

Orange Sky Golden Harvest Entertainment

A growing cash generator

To summarize...

- Two-year earnings CAGR at 99.2%.
- A cash generator in net cash position.
- Vertical integrated business to capture profit throughout the value chain of film industry.
- Market leader in HK, Taiwan and Singapore with strong foothold in China.
- Target to operate 70+ cinemas in China by 2013.
- Fill rates at the group cinemas in China are expected to rise.
- More imported films exhibited in China will boost up admission.
- The group is trading at a steep discount to its FY11A BVPS.

Leader in Asian film industry. The former of Orange Sky Golden Harvest Entertainment ("OSGH") is the legendary Asian filmmaker, "Golden Harvest", which was co-founded by Mr. Raymond Chow, Mr. Leonard Ho Koon-cheung and Mr. Leung Fung in the 70s. Since inception, the group has produced and financed over 600 movies. The world renowned "Golden Harvest" brand has been synonyms with quality films, best known for Bruce Lee and Jackie Chan films. The group has been listing on the Stock Exchange of Hong Kong (HKSE: 1132) since 1994, and Mr. Wu Kebo became the single largest shareholder of OSGH since 2007. Today, the group has developed a highly vertical integrated business model, covering film production and financing, movie distribution, and cinema operation. Further, the group is a market leader in Hong Kong, Singapore and Taiwan, and has established strong position in the rapid expanding Mainland China market.

High growth industry. Box office receipts in Mainland China increased by 29% YoY in 2011. Between 2007 and 2011, box office receipts in China increased at a four-year CAGR of about 41%, from RMB3.3b to RMB13.1b. In our view, box office sales in Mainland China have high growth potential, given its low film penetration rate. In 2010, there were only 0.4 screens for each 100,000 population in China, compared to 12.7 in the U.S., 2.0 in Korea and 2.7 in Japan. Per capita movie viewing frequency in 2010 in China was 0.2 times only; significantly lower than 4.3 times in the U.S., 2.9 times in Korea and 1.4 times in Japan. Drivers in the box office sales in China include more movies to exhibited, in particular more imported movies to be shown in China theatres (annual imported Hollywood film quota increased from 20 to 34), more cinemas and screens to be established in China, supportive government to domestic film production industry, advanced technology in movie projection such as 3D and digital projection and upgraded theatre facilities which will enhance movie viewing experience, etc. According to the State 12th Five-Year Development on Film Industry Development, government plans to boost the box office sales in China to RMB35b, representing a growth rate of more than two-fold over the sales level recorded in 2011.

Network expansion. To capture the opportunity in the fast expanding film market, the group has been aggressively expanding its cinema network in China. The group has added 7 new cinemas so far in this year, bringing its total number of cinemas in China to 34 and its number of screen increased to 248 as of the July 16th, 2012. It is expected that the group would open another 16 cinemas in the second of this year, bringing its total number of cinemas to 50 by the end of 2012. According to the management plan, the group will open 20+ more cinemas in 2013. Management's development strategy in Mainland China is to put up more multiplexes in 1st tier cities such as Beijing, Shanghai, Guangzhou and Shenzhen for brand building and increase market share in the country by expanding into 2nd and 3rd tier cities. As of the end of FY11A, the group was holding HK\$760m cash with net cash position of about HK\$202m, sufficient for its development in two years, by our estimation.

Ticker	1132 HK
Rating	Not Rated
Price (HK\$)	0.40
Target Price (HK\$)	-
12m Price Range (HK\$)	0.24-0.42
Market cap. (US\$m)	135.7
Daily t/o (US\$m)	0.1
Free float (%)	26.1

Financial summary

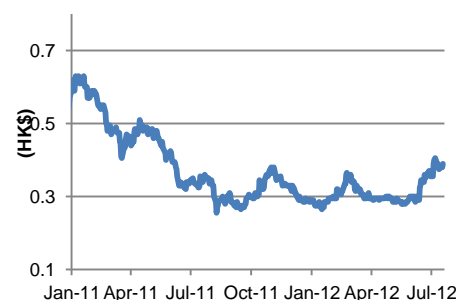
Year to Dec	Jul 08A to Dec 09A	10A	11A
Turnover (HK\$m)	1,230.9	1,077.5	1,369.6
Net Profit (HK\$m)	94.9	72.4	94.9
Diluted EPS (HK\$ cent)	5.15	2.78	3.63
Diluted P/E (x)	7.6	14.0	10.7
Diluted P/B (x)	1.1	0.8	0.7
EV/EBITDA (x)	5.1	4.3	3.7
Yield (%)	2	-	-
ROE (%)	10	5	6
ROCE (%)	5	7	7
N. Gear. (%)	N.Cash	N.Cash	N.Cash

Source: SBI E2

	12F	13F	14F
Consensus EPS (HK\$)	-	-	-
Previous earnings (HK\$m)	-	-	-
Previous EPS (HK\$)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)			
Actual price changes (%)			



Source: Bloomberg

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Boost up fill rate and profitability. Fill rate at the group's cinemas in China was 15.4% in 2011, and we expect the fill rate at the group's cinemas in China to rise going forward. As it will take about six months to warm up a new cinema typically, we expect more seats at the group's 18 new cinemas which were opened in the second-half of 2011 to be filled. Further, the provision of alternative contents other than conventional movie such as broadcasting of live concert and sport events would attract more audiences. Tickets for such contents are usually higher than that for conventional movie. The group has also launched club-like premium cinemas and gold class cinemas cater for high-end market. Such cinemas are expected to generate more revenue per admission and enjoy higher profit margin, as they provide VIP services to audience for premium prices.

Strong cash flow. Circuit line operation is a cash generator, as selling of movie tickets and candies are cash based transaction. In fact, the group's respective operating cash flow for FY10A and FY11A were HK\$189.0m and HK\$289.5m, respectively. As of the end of FY11A, the group was holding HK\$706m cash with net cash position of about HK\$202m. Sufficient cash will fuel the group expansion at a fast pace.

Proven track record. For FY11A, the group's core earnings increased remarkably by 87%, from about HK\$47.0m to HK\$88.0m, thanks to 26.0% YoY growth in revenue generated from its cinema operations. Between FY09A and FY11A, the group's core earnings grew at a two-year CAGR of 99.2%.

Below book valuation. The group's FY11A BVPS (Share capital HK\$1,513.8m, # of shares 2,679.8m) is HK\$0.56 per share. Current share price of the group is substantially below its reported book value per share.

Cinema operation. For FY11A, revenue generated from the group's cinema operations was HK\$1,248.5m, representing an annualized growth rate of 26%, and accounted for about 88.4% of the group's total turnover for the period. Thus, cinema operation is the major sources of revenue and cash inflow for the group. As of the end of July 16th, 2012, the group operates 61 multiplex with 464 screens in Mainland China, Hong Kong, Taiwan and Singapore.

Table 1. Overview of OSGH circuit lines

As of the end of December 2011	HK	China	Singapore	Taiwan	Total
Gross box office (HK\$m)	173.2	226.5	497.3	774.8	1,671.8
# of cinemas	6	27	10	10	53
# of screens	26	197	81	101	405
# of seats	5,400	29,116	15,165	22,488	72,169
Gross box office per screen (HK\$m)	6.7	1.1	6.1	7.7	4.1
Gross box office per seats (HK\$)	32,100.0	7,800.0	32,800.0	34,500.0	23,200.0
Fill rate (%)	22.6	15.4	33.5	25.9	24.3
Paid admission (m)	2.9	5.3	9.3	12.1	29.5
Average ticket price (HK\$)	60.7	42.8	53.6	64.1	56.7

Source: SBI E2

Table 2. FY11A Cinemas revenue by market

HK\$m (revenue from cinema)	FY11A	% of revenue	FY10A	% of revenue
Hong Kong	201.3	16.1	216.4	21.8
Mainland China	328.3	26.3	187.3	18.9
Taiwan	369.1	29.6	288.9	29.2
Singapore	349.8	28.0	298.2	30.1
Total	1248.5	100.0	990.9	100.0

Source: SBI E2

Revenue model of cinemas. Cinema operation is a cash business in nature, as selling of movie tickets and candies are cash based transaction. Major cost items of cinemas include film rental expense, premise rental, staff cost as well as depreciation of screens, fixtures, furniture and equipments. Among all the cost items, film rental expense is the largest cost and is variable in nature. In general, cinema operator pays 45.0% of box office receipts to participants upstream, such as movie producers and distributor, after operator received cash from box office. Premise rental expense account for about 15% - 20% of the box office receipts by our estimation. Landlord either takes minimum lease payments or share of turnover, whichever is higher. Gross profit margin of box office receipts is estimated at 55%. Snack sales of candy bar at theatre accounts for about 20% revenue of cinema, with gross profit margin estimated at 75.0%, by estimation. Advertising is another source of income for cinemas. In general, the blended margin of a cinema is about 58%. Should the movie exhibited in the cinema is distributed by the cinema operator itself, blended margin of cinema operator could be enhanced by another 4.1%-6.8%, by our estimation.

Track record of cinemas. Between 2007 and 2011, total screens number of the group cinema networks increased at a four-year CAGR of 22.3%, from 177 screens to 405 screens. Meanwhile, total admissions to the group's cinemas increased at a four-year CAGR of 11.4%, from 18.9m to 29.5m. The increase in admission during the period had driven the group's box office receipts to increase at a four-year CAGR of 16.3%, from HK\$915m to HK\$1,672m (before government charges and minority interests).

Cinemas operation in China. Between 2007 and 2011, box office receipts at the group's cinemas in China increased at a four-year CAGR of 49.4%. In FY11A, gross box office receipts before government taxes and charges of the group's cinemas operation in China increased 44.3% YoY to RMB189m. In FY11A, the group opened 18 cinemas in China and most of them started operation in second-half, bring its total number of cinemas to 27 at the end of last year.

Competitive landscape in China. According to National Bureau of Statistics of China, in 2010, there were 37 movie cinema circuits with 1,820 cinemas and 6,256 screens in China. On average, each movie theatre had 3.4 screens. In terms of box office receipts, the top ten cinema circuits operators account for 70.6% of the China market. In terms of gross box office receipts, the group accounted for about 1.7% share in Mainland China market.

Table 3. Top ten circuit lines operators in Mainland China in 2011

Ranking	Company	# of cinemas	# of screens	Box office receipts (RMBm)
1	Wanda Cinema Line Co., Ltd	86	730 (IMAX:47)	1,785
2	China Films Stellar Film Chain Co., Ltd	165	887	1,377
3	Shanghai Lian He Theater Co., Ltd.	210	959 (IMAX:8)	1,303
4	Shenzhen China Film South Cinema Circuit Co., Ltd	94	312	1,086
5	G.Z. JinYizhujiang Movie Circuit Co., Ltd.	100	N.A.	851
6	Beijing New Film Association Co., Ltd	85	533	763
7	Guangdong Dadi Digital Cinema Co., Ltd	147	563	677
8	Zhejiang Time Cinema Theater Company Co., Ltd	86	407	557
9	The Pacific Cineplex Co., Ltd	57	320	468
10	Liaoning North Film Theater Chain Co., Ltd	56	210	382

Source: SBI E2

Cinemas operation in Singapore. The group operates Cinemas in Singapore through its 50%-owned JCE Golden Village. As of the end of March 2012, Golden Village operates 10 cinemas with 81 screens in Singapore. Between 2007 and 2011, box office receipts of Golden Village's cinemas increased a four-year CAGR of 10.1%, from HK\$339.0m to HK\$497.3m. Box office receipts of Golden Village increased 16.3% YoY in FY11A. The group shared a net profit of HK\$48m from Golden Village for FY11A, up 37.0% from the corresponding period last year. With market share of 43.0%, Golden Village is the leading movie Cinemas operator in Singapore.

Cinemas operation in Taiwan. The group operates Cinemas in Taiwan through its 35.71%-owned Vie Show Cinema. Following the open of cinema in Taichung with 7 screens at Top City and its first premier cinema in New Taipei City with 9 screens at Banciao Mega City, Vie Show Cinema operates 10 Cinemas with 101 screens in Taiwan as of the end of March 2012. Between 2007 and 2011, box office receipts of Vie Show Cinema increased at a four-year CAGR of 18.7%, from HK\$390.8m to HK\$774.8m. In FY11A, box office receipts and admission to Vie Show's cinema increased about 30.0% YoY, outperformed the 22.6% growth in Taiwan market box office receipts. The group's share of net profit from Vie Show increased 48.0% YoY to HK\$37.0m in FY11A. With market share of 38.0%, Vie Show was the market leader among all Cinema operators in Taiwan in last year.

Cinemas operation in Hong Kong. The group has 6 cinemas with 26 screens as of the end of March 2012. Between 2007 and 2011, box office receipts of the group's cinemas operation in Hong Kong increased at a four-year CAGR of 5.5%, from HK\$140m to HK\$173.2m. In last year, box office receipts and admissions of the group's 6 cinemas in Hong Kong (excluding the GH Hollywood, which was closed in March 2011 due to the expiry of lease) increased 13% and 18%, respectively. It is expected that the group can maintain a market share of 12% in Hong Kong market going forward.

Upgrade equipment. To enhance the viewing experience of its customers, most of the group's movie theatres installed advanced equipments. All of the group's screens in Hong Kong, Mainland China and Taiwan are digitalized, while in Singapore, 69% of Golden Village's screens are digitized. Further, some of the group's movie theatres are equipped with projectors and screens that accommodate IMAX. IMAX is a motion picture film format and a set of proprietary cinema projection standards created by the Canadian company IMAX Corporation. It has the capacity to record and display images of far greater size and resolution than conventional film exhibition systems. The group's JCE, Vie Show is the exclusive digital IMAX operator in Taiwan. Vie Show will add one more IMAX screen to increase the total number of IMAX screens to 6 by end of 2012. Equipments installed at the group's selected prime cinemas in China are accommodating IMAX as well. The group has also formed ally with SONY and installed the SONY 4K digital projection systems at its theatres in China.

In Hong Kong, the Group has installed 38 Motion Chairs D-BOX in 2 screens at GH Mongkok and plans to install another 74 Motion Chairs D-BOX at GH Citywalk and Golden Gateway in this year. The Motion Chairs D-BOX presents authentic motion effects synchronized with onscreen actions to perfectly deliver extraordinary theatrical experience to audience.

Alternative contents. To attract more admission to its cinemas and increase ticket price, the group has been providing contents other than conventional movie. The group's cinemas in Taiwan and Singapore provided contents such as live broadcast of AKB48 Concert and L'Arc-en-Ciel Concert, which were well-received by customers despite the ticket price were more than double of normal movie ticket price. In December 2011, the Group has entered into a strategic alliance agreement with T-JOY Group ("T-JOY"), under which the group will broadcast the digital content provided by T-JOY and the group will provide its production for broadcasting at T-JOYs 19 multiplexes in Japan.

Transforming theatre into club. To expand the revenue sources of cinemas, increase revenue per admission and differentiate its cinemas from competitors', the group has been expanding the function of some of its movie theatres from solely film exhibition hall only to luxurious clubs and social gathering places. The group's JCE in Singapore Golden Village operates three Gold Class cinemas which offered luxury movie viewing with exclusive lounge, plush electronic recliner seats comparable to First Class airline seats equipped with call buttons for faster and more discreet service, and super wide screens and digital sound systems. The average occupancy rate of Gold Class cinemas is over 50% and it generates high food and beverage sales income by serving various foods and wines, in addition to traditional candy bar items. In December 2011, the group was granted cinema management and operational rights of a cinema located at PCCW Centre in Beijing, namely Orange Cinemas (Beijing). The Orange Cinema adopt membership system and is the group's first flagship movie club in China. Orange cinema integrates film exhibition, music, bar and customized services into one venue. The hall of the theatre can be used as various function such as party, conference, film releasing, exhibition, social gathering...etc. More Orange cinema will be opened in 1st tier cities in China such as Shanghai and Guangzhou.

Library of rich contents. The group is a leading film distributor in Asia with library of rich contents. In FY11A and FY10A, the group distributed over 130 films and 95 films, respectively, in Mainland China, Hong Kong, Taiwan and Singapore. The group's film distribution strategy is focusing on releasing high quality selected non-Chinese language films. Stipulated by World Trade Organization, starting from 2011, China will increase the imported film quota from 20 to 34, and as the leading distributor in the region, the group's film distribution division is set to benefit from the change in policy. The group is under negotiation to distribute several foreign films on big screens in Mainland China in 2012.

The group has rich film library with more than 140 Chinese-language film and TV titles with perpetual distribution rights. Such library is expected to generate stable recurrent income of about HK\$10.0m per annum, by our estimation. In FY11A, the group's film distribution division reported revenue of HK\$162.0m, representing an annualized growth rate of 26.6%. Film distributor usually gets 4.1%-6.8% of the box office receipts, and the cinema circuit operators takes 55.0% of the box office by industrial practice. Thus, gross profit margin of the group's cinemas would increase at least by 4.1% should they exhibit the film distributed by its owned film distribution division.

Film and TV production. Since the inception in the 70's, "Golden Harvest" has been the world renowned brand in film production. In recent years, the group has invested/financed the production of blockbusters including "Warlords", "Red Cliff", "Storm Warriors", "Bang Jia Bing Ji Ling", "You Deserve to Be Single". In 2011, the group made small investment in two film productions, "Beginning of the Great Revival (The founding of a Party)", and "Ye Dian Gui Tan". It also produced two Chinese TV drama series "Golden Code" and "Ocean Espionage". The group's production division reported revenue of HK\$70.0m in FY11A.

Track recorded in recent years. The group's respective two-year turnover and net profit CAGR between FY09A and FY11A were 30.0% and 108.0%. Stripping off the exceptional gain of HK\$29.4m, the group two-year net earnings CAGR between FY09A and FY11A were 99.2%.

The group recognized exceptional gains in both FY10A and FY11A. In FY10A, the group recorded a gain of HK\$26.7m on settlement of claim in respect of the settlement sum received by the group for damages against and provision of consultancy service to a landlord in Mainland China.

In FY11A, the group reported a gain of HK\$29.4m, as the group entered into settlement agreement with Legend Pictures, LLC and received a sum of US\$30.0m for transferring its equity interest in Legendary back to Legendary and termination of non-binding memorandum of understanding dated 23 September 2010. Nevertheless, due to the decline in value of equity interests in certain equity investments, the group reported an impairment provision and a loss on disposal of investment in aggregate of HK\$21.4m.

On year-on-year basis, the group's turnover increased 27.1%, from HK\$1,077.5m to HK\$1,369.6m for FY11A. Meanwhile, the group's core earnings increased remarkably by 87%, from about HK\$47.0m to HK\$88.0m, thanks to 26.0% YoY growth in revenue generated from its cinema operation. Cinema operation was major revenue generator to the group in last fiscal year, contributing about 88.4% of the group's revenue. Geographically, Mainland China was the major market of the group, contributing 29.4% of the group's revenue, followed by 26.4% from Taiwan 25.7% from Singapore, and 18.5% from Hong Kong. With revenue from China surged 73.0% YoY in last fiscal year, operations in Mainland China market was the major growth engine of cinema operation. Going forward, we expect Mainland China remains the major growth driver and revenue generator for the group. The group's circuit lines in Singapore and Taiwan are operated by its 50%-owned JCE Golden Village and 35.71%-owned JCE Vie Show Cinema. The group consolidates results from the two JCE proportionally.

GP and cost structure. Blended margin of the group for FY11A and FY10A were 57.9% and 58.3%, respectively. Major items of the group's COGS are rental for movie and cost for inventory of snack sold in candy bar at the theatres. Rental for movie are variable cost item and it account for approximately 45.0% of the box office receipts. By estimation, GP of candy bar sales is about 75.0%, and candy bar sales account for about 20% of the box office receipts. Rental of the premises, depreciation and amortization as well as most of the staff costs are booked in selling and distribution costs. For premise rental expense, landlord either takes minimum lease payments or share of turnover, whichever is higher.

Financial fitness. Cinemas operation is a cash business in nature, as selling of movie tickets and candies are cash transaction, thus, the group's operating cash flow is strong. The group's respective operating cash flow for FY10A and FY11A were HK\$189.0m and HK\$289.5m, respectively. As of the end of FY11A, the group was in net cash position of about HK\$250m. Capital expenditure for FY12F is estimated to be HK\$300.0m-HK\$400.0m. Thus, the group has sufficient financial resources for its development in this fiscal year, in our view. The group's reported FY11A BVPS (Share capital HK\$1,513.8m, # of shares 2,679.8m) was HK\$0.56 per share.

Table 4. Valuation of Peers.

Company Name	Ticker	Biz zone	Currency	Mkt Cap (US\$m)	Last Close Price (Local)	Hist P/E	P/E Current year	1 – Yr Fwd	P/B (x)	EPS	Growth (%)
Orange Sky Golden	1132 HK	China, HK, Singapore	HKD	134.1	0.39	10.9	n.a.	n.a.	0.7	0.036	28.2
SMI Corp	198 HK	China	HKD	193.3	0.19	14.1	n.a.	n.a.	0.6	0.013	(53.1)
Mei Ah Entertain	391 HK	HK	HKD	71.5	0.10	n.a.	n.a.	n.a.	0.9	0.010	(6.6)
Media Asia	8075 HK	HK	HKD	114.6	0.07	n.a.	n.a.	n.a.	n.a.	(0.019)	n.a.
Bingo Group	8220 HK	HK	HKD	61.8	0.08	n.a.	n.a.	n.a.	3.6	(0.053)	n.a.
Huayi Brothers	300027 CH	China	CNY	1,566.3	16.52	51.5	30.5	21.5	5.8	0.410	39.1
BONA File Gr-adr	BONA US	China	USD	358.7	5.90	24.6	17.3	11.2	1.9	3.814	
Carmike Cinemas	CKEC US	US	USD	238.6	13.42	10.4	13.6	10.8	4.2	(4.671)	39.8
Cinemark	CNK US	US	USD	2,729.0	23.75	15.8	15.1	13.3	2.6	8.952	(11.5)
Regal Entertai-A	RGC US	US	USD	2,151.6	13.85	16.7	15.2	14.8	n.a.	2.024	(49.0)

Source: Bloomberg

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HOLD : absolute return of -10% to +10% over the next six months

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