

Embarking on a growth phase

China Media

Landune (245 HK, HK\$0.191)

Not Rated

Top-up placement to fund expansion. Landune announced today that on 28 September 2006 the company issued and placed 832.2m new shares at HK\$0.188 per share. The issue price represented a 1.6% discount to the last closing price of HK\$0.191 prior to the announcement. The newly issued shares represent 19.67% of the existing share capital and 16.44% of the enlarged share capital. The top-up placement will raise a net proceed of c. HK\$150m for the company.

Expansion activities focused on direct TV shopping. Management plans to utilize the funds to expand its direct TV shopping operations under Seven Star (Shanghai). The expansion activities will include:

- *Airtime purchase* – Management aims to increase its TV ad spend by about 50% to RMB300m in FY12/07F. A significant portion of the newly raised funds will be used for this purpose. Typically, Landune is required to pay a 20% initial deposit at the end of the year to secure airtime for the upcoming year. Note that the direct TV sales operations typically generates a 3:1 sales / ad spend ratio. The contract terms usually range from 3 months, 6 months to a maximum of 1 year.
- *Acquisitions* – Landune is looking to acquire some of its local distributors, who also have direct TV sales operations and call centres.
- *Joint ventures* – The company will be seeking to form JVs with various satellite and local TV stations to set up dedicated TV home shopping channels (similar to QVC in North America).
- *Strengthen media consulting capabilities* – Landune will acquire or invest in the marketing divisions of OEM suppliers, if their products and brands are considered to have strategic and recognition value.

Benefiting from rising middle class. As we have mentioned before, Landune is a direct proxy to China's growing middle class as consumers are increasingly shifting their spending towards discretionary consumption. The company's main target audience, namely middle class housewives and female adolescents, is firmly entrenched in this demographic group.

Airtime rate card increase is justified. Historically, rate card for airtime on satellite and local TV stations rise between 10% to 20% per year, depending on the stations' penetration rate. In our view, the rate card increase is justified by the increasing viewership of the station, which will help drive direct TV sales.

From net debt to net cash. Landune recorded a net profit of HK\$10.0m in 1H FY12/06, reversing a HK\$8.3m loss a year ago. However, we believe that the key takeaway from the interim results was the company's successful debt reduction. As at 30 June 2006, Landune was in a net cash position of HK\$27.7m on a total equity of HK\$70.1m. The company had previously been in a net debt position of HK\$15.6m at the end of FY12/05. The top-up placement would boost Landune's war chest to c. HK\$180m, or HK\$0.031/share fully diluted.

Low risk in direct TV sales operations. Landune's direct TV sales operations under Seven Star (Shanghai) have minimal risks. All sales are settled by cash or debit cards on delivery to customers. Seven Star (Shanghai) generally bears shipping expenses, but these costs are transferred to the customers for some high value items. Inventory turnover days are relatively low at 15 days as it procures the product only when an order is received. A/R and A/P turnover days are roughly the same at around 30 days. Return ratio, including defective products and orders rejected by customers on delivery, is <3%.

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Solid product and brand portfolio. The direct TV sales operations (including above and below-the-line) currently have a portfolio of over 150 products, divided into 6 divisions. Note that over 80% of the portfolio's products carry the company's own brand names or trademarks. Around 5 to 10 new products and between 10 to 15 new infomercials are produced and introduced each year.

FY12/06F net profit mainly contributed by Pei Lian. Landune's FY12/06F results will largely be contributed by Pei Lian (expected to be RMB27m in FY12/06F), the company's media management division, as the direct TV sales operations are migrated into Seven Star (Shanghai), starting from 4Q FY12/06. For the full year FY12/06F, we expect the direct TV sales operations to achieve a net profit of around RMB100m, up 66% YoY, on a 42% YoY increase in turnover to RMB933.9m on a proforma basis and PRC accounting standards.

Seven Star will become a growth driver. We expect at least a 10-20% profit increase for the direct TV sales operations in FY12/07F, though management guidance is much more optimistic (+50% YoY sales growth). Even if we take our more conservative stance, we expect Seven Star (Shanghai) to contribute a FY12/07F net profit (before 30% minority expenses) of RMB106.5m to RMB121.2m, on a turnover of RMB\$1,363.2m. Together with an expected RMB44.0m contribution from Pei Lian, we expect Landune to make a net profit of between RMB114.4m to 124.7m, representing a fully diluted EPS of HK\$0.0188 to HK\$0.0205, based on 5.85^am shares. In other words, the stock is only trading at 9.3 to 10.2x FY12/07F P/E.

Future success hinges on three key factors. Landune's future success will be dependent on the company's ability to 1) ramp up TV airtime and market share, 2) increase penetration and viewership in the market place and 3) derive economies in the areas of airtime, product procurement and operating scale.

Table 4: Valuation comparisons

Company Name	Ticker	Country	Mkt Cap (US\$m)	Price	His. Turnover (US\$m)	His. Net Profit (US\$m)	Nxt Yr P/E (x)
Direct TV Sales/Media							
GS Home Shopping	028150 KS	Korea	603.8	KW74,000	691.7	76.5	7.9
CJ Home Shopping	035760 KS	Korea	1,087.4	KW79,600	745.9	81.3	12.2
Ideal Shopping Direct	IDS LN	UK	141.2	GBp259.50	148.5	9.7	11.7
Valuevision Media	VVTV US	US	431.3	US\$11.41	691.9	(15.8)	53.6
InterActiveCorp	IACI US	US	8,513.2	US\$28.54	5,753.7	876.2	16.4
Focus Media	FMCN US	China	3,080.7	US\$59.93	68.23	23.6	24.6
Qin Jia Yuan	2366 HK	HK	149.7	HK\$2.31	13.6	8.5	10.5
Average							13.9*
China Retail							
Hongxing Sports	CHHS SP	China	406.9	SGD1.60	38.4	5.8	11.4
Hongguo	HGUO SP	China	164.3	SGD0.66	53.9	9.0	12.0
Li Ning	2331 HK	China	1,173.0	HK\$9.38	311.1	23.7	27.8
Parkson	3368 HK	China	2,041.7	HK\$28.10	143.7	31.5	27.5
Lianhua	980 HK	China	717.7	HK\$8.56	1,816.8	30.4	17.0
Wumart	8277 HK	China	1,056.1	HK\$25.00	497.4	20.9	21.9
Suning Appliance	002024 CH	China	2,376.0	RMB47.9	2,019.9	44.5	25.6
China Paradise	503 HK	China	622.6	HK\$2.03	1,554.5	36.7	39.6
GOME	493 HK	China	1,857.8	HK\$6.11	2,279.7	63.3	14.8
Average							22.0
Landune	245 HK	HK	103.6	HK\$0.191	3.0	(2.1)	9.3-10.2

* Excludes Valuevision Media

Source: Bloomberg and SBI E2-Capital

Disclosure of interests: SBI E2-Capital acted as the sole bookrunner for the Landune top-up placement (832.2m new shares at HK\$0.188 each) on 28 September 2006

^a Fully diluted number of shares includes consideration shares to be issued as part of the Shanghai Pei Lian acquisition based on an expected net profit of HK\$27m for the first full financial year after the completion of the acquisition. Under the terms of the acquisition, the number of consideration shares to be issued is equivalent to 3 times the net profit for the first full financial year after completion of the acquisition, at HK\$0.1025 per consideration share.