

Pico: Major ramp coming

Recommendation: BUY (unchanged)

Hong Kong Media

Price	HK\$1.81	Year to	Net profit	EPS	EPS	P/E	P/B	EV/EBITDA	Yield	ROE	ROCE	N. Gear.
Target price	HK\$2.35 (+30%)	Oct	HK\$m	HK\$	Δ %	x	x	x	%	%	%	%
12 mth range	HK\$0.78-1.83	05A	120.6	0.106	163.3	17.0	3.9	4.8	6.4	23.4	24.5	Cash
Market cap.	US\$276.8m	06A	135.3	0.116	9.3	15.6	3.2	4.4	4.1	21.8	22.9	Cash
Daily t/o, 3 mth	US\$1.1m	07F	202.6	0.170	46.5	10.6	2.9	3.1	5.2	28.2	30.2	Cash
Free float %	49.4%	08F	273.2	0.230	34.9	7.9	2.2	2.3	7.1	31.8	34.8	Cash
Ticker	752.HK/752 HK	09F	241.0	0.202	(11.8)	8.9	1.9	2.4	6.2	22.8	27.3	Cash

Relative to Hang Seng Index (1 mth, 3 mth, 12 mth): +70.4%, -6.2%, +1.4%

Actual price changes (1 mth, 3 mth, 12 mth): +3.4%, -2.7%, +16.0%

Consensus EPS (07F-08F): HK\$0.164, HK\$0.213

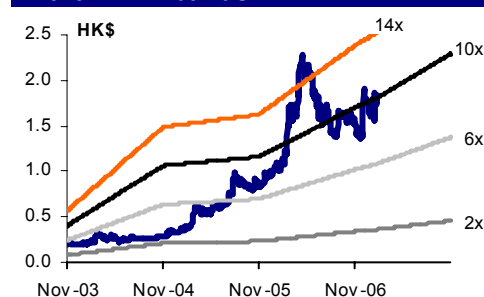
Previous forecasts (07F-09F): HK\$205.2m (\$0.172), HK\$266.8m (\$0.224), n/a

Key points:

- FY10/06 net profit up 12.1% YoY to HK\$135.3m, turnover up 5.2% YoY to HK\$1,803.5m in line with estimates.
- With disappointing FY10/06 behind, investors can squarely focus on the promising growth prospects in FY10/07 and beyond.
- Several major events, such as the Shanghai Auto Show and ITU Telecom World 2006 will be booked in FY10/07, sustaining the growth momentum in the exhibition segment in the lead up to 2008 Beijing Olympics.
- Museum, theme park and interior design business recovered from the sluggish first half. Opportunities in the Middle East, South East Asia and emerging interior fit-out demand from global MNCs should spur this segments' growth.
- We project FY10/07F net profit to hit HK\$202.6m, up 49.7% YoY. EPS to grow 46.5% YoY to HK\$0.170.
- Pico remains the only play with a significant exposure to the emerging MICE sector and the burgeoning exhibition industry. Market has continued to incorrectly value Pico with smaller local plays and the counter is deeply undervalued against international comparables of its size. Our target price of HK\$2.35 represents 14x forward FY10/07F P/E compared to 20x+ traded by peers.

FY10/06 net profit HK\$135.3m. Pico's net profit came in at HK\$135.3m, up 12.1% YoY and in line with our expectations. The results were at the low end of our estimate as there was no write back on the HK\$10m provision for the Torino Winter Olympics, which was booked during the first half of the year. Turnover edged up 5.2% YoY to HK\$1,803.5m driven mainly by a 24.2% YoY rise in its largest segment, exhibition and event marketing services. Gross margin expanded 1.6 pct to 34.1%, though operating margins improved only a mild 0.3 pct to 9.1%, weighed down by increasing SG&A expenses. Selling expenses jumped 14.1% YoY while G&A expenses rose 12.4% YoY. In all, SG&A accounted for 27.2% of turnover (c.f. 25.2% in FY10/05).

Chart 1: P/E bands



Source: SBI E2-Capital

Disappointing FY10/06 behind, focus on ramping FY10/07. Pico could not be happier that FY10/06 is now behind them. The past financial year was undoubtedly a disappointment for the company with event delays and provisions in the exhibition contracting segment, a transient pause in the museum and theme park fit-out market and a slowdown in its conference and show management business. However, as we have highlighted many times before ("MICE space offers potential upside" (29 Nov 2006) and "HK to boost exhibition space" (11 Jan

2007)), the company's growth prospects are promising in FY10/07 and beyond, with steady growth in mainstream segments and emerging opportunities in other businesses.

Table 1: Interim results

Year to Oct	Turnover (HK\$m)	Gross profit (HK\$m)	Gross margin (%)	Pre-tax profit (HK\$m)	Tax rate (%)	Net profit (HK\$m)	EPS (HK\$)	DPS (HK\$)
FY06	1,803.5	615.9	34.1	177.3	16.4	135.3	0.116	0.075
FY05	1,714.8	557.6	32.5	154.8	16.0	120.6	0.106	0.115*
YoY (%)	5.2	10.5		14.5		12.1	9.3	(34.8)

Source: Company data

Note: * FY10/05 dividend included a one-off special dividend of HK\$0.100 per share

Mainstream exhibition contracting services continue to underpin growth. Driven by a surge in exhibition activities in Greater China and South East Asia, turnover in Pico's main exhibition and event marketing services surged 24.2% YoY to HK\$1,472.4m, accounting for 81.6% of turnover (c.f. 69.1%). The company maintained its status as Asia's leading exhibition contracting services provider completing in excess of 600 exhibitions and special events. As a testament to its global reach, the company's projects stretched across China, Hong Kong, Taiwan, Vietnam, Korea, India, Japan, Singapore, Malaysia, Thailand (Asia), Middle East, UK (Europe) and US (North America). Going into FY10/07, we continue to expect the segment to be a key driver of growth. A number of major events that flowed over from FY10/06 to FY10/07 were completed at the end of 2006, including the ITU Telecom World 2006 conference and the Shanghai Auto Show. Furthermore, we believe this business will be spurred by a number of industry catalysts including the emergence of the exhibition market in the Middle East, development of manufacturing base in South East Asian countries and the build-up to 2008 Beijing Olympics and 2010 Shanghai World Expo in China. New projects announced by the management include Integrated Systems China 2007 and International Furniture Fair Singapore.

Better 2H FY10/06 for museum, theme park and interior design business. The improving operating environment in this sector was reflected in a better second half result. Turnover recovered from HK\$35.6m in 1H FY10/06 to record a full-year contribution of HK\$101.8m. Top line was down 63.1% YoY as the completion of Hong Kong Disneyland related contracts boosted the segment's revenues in FY10/05. In our view, this segment may potentially have the most upside within Pico's business portfolio as Asia shifts its focus into the meeting, incentive, convention and exhibition (MICE) market. During the year, the company completed a number of projects in Singapore, Malaysia and Thailand, as well as securing a number of contracts in the Middle East. Singapore contracts included the VIP luxury terminal at Changi Airport, NEWater Visitor Centre, gallery interior fit-out at Philatelic Museum and the TigerLIVE Gallery located at St. James Power Station entertainment spot. Our read through is that Pico is consciously building up its "conceptualise, design and build" portfolio in this sector to position itself to secure key fit-out contracts for Singapore's two casino projects, which plans to feature the world's largest aquarium at Universal Studios theme park and SEA's largest convention centre. Furthermore, we see Pico as a prime beneficiary of the Singapore government's efforts to improve trade ties with the Middle East. Towards the end of last year, the company secured a museum fit-out contract of around US\$5m in Jordan and the company is tendering for additional work in that region.

Fulfilling a new demand in retail store fit-outs. We believe that museum, theme park and interior business will be further spurred by emerging interior fit-out demand from global MNCs. To maintain brand consistency, global brand owners require their stores and other customer touch points to have a consistent appearance and theme. The need to maintain this production and construction quality control across wide geographic base has created a demand that Pico, with its global distribution network, can substantially benefit from. The production scale also raises the entry barriers and reduces the amount of tender competition. The company has already built up a track record in completing interior fit-outs of a high quality through its museum, theme park fit-outs as well as interior fit-outs for several tier one retail chains in Hong Kong and Singapore and we see this as a natural extension of their business. The company has secured a number of high profile fit-out contracts of this nature including fit-out of Barcardi Global Merchandise stores in Europe, Samsung service centres in the Middle East and Vietnam and L'Occitane retail outlets in the Middle East and the US. As we have mentioned previously before, Pico is also currently tendering for fit-out contract in India for a global handset manufacturer with an expected contract sum in the region of HK\$200-300m.

Finalizing contracts for Venetian Ph II. With its Venetian Macau Ph I interior fit-out works nearing completion, Pico is in the process of finalizing the contract details for Ph II fit-out works. Management estimates the Ph II contract to be in the region of HK\$150m, compared with the Ph I contract of HK\$34m.

Truly a global player. After years of restructuring and expansion, Pico is emerging as a true global player. The company now has an international network of 30 offices, with around 2,500 staff in 18 countries. In FY10/06, the company derived 53.9% of revenues from Greater China.

Halo effects beginning to show. Pico's business strategy is to secure a growing portion of a company's marketing budget over time by initially providing exhibition contracting services and then cross selling its other wide ranging businesses. We believe that this halo effect is beginning to show. After providing exhibition contracting services to Motorola over the past few years, the company has cross-sold its interior fit-out services to the handset maker and successfully completed an interior fit-out contract at Motorola headquarters in the US.

49.7% growth in FY10/07F net profit. We project Pico is on the verge of a ramp up cycle in its financials and expect FY10/07F net profit to hit HK\$202.6m, up 49.7% YoY (previously HK\$205.2m). Our revised forecast accounts for: 1) the new SG&A cost structure; 2) increased contribution from the hall management services as operations at its new Chongqing exhibition centre scales up and 3) a more conservative forecast for the exhibition contracting services. Upside to our estimates will come in faster-than-expected roll out of its signage replacement contract with Shell and further contract wins in its interior fit-out business.

Good opportunity to accumulate, target price HK\$2.35. Pico remains one of our favourite plays in the China media sector. It has scarcity value, being the only play on the Hong Kong and China bourse to have a significant exposure to the emerging MICE sector in Asia and the continual growth in China's exhibition sector. The counter is also deeply undervalued compared with other international comparables of its size such as VIAD Corp (VVI US) and GL Events (GLO FP). We maintain our 14x forward FY10/07F P/E valuation, implying a target price of HK\$2.35. Peers trades at 20x+ based on consensus estimates.

Table 1: earnings model

Year to Oct (HK\$m)	04A	05A	06A	07F	08F	09F
Turnover						
Exhibition & exhibition related business	1,078.7	1,185.6	1,472.4	1,811.4	2,351.6	2,108.8
Museum interior fit-outs	110.9	276.0	101.8	139.4	178.0	213.6
Sign advertising	79.9	93.0	107.4	124.5	117.5	126.8
Exhibition & conference organiser	28.2	119.9	38.4	49.5	59.1	72.6
Exhibition hall management & related business	32.1	40.3	83.5	121.8	184.1	215.1
Other activities	20.1	-	-	-	-	-
	1,349.9	1,714.8	1,803.5	2,246.7	2,890.3	2,736.9
% chg	39.0	27.0	5.2	24.6	28.6	(5.3)
Cost of revenues	(947.7)	(1,157.2)	(1,187.6)	(1,486.0)	(1,900.9)	(1,830.3)
Gross profit	402.2	557.6	615.9	760.7	989.4	906.6
Other income	21.5	28.6	39.7	42.1	45.3	50.5
Selling and marketing expenses	(164.0)	(213.1)	(243.1)	(269.7)	(347.6)	(305.2)
G&A expenses	(201.8)	(220.1)	(247.4)	(286.4)	(344.4)	(325.7)
Other operating expenses	(3.1)	(1.8)	(0.4)	(0.3)	(4.1)	(3.9)
Operating profit	54.6	151.6	164.7	247.2	338.5	322.3
Net int. income/(exp.)	(2.7)	(2.9)	(3.0)	(3.1)	(3.4)	(3.3)
Exceptionals	6.1	-	-	-	-	-
Associates	16.3	6.6	15.6	18.3	18.6	16.8
Jointly-controlled entit.	-	-	-	-	-	-
Pre-tax profit	74.3	154.8	177.3	262.4	353.7	335.8
Tax	(19.0)	(27.5)	(29.0)	(42.2)	(56.7)	(73.9)
Minority interests	(10.2)	(9.5)	(12.9)	(17.6)	(23.8)	(21.0)
Net profit	45.1	120.6	135.3	202.6	273.2	241.0
% chg	249.0	167.5	12.1	49.7	34.9	(11.8)

Source: company data, SBI E2-Capital

Disclosure of interests: SBI E2-Capital Securities Ltd. acted as the Bookrunner and Placing Agent for Pico's top-up placement 42m shares at HK\$2.025 on May 10, 2006.

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