

United Power

Sing a simple song

Not Rated

1

China Consumer

Financial summary

Year to Mar	08A	09A	10F	11F	12F
Turnover (HK\$m)	159.3	216.5	344.6	491.3	660.1
Net Profit (HK\$m)	31.9 (190.8)		(6.3)	81.1	175.5
EPS (HK\$)	0.011 (0.056)				
EPS Δ%		n.a.			
P/E (x)	25.7	(5.0)			
P/B (x)	0.8	1.2			
EV/EBITDA (x)	68.0	n.a.			
Yield (%)	n.a.	n.a.			
ROE (%)	4.0	(22.2)			
ROCE (%)	4.1	(22.3)			
N. Gear. (%)	cash	cash			

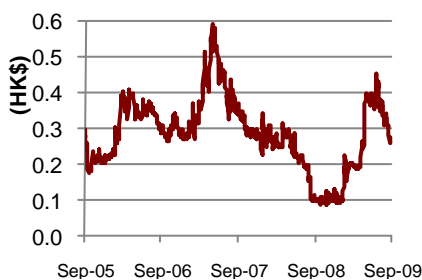
Source: SBI E2-Capital

Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	-17.7	-40.4	+97.3
Actual price changes (%)	-12.7	-32.1	+129.2

	08F	09F	10F
Consensus EPS (HK\$)	n.a.	n.a.	n.a.
Previous forecasts (HK\$m)	n.a.	n.a.	n.a.
Previous EPS (HK\$)	n.a.	n.a.	n.a.

Price Chart


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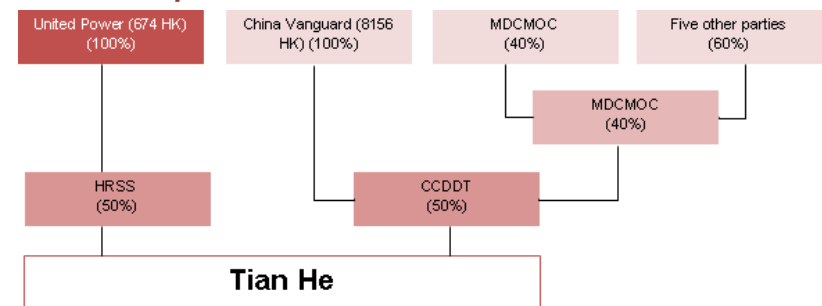
Ticker:	0674.HK	12 mth range:	HK\$0.06-0.47
Price:	HK\$0.28	Market cap:	US\$399.1m
Target:	n.a.	Daily t/o, 3 mth:	US\$6.8m
		Free float %:	29.8%

Key points:

- * Sole agent of CAVCA and MCSC to collect copyright license fee from karaoke operators.
- * Annual license fee is estimated at ~RMB7.5b p.a..
- * Execution is critical.
- * Net profit expected to achieve HK\$278.6m in FY03/13F.

Exclusive license fee collector. United Power (UP) used to operate multiple businesses such as restaurant, hotel, wedding services, entertainment and property investment. In Apr 2009, the company acquired Hua Rong Sheng Shi Holding Ltd (HRSS). HRSS controls 50.0% interest in Tian He Culture Holding (TH), a 50:50 joint venture with China Culture Development Digital Technology Co. Ltd (CCDDT), which, in turn, is owned by China Vanguard (8156 HK, HK\$XXX) (49.0%), Market Development Center of the Ministry of Culture (MDCMOC) (“文化部文化市場發展中心”) (indirectly 20.4%) and other five third parties (indirectly 30.6%). TH has a service agreement with two government authorized associations, China Audio Video Copyright Association (CAVCA) (“中國音像著作權集體管理協會”) and Music Copyright Society of China (MCSC) (“中國音樂著作權協會”), as the exclusive provider of copyright license fees settlement and collection services in respect of the karaoke music products and videos managed and administered by the two associations for a term of 10 years from 2007 to 2017 and is entitled a service charge equivalent to 25% of the fees collected.

Chart 1: Corporate structure



Source: Compiled by SBI E2-Capital

Market estimates. According to Copyright License Fee Standard for Karaoke Operation Industry (“卡拉OK 经营行业版权使用费标准”), copyright royalty is calculated at RMB12 per room per day. The actual rate for 2009 is set by CAVCA at RMB8-11, varying geographically. Considering there are ~60,000 karaoke venues in China (2007: 56,722, 2006: 51,742) with average number of rooms at 20-40, we estimate total license fee incurred each year could reach as much as ~RMB7.5b.

Table 1: CAVCA's fee scheduel for 2009 (RMB/terminal/day)

Region	Region	Region	Region	Region			
Shanghai	11.0	Liaoning	9.2	Henan	8.3	Sichuan	8.0
Beijing	11.0	Inner Mongolia	8.7	Hubei	8.3	Ningxia	8.0
Zhejiang	10.0	Hebei	8.6	Hainan	8.2	Xinjiang	8.0
Tianjin	10.0	Chongqing	8.6	Guangxi	8.2	Qinghai	8.0
Guangdong	10.0	Jilin	8.4	Shannxi	8.2	Tibet	8.0
Jiangsu	9.6	Shanxi	8.3	Anhui	8.2	Gansu	8.0
Fujian	9.3	Hunan	8.3	Jiangxi	8.2	Guizhou	8.0
Shandong	9.2	Heilongjiang	8.3	Yunnan	8.2		

Source: CACAV

A matter of execution. For TH in particular, we think two other factors are also important in determining income besides the predictable market potential:

- penetration rate – proportion of all karaoke venue being reached. Obstacles include: 1) still low awareness of copyright protection in China; 2) insufficient collecting coverage countrywide. Our DCFE model shows that each 1% change in penetration rate could lead 0.7-1.7% change in UP's fair value.
- ramping-up pace – speed in achieving a certain level of penetration ratio. The issue is critical especially when considering the limited length (10 year) of the service agreement between TH and CAVCA and MCSC.

TH is proactively strengthening its collecting coverage and pushing the network from prime cities to distant region. 31 subsidiaries have been established at provincial level with collecting points in different city. Penetration ratio has exceeded 50% in some major cities like Shanghai, though still low in aggregate.

Advertisement outlook is uncertain. MDCMOC, under the approval from the Ministry of Culture, has exclusively appointed CCDDT to establish and operate a nationwide karaoke content management service system (CMS). This system, through a centralized database, will not only provide TH accurate usage information of each karaoke venue, facilitating fee calculation and collection, but also a technical platform to broadcast commercials. Although we agree with the management that such a platform could be attractive for some advertisement customers, our concern comes from potential profit sharing among CCDDT (as the operator of CMS), TH and karaoke venue operators. TH might have the least ground to claim the interest, in our view.

Earnings projection for the listco. As 50% owner of TH, UP can proportionally consolidate TH's results. Although turnover from license fee collection business accounted for only 4.6% of the total HK\$216.5m in 03/09A, we believe it, in long run, will rise as the company's core operation. According to our discussion with management, net profit margin of this business could reach +50%, which sounds feasible given the operation's low-cost nature. On the other hand, although the company has signed several advertisement customers like Country Garden (XXXX), we, at the moment, cautiously assume minimal contribution in the future. Overall we expect the company's net profit will hit HK\$278.6m in FY03/13F.

Table 2: Earnings forecasts and major assumptions

Year to Mar	08A	09A	10F	11F	12F	13F
Total number of karaoke venues	56,722	58,499	60,275	62,052	65,887	69,721
Average number of room	30	30	30	30	30	30
Average fee per room (RMB)	8.7	8.7	8.7	8.7	8.7	8.7
Penetration rate (%)	0.0	0.0	15.0	30.0	45.0	60.0
Revenue (HK\$m)	159.3	216.5	344.6	491.3	660.1	843.8
License fee collection	0.7	10.0	121.7	250.5	400.1	562.9
Others	158.6	206.5	223.0	240.8	260.1	280.9
Net profit (HK\$m)	31.9	(190.8)	(6.3)	81.1	175.5	278.6

Source: Company data, SBI E2-Capital

Risks.

- Potential change in copyright license fee standard - some karaoke operators have been complaining that current fee standard is simply too high to afford). However, upside adjustment is also possible, especially after launch of CMS.
- Renew of service contract with CAVCA and MCSC – current contract will expire in 2017. Although it is uneasy for the two associations to shift to another collector, the extension is uncertain at the moment. The successful extension of service contract (from 10 year period to an ongoing concern) can almost double UP's fair value .

Background information

- CAVCA is the only collective management organization in the field of audio-video works or products in China and collectively manages the copyright and the related rights of audios or videos. It has over 80 registered members. Audio / video products under management account for over 90% of Chinese ones used in karaoke.
- MCSC (hereinafter referred to as “ the Society”), which was established in December 17, 1992, is a non profit-making social organization with the status of a legal person in whose name the Chinese music copyright owners exercise their rights by way of collective administration.

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