

Challenges from all sides

Hong Kong Media

i-Cable (1097 HK, HK\$1.60)

Not Rated

1H FY12/06 weighed down by surging costs

- ❑ i-Cable's 1H FY12/06 net profit plunged 59.5% YoY to HK\$62.8m. Turnover edged up 4.2% YoY to HK\$1,274.1m. Operating margin was 6.8% compared to 12.8% a year ago.
- ❑ The worse than expected numbers was the result of surging programming costs from 1) the World Cup, 2) increased locally produced content and 3) foray into movie production. Programming costs jumped 24.7% YoY to HK\$524.4m. A 16.9% YoY rise to HK\$231.7m in SG&A costs also contributed to the profit decline.
- ❑ With the help of the World Cup, pay TV subscribers rose 32k to 770k in 1H FY12/06, higher than expected. ARPU was stable at HK\$209. However, as the event straddled June and July 2006, some of the associated programming costs would still need to be booked in 2H FY12/06. Bundled internet/VoIP packages continue to be well received, as indicated by the stable subscribers and ARPU.
- ❑ Falling margins also reflected the intensifying competitive landscape. NOW TV has targeted to acquire 700k subscribers by 2006 year-end while Galaxy will also emerge as a prominent challenger going forward with its multi-distribution strategy through alliances with both Hutchison and PCCW.

Table 1: Interim results summary

Six months to June	Turnover (HK\$m)	Operating profit (HK\$m)	Net profit (HK\$m)	EPS (HK\$)	DPS (HK\$)
1H FY12/06	1,274.1	86.3	62.8	0.031	0.035
1H FY12/05	1,222.8	156.0	155.2	0.077	0.035
YoY chg (%)	4.2	(44.7)	(59.5)	(59.5)	-

Source: Company data

Table 2: 1H FY12/06 operating metrics

	Pay TV		Internet & Multimedia	
	Subs (k)	ARPU (HK\$)	Subs (k)	ARPU (HK\$)
1H FY12/06	770	209	321	136
2H FY12/05	738	208	320	134
HoH chg	32	1	1	2

Source: Company data

EPL right still an overriding issue. Our key concern is the future of the company's English Premier League (EPL) right, which presently runs through to May 2007. The right is both a blessing and a bane for i-Cable. While it allows the company to charge higher price points to subscribers, the right renewal will come at a substantial premium to our estimate of HK\$650-\$700m that the company is paying under its current 3 year term, which will significantly pressure profitability. Management claimed that viewership on its sports channels is approximately 20% of subscribers during its FY12/05 results announcement. We estimate that the loss of the EPL right may lead to a loss of around HK\$340-390m in pay-TV revenues. Despite the prospects of lower margins from increased programming costs of EPL, we believe that it is in the best interest for i-Cable to successfully renew the licensing right as it will allow the service to maintain a key differentiator against its competitors.

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Diversification positive, but will take time. i-Cable is slowly transforming itself into a full fledge media company. It has begun to produce feature movies and license its contents to different platforms, such as 3G mobile operators, KCRC and overseas free-to-air / cable operators. This is a positive move, but we do not expect significant contribution from these new revenue streams in the near term as they scale up operations. To hedge against the potential loss of EPL, the company has increased its focus on local content. In our view, locally produced lifestyle shows are another key differentiator to NOW TV, which generally relies on sourcing third party contents. We believe that i-Cable's share in Hong Kong's pay TV market may have peaked out and the company is largely in a defensive mode going forward.

Profit forecasts. Our preliminary forecasts call for a net profit of HK\$178.4m (EPS: HK\$0.088) for FY12/06F and HK\$194.7m (EPS: HK\$0.096) for FY12/07F, representing a decline of 69.8% YoY and rise of 8.4% YoY respectively. Note that the company's FY12/05 net profit was boosted by a one off tax credit of HK\$302.3m. Management indicated to maintain a 50% payout ratio going forward. At present, our FY12/07F forecast assumes that the company is able to retain the EPL right.

Valuation. i-Cable currently trades at 18.1x FY12/06F and 16.6x FY12/07F P/E respectively. The valuation is on the high side given the intensified competitive landscape as well as the company's uncertain outlook and changing cost structure.

Table 3: P&L

Year to Dec (HK\$m)	2003A	2004A	2005A
Turnover			
Pay TV	1,734.2	1,888.4	1,884.4
Internet & multimedia	408.6	480.6	558.1
Unallocated	-	6.1	13.3
Elimination	-	(3.4)	(15.0)
	2,142.8	2,371.7	2,440.7
% chg	(0.8)	10.7	2.9
Programming costs	(649.5)	(790.6)	(863.7)
Network expenses	(361.0)	(380.6)	(397.6)
SG&A expenses	(343.1)	(372.7)	(419.3)
D&A expenses	(538.6)	(532.1)	(480.6)
Operating profit	250.6	295.7	279.6
Finance costs, net	(7.1)	(0.2)	3.2
Impairment loss on investment	-	-	(1.5)
Non-operating income	(9.9)	1.5	0.8
Profit before taxation	233.6	297.0	282.1
Tax	(13.1)	(12.7)	300.4
Profit after taxation	220.5	284.3	582.5
Minority interests	-	-	-
Profit attributable to shareholders	220.5	284.3	582.5
% chg	88.0	29.0	104.8
Dividend	(111.1)	(151.4)	(171.6)

Source: Company data