
Skyworth Digital Holdings Limited (HONG KONG / Consumer Discretionary)
 As Of: 19-Jun-2015

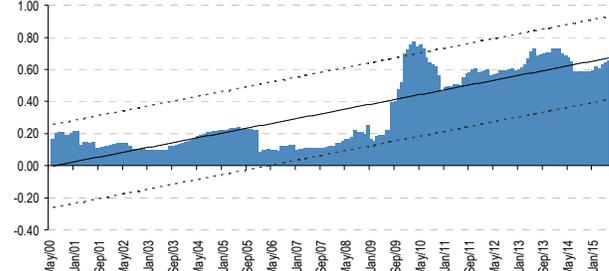
Global Equity Quantitative Analysis

Quant_Strategy@jpmorgan.com

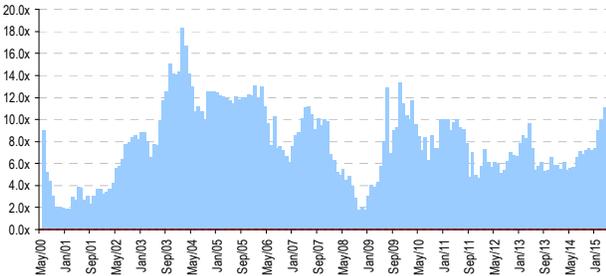
Local Share Price Current: **7.34**



12 Mth Forward EPS Current: **0.66**



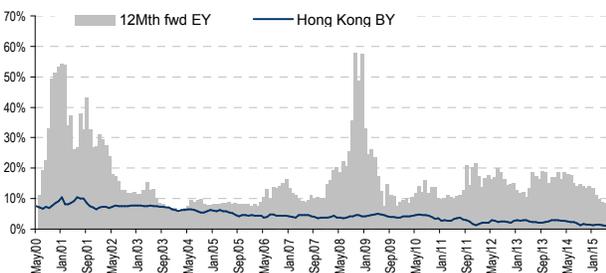
PE (1Yr Forward) Current: **11.2x**



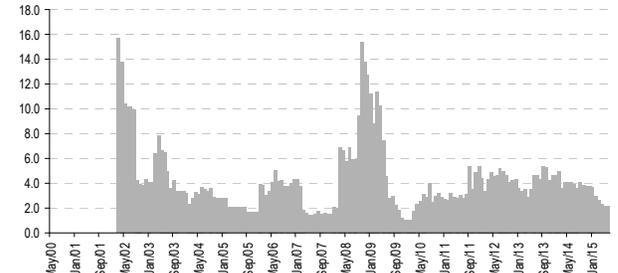
P/E Relative to Hong Kong Index Current: **0.71**



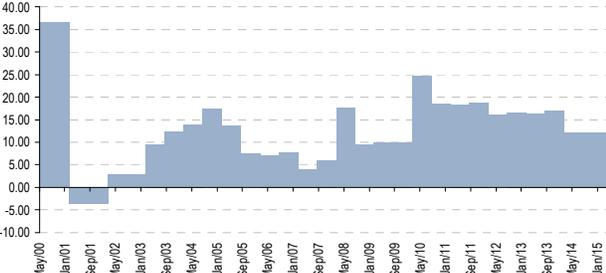
Earnings Yield (& Local Bond Yield) Current: **9%**



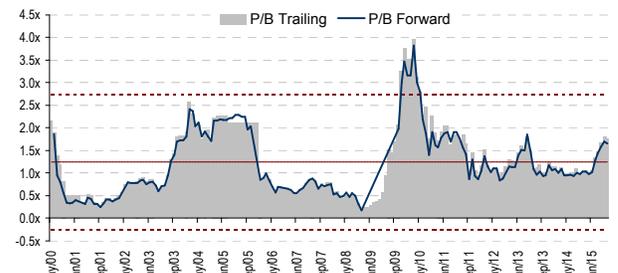
Dividend Yield (Trailing) Current: **2.16**



ROE (Trailing) Current: **12.19**



Price/Book (Value) Current: **1.8x**



Summary

Skyworth Digital Holdings Limited		HONG KONG		TICKER 751 HK		As Of: 19-Jun-15					
Consumer Discretionary						Local Price:		7.34			
						EPS:		0.66			
	Latest	Min	Max	Median	Average	2 S.D.+	2 S.D. -	% to Min	% to Max	% to Med	% to Avg
12mth Forward PE	11.19x										
P/BV (Trailing)	1.77	0.20	3.96	1.03	1.24	2.74	-0.25	-89%	124%	-42%	-30%
Dividend Yield (Trailing)	2.16x	0.00	15.69	3.35	3.71	9.54	-2.11	-100%	626%	55%	72%
ROE (Trailing)	12.19	-3.68	36.45	12.19	12.67	29.98	-4.65	-130%	199%	0%	4%

Source: Bloomberg, Reuters Global Fundamentals, IBES CONSENSUS, JPMorgan Quantitative & Derivative Strategy

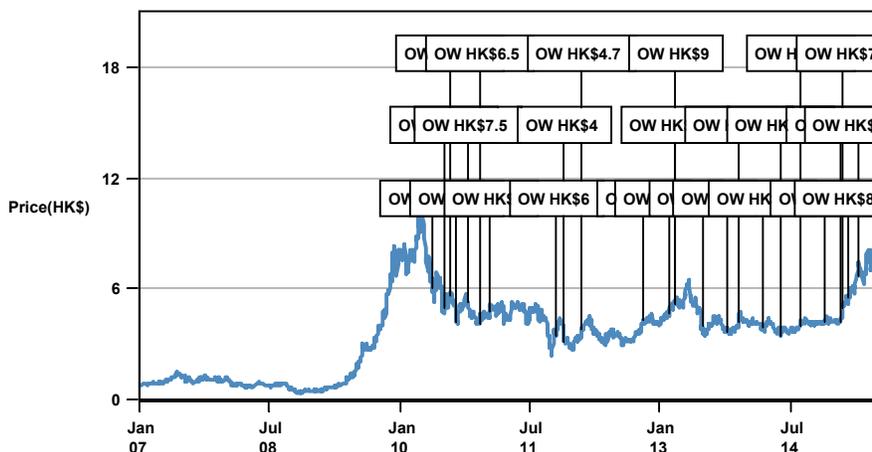
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Skyworth Digital Holdings (0751.HK, 751 HK) Price Chart



Source: Bloomberg and J.P. Morgan; price data adjusted for stock splits and dividends. Initiated coverage May 19, 2010.

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

The chart(s) show J.P. Morgan's continuing coverage of the stocks; the current analysts may or may not have covered it over the entire period.

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J.P. Morgan Global Equity Research Coverage	43%	44%	13%
IB clients*	55%	49%	37%
JPMS Equity Research Coverage	44%	48%	9%
IB clients*	75%	68%	54%

*Percentage of investment banking clients in each rating category.

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