

Skyworth Digital Holdings Ltd.

GPM doesn't appear sustainable

We reiterate our Underweight rating and 12-month price target of HK\$6.90 as we believe the impressive results for 2H FY15 are already fully priced in and may not be sustainable given the sluggish TV demand and intensifying competitive dynamics in the China market, margin dilution from its overseas TV business and uncertain contributions from its home appliance and Cloud TV segments.

Impressive GPM and non-operating income may not be sustainable: The gross profit margin for LCD TVs in China improved to 22.1% for FY15 from 20.5% for FY14, given the following: 1) greater 4K2K TV and smart TV adoption; 2) models from higher GPM small-size TVs that Skyworth's peers have ignored; and 3) successful sell-through of models with margins of greater than 25%, such as the Glee series. Also, overseas TV sales turned profitable at HK\$120mn for FY15 from a loss of HK\$14mn for FY14 after overall volume rose 42% y/y. However, we believe it will not be easy for Skyworth to repeat this success due to sluggish TV demand and the intensified competitive dynamics (please see [here](#) for more details) in the China market and aggressive expansion in the overseas TV market (margin dilutive) through its OEM business model. For FY15, its GPM was 7.6% for overseas TV sales vs. 22.1% for China TV sales.

Other key takeaways from the investor conference: 1) Management for the first time provided quantitative projections on its new revenue stream from Cloud TV. The guidance for total revenue of RMB80mn for FY16 is in line with our expectation while management guides for a net margin of more than 50% after profit sharing with content providers. 2) Management spoke less on Skyworth's home appliance applications, only providing a target of 600,000 air conditioner units for FY16. 3) Management aims to triple Skyworth's overseas TV business to 10mn in FY17 from 3.7mn in FY15 in which its own brand will increase to 30% of total units from 13%. 4) Capex for FY16 was guided to be just slightly lower at HK\$1.9bn from HK\$2.2bn for FY15. And 5) panel price trends are guided to be stable to declining with small-size panels to decline more while high-end panels are to remain resilient.

Earnings revisions: We update our model with the actual FY15 results and slightly lift our EPS estimate for FY16 by 2% on our new China TV/overseas TV unit assumptions.

0751.HK: Financial and Valuation Metrics EPS HKD

FY Mar	2014	2015	2016	2017	2018
EPS	0.45A	1.11A	0.58E	0.77E	0.70E
Previous EPS	0.45A	1.00E	0.58E	0.65E	N/A
Consensus EPS	0.49A	0.66E	0.64E	0.70E	N/A
P/E	16.7	6.7	12.8	9.7	10.6

Source: Barclays Research.

Consensus numbers are from Thomson Reuters

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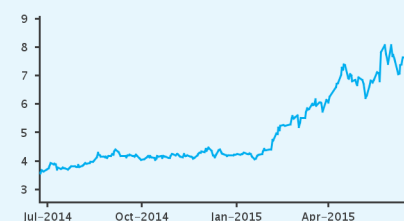
Stock Rating	UNDERWEIGHT Unchanged
Industry View	NEUTRAL Unchanged
Price Target	HKD 6.90 Unchanged

Price (22-Jun-2015)	HKD 7.43
Potential Upside/Downside	-7%
Tickers	751 HK / 0751.HK

Market Cap (USD mn)	2733
Shares Outstanding (mn)	2850.71
Free Float (%)	63.17
52 Wk Avg Daily Volume (mn)	9.6
52 Wk Avg Daily Value (USD mn)	6.68
Dividend Yield (%)	2.1
Return on Equity TTM (%)	12.19
Current BVPS (HKD)	4.15

Source: Thomson Reuters

Price Performance	Exchange-HKG
52 Week range	HKD 8.26-3.48



[Link to Barclays Live for interactive charting](#)

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Skyworth Digital Holdings Ltd. (0751.HK)

Stock Rating: UNDERWEIGHT

Income statement (HKDmn)	2015A	2016E	2017E	2018E	CAGR
Revenue	40,135	48,486	59,695	63,193	16.3%
EBITDA	1,874	2,217	2,877	2,050	3.0%
EBIT	1,452	1,711	2,270	2,050	12.2%
Pre-tax income	4,176	2,250	2,879	2,660	-14.0%
Net income	3,128	1,635	2,153	1,972	-14.2%
EPS (reported) (HKD)	1.11	0.58	0.77	0.70	-14.2%
Diluted shares (mn)	2,810.0	2,810.0	2,810.0	2,810.0	0.0%
DPS (HKD)	0.24	0.19	0.25	0.22	-2.8%

Price (22-Jun-2015) HKD 7.43
Price Target HKD 6.90

Why Underweight? We see the outlook for Skyworth as stable, but we think its impressive China TV unit growth and margins will be difficult to maintain. The earnings contribution from home appliances and new cloud TV revenue stream may be limited near term.

Upside case HKD 10.50

We assume that Skyworth can increase sales from its home appliance segment and from its new revenue stream from Cloud TV through active daily users, delivering EPS of HK\$0.70 for FY17 with the market likely to re-rate the valuation to a P/E of 15x on the higher growth outlook.

Downside case HKD 4.00

We assume Skyworth cannot monetize its Cloud TV platform while its home appliance business is not earnings accretive and its core business China TV suffers from ASP and gross margin erosion. Thus, we see EPS downside to HK\$0.50 with the valuation de-rated to a P/E of 8x.

Margin and return data	Average				
Gross margin (%)	20.0	17.9	16.3	15.9	17.5
EBITDA margin (%)	4.7	4.6	4.8	3.2	4.3
EBIT margin (%)	3.6	3.5	3.8	3.2	3.5
Pre-tax margin (%)	10.4	4.6	4.8	4.2	6.0
Net margin (%)	7.8	3.4	3.6	3.1	4.5
ROIC (%)	3.0	6.0	7.6	6.4	5.8
ROA (%)	9.2	4.3	5.1	4.3	5.7
ROE (%)	24.7	11.3	13.7	11.5	15.3

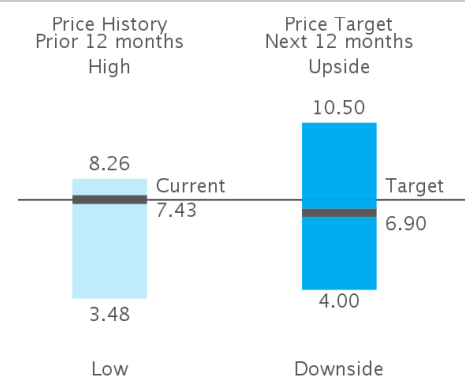
Balance sheet and cash flow (HKDmn)	CAGR				
Tangible fixed assets	5,100	6,120	7,344	8,813	20.0%
Intangible fixed assets	0	0	0	0	N/A
Cash and equivalents	4,784	6,414	9,751	9,787	26.9%
Total assets	35,901	39,524	44,905	47,164	9.5%
Short and long-term debt	7,343	6,843	6,843	6,843	-2.3%
Net debt/(funds)	2,559	429	-2,908	-2,944	N/A
Other long-term liabilities	786	786	786	786	0.0%
Total liabilities	22,038	24,549	28,466	29,384	10.1%
Shareholders' equity	13,863	14,975	16,439	17,780	8.6%
Change in working capital	-1,115	2,142	3,235	206	N/A
Cash flow from operations	2,431	4,283	5,997	2,179	-3.6%
Capital expenditure	-1,272	-1,526	-1,832	-1,469	N/A
Free cash flow	1,159	2,756	4,165	710	-15.1%

Valuation and leverage metrics	Average				
P/E (reported) (x)	6.7	12.8	9.7	10.6	9.9
EV/EBITDA (x)	11.8	9.0	5.8	8.1	8.7
Equity FCF yield (%)	5.6	13.2	19.9	3.4	10.5
P/BV (x)	1.5	1.4	1.3	1.2	1.4
Dividend yield (%)	3.3	2.5	3.3	3.0	3.0
Total debt/capital (%)	34.6	31.4	29.4	27.8	30.8
Net debt/equity (%)	18.5	2.9	-17.7	-16.6	-3.2

Selected operating metrics

Inventory turnover days	81	69	57	54
Account receivable days	91	78	66	66
Account payable days	100	88	85	89
Cash conversion cycle (days)	73	59	38	31

Upside/Downside scenarios



Source: Company data, Barclays Research
Note: FY End Mar

FIGURE 1

Skyworth – statistical abstract

Year to 31-Mar	Net profit HK (\$mn)	EPS HK (cent)	EPS Growth (%)	P/E (x)	P/B (x)	ROE (%)	BImbg EPS (HK \$ cent)	% Diff (%)
2012	1,252	46.28	5%	16.05	2.31	15.73		
2013	1,501	54.36	17%	13.67	2.04	15.88		
2014	1,254	44.63	-18%	16.65	1.89	11.58		
2015	3,128	111.32	149%	6.67	1.55	24.74	53.0	110%
2016E	1,635	58.17	-48%	12.77	1.43	11.34	64.8	-10%
2017E	2,153	76.63	32%	9.70	1.30	13.71	69.2	11%

Source: Company reports, Bloomberg consensus estimates, Barclays Research estimates

Revising earnings estimates

We update the numbers for FY15 according to Skyworth's published results and slightly increase our EPS estimate for FY16 by 2% after we factor in our now higher assumptions on China TV and overseas TV units.

FIGURE 2

Skyworth – earnings revisions table

	1H FY14	2H FY14	1H FY15	2H FY15	1H FY16E	2H FY16E
Original estimates						
Revenue (HK\$m)	20,022.0	19,458.3	18,478.0	22,024.7	20,325.8	25,412.6
Gross Profit	3,833.0	3,796.0	3,612.0	4,309.7	3,861.9	4,659.6
Gross Margin (%)	19%	20%	20%	20%	19%	18%
Op Profit	716.12	342.88	575.12	776.55	711.52	845.83
Op Margin (%)	4%	2%	3%	4%	4%	3%
Net Profit	718.6	535.4	824.1	1,976.0	777.4	843.2
Net Margin (%)	4%	3%	4%	9%	4%	3%
Net EPS (HK\$ cents)	0.26	0.19	0.29	0.70	0.28	0.30
Annual EPS (HK\$ cent)		0.45		1.00		0.58
Bloomberg EPS (HK\$ cent)						
New estimates						
Revenue (HK\$m)	20,022.0	19,458.3	18,478.0	21,657.0	20,325.8	28,160.3
Gross Profit	3,833.0	3,796.0	3,612.0	4,411.0	3,861.9	4,814.0
Gross Margin (%)	19%	20%	20%	20%	19%	17%
Op Profit	716.12	342.88	575.12	876.88	711.52	999.12
Op Margin (%)	4%	2%	3%	4%	4%	4%
Net Profit	718.6	535.4	824.1	2,301.9	777.4	857.3
Net Margin (%)	4%	3%	4%	11%	4%	3%
Net EPS (HK\$)	0.26	0.19	0.29	0.82	0.28	0.31
Annual EPS (HK\$)		0.45		1.11		0.58
Bloomberg EPS (HK\$ cent)						
Revisions (%)						
Sales	0%	0%	0%	-2%	0%	11%
Gross Profit	0%	0%	0%	2%	0%	3%
Op Profit	0%	0%	0%	13%	0%	18%
Net Profit	0%	0%	0%	16%	0%	2%
Annual EPS		0%		16%		2%

Source: Company reports, Barclays Research estimates

FIGURE 3

Skyworth – semi-annual income statement (HK\$ mn)

Year-end 31 Mar	1H FY13	2H FY13	1H FY14	2H FY14	1H FY15	2H FY15	1H FY16E	2H FY16E	1H FY17E	2H FY17E	FY14	FY15	FY16E	FY17E
Sales	16,389	21,435	20,022	19,458	18,478	21,657	20,326	28,160	22,358	37,337	39,480	40,135	48,486	59,695
COGS	(13,088)	(17,330)	(16,189)	(15,662)	(14,866)	(17,246)	(16,464)	(23,346)	(18,110)	(31,844)	(31,851)	(32,112)	(39,810)	(49,954)
Gross profit	3,301	4,105	3,833	3,796	3,612	4,411	3,862	4,814	4,248	5,493	7,629	8,023	8,676	9,741
Op expenses	(2,693)	(3,249)	(3,117)	(3,453)	(3,037)	(3,534)	(3,150)	(3,815)	(3,354)	(4,118)	(6,570)	(6,571)	(6,965)	(7,471)
Op Income	608	856	716	343	575	877	712	999	894	1,375	1,059	1,452	1,711	2,270
Int&other inc/(exp)	166	303	256	385	524	2,198	267	273	267	343	641	2,724	540	610
Pretax income	774	1,159	972	728	1,099	3,075	979	1,272	1,161	1,718	1,700	4,176	2,250	2,879
Taxes or credits	(205)	(220)	(254)	(193)	(275)	(773)	(201)	(415)	(234)	(270)	(446)	(1,048)	(616)	(726)
Net income	569	932	719	535	824	2,302	777	857	927	1,448	1,254	3,128	1,635	2,153
EPS (HK\$ cents)	20.96	33.15	25.57	19.05	29.33	81.99	27.66	30.51	33.00	51.53	44.63	111.32	58.17	76.63
Shares (mn)	2,715	2,811	2,810	2,810	2,810	2,808	2,810	2,810	2,810	2,810	2,810	2,810	2,810	2,810
Margin analysis (%)														
Gross margin	20.1%	19.2%	19.1%	19.5%	19.5%	20.4%	19.0%	17.1%	19.0%	14.7%	19.3%	20.0%	17.9%	16.3%
Op margin	3.7%	4.0%	3.6%	1.8%	3.1%	4.0%	3.5%	3.5%	4.0%	3.7%	2.7%	3.6%	3.5%	3.8%
Pre-tax margin	4.7%	5.4%	4.9%	3.7%	5.9%	14.2%	4.8%	4.5%	5.2%	4.6%	4.3%	10.4%	4.6%	4.8%
Net margin	3.5%	4.3%	3.6%	2.8%	4.5%	10.6%	3.8%	3.0%	4.1%	3.9%	3.2%	7.8%	3.4%	3.6%
Changes y/y (%)														
Sales	25.4%	42.3%	22.2%	-9.2%	-7.7%	11.3%	10.0%	30.0%	10.0%	32.6%	4.4%	1.7%	20.8%	23.1%
Gross profit	19.1%	28.9%	16.1%	-7.5%	-5.8%	16.2%	6.9%	9.1%	10.0%	14.1%	3.0%	5.2%	8.1%	12.3%
Op income	20.6%	10.5%	17.8%	-59.9%	-19.7%	155.7%	23.7%	13.9%	25.7%	37.6%	-27.7%	37.1%	17.8%	32.7%
Net income	23.4%	12.0%	26.3%	-42.5%	14.7%	330.0%	-5.7%	-62.8%	19.3%	68.9%	-16.5%	149.4%	-47.7%	31.7%
Changes q/q (%)														
Sales	8.8%	30.8%	-6.6%	-2.8%	-5.3%	17.2%	-6.1%	38.5%	-20.6%	67.0%				
Gross profit	3.6%	24.4%	-6.6%	-1.0%	N/A	22.1%	-12.4%	24.7%	-11.8%	29.3%				
Op income	-21.5%	40.7%	-16.3%	-52.1%	N/A	52.5%	-18.9%	40.4%	-10.5%	53.7%				
Net income	-31.6%	63.7%	-22.9%	-25.5%	-5.1%	179.3%	-66.2%	10.3%	8.2%	56.1%				

Source: Company reports, Barclays Research estimates

FIGURE 4

Skyworth – our key assumptions

	FY12	FY13	FY14	FY15	FY16E	FY17E
Unit sales by application (000)						
China TV units	7,024	8,705	8,606	9,459	9,932	10,230
Oversea TV units	2,226	2,721	2,615	3,715	5,944	10,105
Home Appliance			1,200	1,200	2,000	3,000
Air conditioning					600	1,200
ASP (HK\$)						
China TV	3,121	3,114	3,051	2,577	2,525	2,475
Oversea TV	1,364	1,107	1,250	1,550	1,550	1,550
Home Appliance			2,100	1,978	2,000	2,000
Air Conditioning				4,000	4,000	4,000
Revenue Breakdown (HK\$mn)						
China TV	21,922	27,107	26,257	24,376	25,083	25,319
Overseas TV	1,632	2,459	3,269	5,758	9,213	15,662
Set top box	3,264	3,896	4,285	4,376	4,507	4,597
LCD module	281	530	900	642	674	708
Home Appliance	478	643	2,520	2,374	6,400	10,800
Others	450	1,513	2,249	2,609	2,609	2,609
Changes in Revenue (%)						
Total Revenue		34%	4%	2%	21%	23%
China TV		24%	-3%	-7%	3%	1%
Overseas TV		51%	33%	76%	60%	70%
Set top box		19%	10%	2%	3%	2%
LCD module		88%	70%	-29%	5%	5%
Home Appliance		34%	292%	-6%	170%	69%
Others		236%	49%	16%	0%	0%
Gross Profit Margin (%)						
Total GPM	21.2%	19.6%	19.3%	20.0%	17.9%	16.3%
China TV	21.8%	20.9%	20.5%	22.1%	21.0%	20.0%
Overseas TV	6.1%	4.2%	7.2%	7.6%	8.0%	8.0%
Set top box	27.8%	27.8%	24.0%	23.0%	24.0%	24.0%
LCD module	13.5%	20.4%	13.9%	9.4%	9.0%	9.0%
Home Appliance	12.3%	10.8%	21.9%	20.3%	19.0%	18.0%
Others	11.0%	14.2%	12.0%	25.0%	12.0%	12.0%
Revenue Mix						
China TV	78%	72%	67%	61%	52%	42%
Overseas TV	6%	7%	8%	14%	19%	26%
Set top box	12%	10%	11%	11%	9%	8%
LCD module	1%	1%	2%	2%	1%	1%
Home Appliance	2%	2%	6%	6%	13%	18%
Others	2%	4%	6%	7%	5%	4%

Source: Company reports, Barclays Research estimates

Valuation and key risks

Our 12-month price target for Skyworth is HK\$6.90 based on our target P/E of 12x applied to our revised EPS for FY16 of HK\$0.58. We believe our target P/E is justified given the 12% EPS CAGR we forecast for FY14-17E (PEG=1) after we factor in the new revenue stream from its Cloud TV users.

The key upside risks to our price target, in our view, include the following: 1) better-than-expected China TV demand thanks to a stronger GDP/property outlook or if Skyworth were able to increase its market share to more than 20%; 2) strong execution of its air conditioner product lines, helping to grow revenue and profit; and 3) Skyworth's Internet team being able to deliver on smart TV targets and grow its active users, generating higher Internet revenue than we now expect.

FIGURE 5
Skyworth – P/E



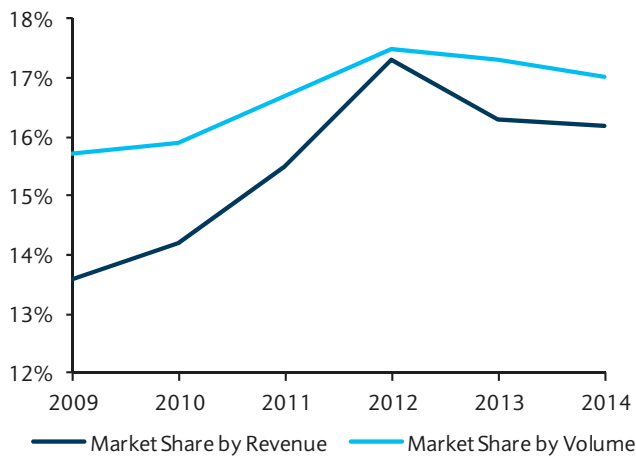
Source: Bloomberg, Barclays Research estimates

FIGURE 6
Skyworth – P/B



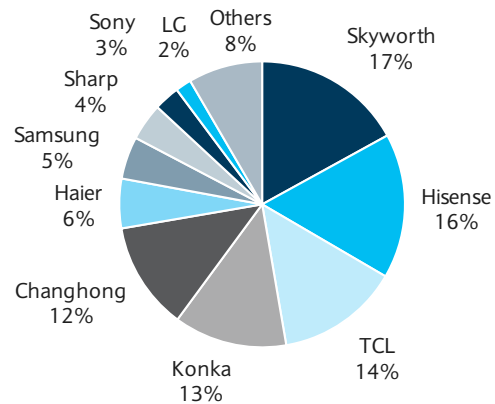
Source: Bloomberg, Barclays Research estimates

FIGURE 7
Skyworth – China LCD TV market shares



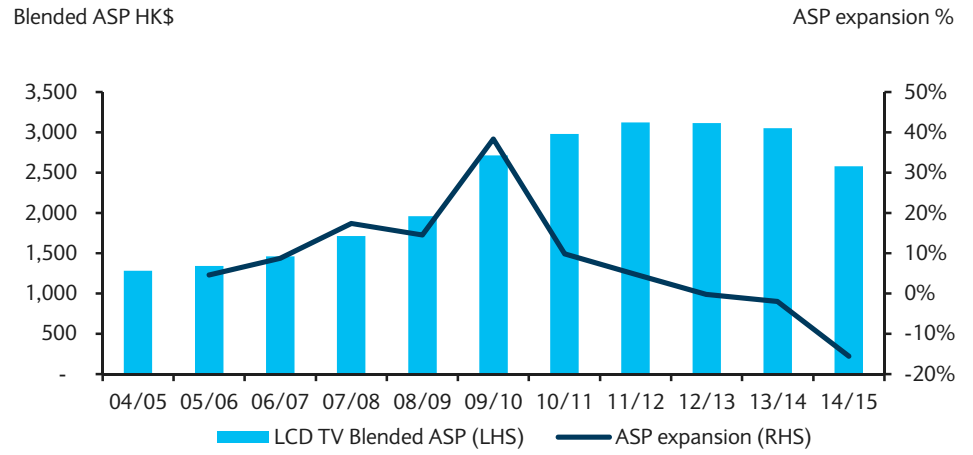
Source: Company data, Barclays Research

FIGURE 8
China LCD TV – market shares, 2014



Source: Company data, Barclays Research

FIGURE 9
Skyworth – blended ASP for China TV continues to trend down



Source: Company reports, Barclays Research

FIGURE 10
Skyworth – projected revenue breakdown for its Cloud TV user database

	RMB \$mn
Content	20
Advertising	20
Gaming	10
Education	10
Shopping	10
Travel	10
Total	80

Source: Company reports, Barclays Research

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Primary Stocks (Ticker, Date, Price)

Skyworth Digital Holdings Ltd. (0751.HK, 22-Jun-2015, HKD 7.43), Underweight/Neutral, J

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Master limited partnerships (MLPs) are pass-through entities structured as publicly listed partnerships. For tax purposes, distributions to MLP unit holders may be treated as a return of principal. Investors should consult their own tax advisors before investing in MLP units.

Guide to the Barclays Fundamental Equity Research Rating System:

Our coverage analysts use a relative rating system in which they rate stocks as Overweight, Equal Weight or Underweight (see definitions below) relative to other companies covered by the analyst or a team of analysts that are deemed to be in the same industry (the "industry coverage universe").

In addition to the stock rating, we provide industry views which rate the outlook for the industry coverage universe as Positive, Neutral or Negative (see definitions below). A rating system using terms such as buy, hold and sell is not the equivalent of our rating system. Investors should carefully read the entire research report including the definitions of all ratings and not infer its contents from ratings alone.

Stock Rating

Overweight - The stock is expected to outperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Equal Weight - The stock is expected to perform in line with the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Underweight - The stock is expected to underperform the unweighted expected total return of the industry coverage universe over a 12-month investment horizon.

Rating Suspended - The rating and target price have been suspended temporarily due to market events that made coverage impracticable or to comply with applicable regulations and/or firm policies in certain circumstances including where the Investment Bank of Barclays Bank PLC is acting in an advisory capacity in a merger or strategic transaction involving the company.

Industry View

Positive - industry coverage universe fundamentals/valuations are improving.

Neutral - industry coverage universe fundamentals/valuations are steady, neither improving nor deteriorating.

Negative - industry coverage universe fundamentals/valuations are deteriorating.

Below is the list of companies that constitute the "industry coverage universe":

Asia ex-Japan IT Hardware

Acer Inc. (2353.TW)	Advantech (2395.TW)	Asustek Computer Inc. (2357.TW)
Compal Electronics Inc. (2324.TW)	Delta Electronics Inc. (2308.TW)	Epistar Corporation (2448.TW)
Hon Hai Precision Industry Co., Ltd. (2317.TW)	Lenovo Group Ltd. (0992.HK)	LG Innotek (011070.KS)
Lite-On Technology Corp. (2301.TW)	Lumens Co., Ltd. (038060.KQ)	PAX Global Technology Ltd. (0327.HK)
Pegatron Corp. (4938.TW)	Quanta Computer Inc. (2382.TW)	Samsung Electro-Mechanics (009150.KS)
Samsung SDI (006400.KS)	Skyworth Digital Holdings Ltd. (0751.HK)	Wistron Corporation (3231.TW)

Distribution of Ratings:

Barclays Equity Research has 2678 companies under coverage.

43% have been assigned an Overweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Buy rating; 54% of companies with this rating are investment banking clients of the Firm.

41% have been assigned an Equal Weight rating which, for purposes of mandatory regulatory disclosures, is classified as a Hold rating; 46% of companies with this rating are investment banking clients of the Firm.

15% have been assigned an Underweight rating which, for purposes of mandatory regulatory disclosures, is classified as a Sell rating; 42% of companies with this rating are investment banking clients of the Firm.

Guide to the Barclays Research Price Target:

Each analyst has a single price target on the stocks that they cover. The price target represents that analyst's expectation of where the stock will trade in the next 12 months. Upside/downside scenarios, where provided, represent potential upside/potential downside to each analyst's price target over the same 12-month period.

Top Picks:

Barclays Equity Research's "Top Picks" represent the single best alpha-generating investment idea within each industry (as defined by the relevant "industry coverage universe"), taken from among the Overweight-rated stocks within that industry. Barclays Equity Research publishes global and regional "Top Picks" reports every quarter and analysts may also publish intra-quarter changes to their Top Picks, as necessary. While analysts may highlight other Overweight-rated stocks in their published research in addition to their Top Pick, there can only be one "Top Pick" for each industry. The current list of Top Picks is available on

IMPORTANT DISCLOSURES CONTINUED

<https://live.barcap.com/go/RSL/servlets/dv.search?pubType=4526&contentType=latest>.

To see a list of companies that comprise a particular industry coverage universe, please go to <http://publicresearch.barclays.com>.

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IMPORTANT DISCLOSURES CONTINUED

Skyworth Digital Holdings Ltd. (751 HK / 0751.HK)

Stock Rating

Industry View

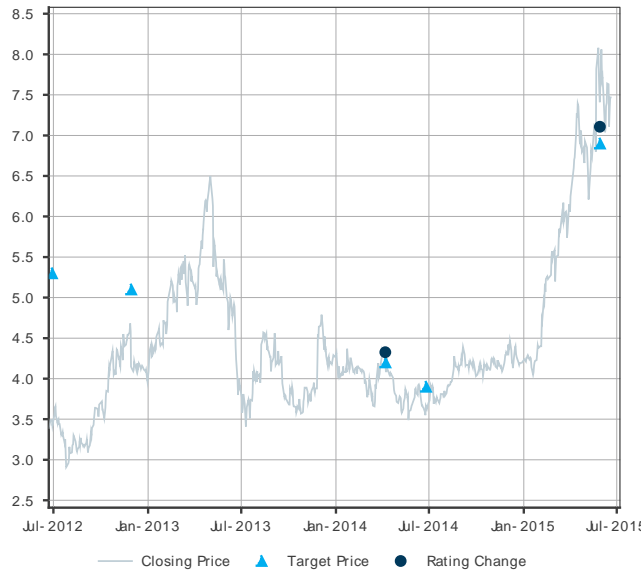
HKD 7.43 (22-Jun-2015)

UNDERWEIGHT

NEUTRAL

Rating and Price Target Chart - HKD (as of 22-Jun-2015)

Currency=HKD



Date	Closing Price	Rating	Adjusted Price Target
29-May-2015	7.41	Underweight	6.90
25-Jun-2014	3.67		3.90
07-Apr-2014	4.21	Equal Weight	4.20
29-Nov-2012	4.15		5.10
28-Jun-2012	3.49		5.30

Source: Thomson Reuters, Barclays Research

Historical stock prices and price targets may have been adjusted for stock splits and dividends.

Source: IDC, Barclays Research

[Link to Barclays Live for interactive charting](#)

J: Barclays Bank PLC and/or an affiliate trades regularly in the securities of Skyworth Digital Holdings Ltd..

Valuation Methodology: Our 12-month price target for Skyworth is HK\$6.90 based on our target P/E of 12x applied to our EPS estimate for FY16 of HK\$0.58. Our target P/E is 1 standard deviation above the 3-year average. We believe our target P/E is justified given the 12% EPS CAGR we forecast for FY14-17E (PEG=1).

Risks which May Impede the Achievement of the Barclays Research Price Target: The key upside risks to our price target, in our view, include the following: 1) better-than-expected China TV demand thanks to a stronger GDP/property outlook or if Skyworth were able to increase its market share to more than 20%; 2) strong execution of its air conditioner product lines, helping to grow revenue and profit; and 3) Skyworth's Internet team being able to deliver on smart TV targets and grow its active users, generating higher Internet revenue than we now expect.

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