

China Seven Star



Loss expected for 2007

HOLD (unchanged)

Profit warning issued. China Seven Star issued on 22 Apr 2008 a profit warning hinting at an operating loss for FY12/07F and impairment of goodwill, related to the acquisition of Top Pro and Shanghai Pei Lian, totaling HK\$247.7m. Given the tough TV home shopping environment in 2H 2007, the management decided to make a full provision for impairment loss of such goodwill. The company will announce its FY12/07 annual results on 28 April.

China Retail

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Why operating loss. Following the success of the TV home shopping operations of China Seven Star and Acorn (ATV US), competition intensified in 2H 2007 with: 1) expansion of incumbent second liners, such as Dongfang CJ and TVSN; 2) entry of new well funded start ups, such as Happigo; and 3) relatively little product differentiation amongst the competitors. The increase competition for air time, together with brand owners ramping up their TV advertising leading up to the 2008 Beijing Olympics, significantly drove up air time costs putting significant pressure on margins and the sales-adspend ratio.

Stock data

Price	HK\$0.135
Target price	n/a
12 mth range	HK\$0.125-1.410
Market cap.	US\$126.7m
Daily t/o, 3 mth	US\$1.0m
Free float %	46.7%
Ticker	0245.HK/245 HK

Handset market saturation. By end-2007, several branded domestic handset manufacturers bypassed Seven Star and other TV home shopping companies and directly placed informercials on satellite TV networks. This further saturated an already competitive space and undermined one of Seven Star's strong cash generators i.e. handset sales.

Financial summary

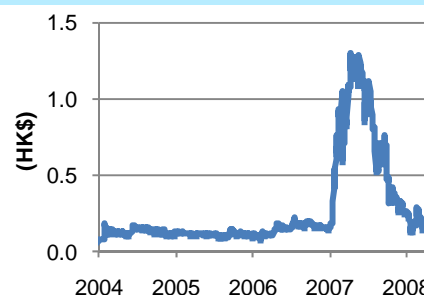
Year to Dec	05A	06A	07F	08F	09F
Turnover (HK\$m)	23.1	92.4	612.9	617.5	755.3
Net profit (HK\$m)	(16.6)	29.6(286.7)	44.8	48.9	
EPS (HK\$)	(0.004)	0.007(0.040)	0.006	0.007	
EPS Δ %	n/a	n/a	n/a	n/a	9.3
P/E (x)	n/a	19.5	n/a	21.8	19.9
P/B (x)	n/a	2.4	2.3	2.9	2.2
EV/EBITDA (x)	n/a	15.2	1.3	9.6	5.3
Yield (%)	12.0	-	-	-	-
ROE (%)	n/a	24.2	n/a	12.6	12.5
ROCE (%)	n/a	28.7	n/a	13.8	13.4
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Near-term challenges. We believe Seven Star's decision to withdraw from the acquisition of handset sourcing company Uniscope was a positive move removing one of the uncertainties, but other challenges remain:

- Fierce competition in the industry;
- Higher air time costs;
- Difficulties in broadening its product portfolio.

Adjusting our FY12/07F estimate. Taking into account its profit warning announcement, we estimate the company's FY12/07F net loss at HK\$286.7m. However, it is difficult to gauge the magnitude of the operational deleveraging. We maintain our HOLD call on the counter and will review our target price and estimates after the result announcement and meeting with the management.

Price Chart



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