

National Arts Holdings Limited

Stars Aligning

to summarize...

- Xiqiao Dreamworks development project is a Chinese culture focused integrated film shooting base and entertainment theme park facility.
- Substantial shareholder Checkley Sin injected 51% of the project into the listco in Feb 2011. Mr Sin is the producer of the **Ip Man (叶问)** series of films and has substantial experience in the media industry
- The integrated facility comprises film shooting base, 2 x hotels, theme park, 3,500 capacity performance stadium and temples
- Xiqiao Mountain (西樵山), is a National 4A Scenic Spot. It has a substantial tourism base of 2.0m visitors per year. Its location in south of China has both climatic and transport logistics advantages, ideal for locating a film shooting base and theme park
- Develop of the project is in progress. The Phase 1 temples are scheduled to open in Jul 2011. Company has pre-sold 375,000 non-refundable tickets to local tourist agencies. This will ensure commencement of cash inflow into the company

Transition into integrated film production base and entertainment facility.

National Arts (NA) transitioned into film production focused media company in Apr 2010 when the former IT engineering services company changed its name to "National Arts Holdings Limited" (previously "Vertex Group"). The company currently focuses on provision of film production services, film production driven tourism services and artist management services.

Xiqiao Dreamworks Project injected by substantial shareholder Checkley Sin.

In Nov 2010, substantial shareholder Checkley Sin announced the injection of 51% of the Head Return Limited and Expand Pacific Limited for a consideration of HK\$300.0m, which was satisfied in the form of HK\$30.0m cash, HK\$148.5m in the form of new shares (135.0m new shares @ HK\$1.10/sh) and HK\$121.5m (strike HK\$1.10/sh, 1% coupon, exercisable in 2 tranches). The target companies hold the development rights to the "Xiqiao Dreamworks Project". The transaction was completed in Feb 2011.

Background of substantial shareholder. Checkley Sin has substantial experience in the media industry. He is the producer of the **Ip Man (叶问)** series of films. He develops and manages new up and coming artists, including Dennis To (杜宇航) and Rose Chan (陈嘉桓). He has also organised one of the largest Wing Chun (咏春) events in the world, featuring over 600 masters from 12 countries and attended by 3,000+ spectators (featured in Guinness Book of World Records)

Description of Xiqiao Dreamworks Project. The Xiqiao Dreamworks Project is an integrated entertainment facility featuring film production base, resort hotel(s) and theme park. The 677,000m² development is located at the foots of Xiqiao Mountain (西樵山), Foshan City. It aims to the world's first integrated film production entertainment facility that is focused on the Chinese culture and specifically adapted to the needs of the Chinese film industry. In general, the integrated film production entertainment facility comprises:

- Shooting base for film production
- Theme park featuring entertainment and education elements
- 2 hotels (1 boutique 5-star hotel 250 rooms, 1 5-star resort hotel 250 rooms)
- Performance stadium with seating capacity of 3,500
- Wong Tai Sin Temple (Taoist) and Ti Tsang Wang Temple (Buddhist)

Ticker	8228 HK
Rating	Not Rated
Price (HK\$)	1.18
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	0.34-1.67
Market cap. (US\$m)	121.2
Daily t/o (US\$m)	0.6
Free float (%)	55.35

Financial summary

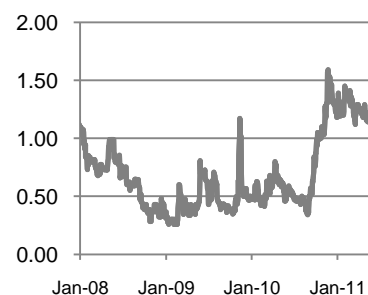
Year to Dec	08A	09A	10A
Turnover (HK\$)	4.7	0.3	11.0
Net Profit (HK\$)	(33.5)	20.3	(36.4)
EPS (HK\$)	(0.051)	0.140	(0.086)
P/E (x)	-	7.1	(11.5)
P/B (x)	-	13.76	1.91
EV/EBITDA (x)	-	-	-
Yield (%)	-	-	-
ROE (%)	55.6	(81.6)	(31.8)
ROCE (%)	12.4	14.5	(31.0)
N. Gear. (%)	94.5	Cash	Cash

Source: SBI/Bloomberg

	09F	10F	11F
Consensus EPS (RMB)	-	-	-
Previous earnings (RMBm)	-	-	-
Previous EPS (RMB)	-	-	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	0.7	-12.3	88.3
Actual price changes (%)	-4.1	-13.9	118.5



Source: Bloomberg

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Chart 1. Project Layout



Source: Company data

Xiqiao location and logistics advantage, ideal film production base. Xiqiao Mountain is an ideal location to develop a film production / entertainment facility. Scenic spots Yunhai Buddhist, Baofeng Temple, Heaven Lake and Spirifer Cave and Square-Stem Bamboo Garden amongst others. It is conveniently located in Southern China (by road transportation: 30 mins from Guangzhou City, 1.5 hours from Shenzhen and 2.5 hours from Hong Kong). Being located in the South, the film production base enjoys temperate climate which is suitable for year round shooting and production, an advantage to other film production bases such as Hengdian, which is subject to snow at least 3 months in the year and wider temperature ranges.

Chart 2. Project Location



Source: National Bureau of Statistics

Strong fundamental tourism base. Xiqiao Mountain is a National Geological Park and designated as a National 4A Scenic Spot with an average 2.0m persons per year tourism base. Scenic spots in the area include Yunhai Buddhist, Baofeng Temple, Heaven Lake and Spirifer Cave and Square-Stem Bamboo Garden amongst others.

Leveraging the “star attraction” to drive tourism attendance. The unique differentiation aspect of the Xiqiao Dreamworks project is that it utilizes the “star attraction” of film stars (shooting at its location) to attract and drive tourism attendance. Xiqiao Dreamworks will offer free rental for film crews to use its shooting base and production services. Film crews would only need to pay for ancillary services such as hotel accommodation, food and beverage etc. Combining Mr Sin’s influence in the media industry, this has a number of unique advantages, including:

- Ensure a steady stream of both film and TV production projects
- High volume of productions ensures relatively high level of occupancy in the hotels
- Constant rotation of film and TV stars on set drives tourism attendance and consistent renewal in fan/tourist interests

Management is anticipating around a minimum of 4 crews per month, with each crew averaging 100-150 persons. This would lead to around a demand of around 60-80 rooms per crew per month, which is around 90% occupancy rate of the boutique 5-star hotel.

Multiple revenue generation touch points. The integrated entertainment facility will be feature rich, with multiple revenue generating touch points. As an example, the Xiqiao Wong Tai Sin Temple will feature a 52kg “pure gold” Wong Tai Sin statue which would be available for photography session for a fee. It would also have revenue generation opportunities in other features such as “gold pick up challenge” in which the challenge is to pick up a 10kg gold brick for a predetermined amount of time. Revenue streams for the respective portions of the entertainment facility include:

- Temples – entrance fees, joss sticks, photo fees, gold pick up challenge
- Boutique hotel – occupancy fees, food and beverage
- Film shooting base – prop rentals by film crews
- Performance stadium – performance ticket revenues
- Theme park – entrance fees, value added rides and education features, food and beverage
- Resort hotel – occupancy fees, food and beverage

Low land rental costs, strong government support keen on leveraging strong local tourism. The local government, keen to leverage its strong tourism base has thrown its support behind the project and given the company favourable lease conditions. The local government has given the project a 40 year lease on the land (20 year + 20 year automatically renewal). Land cost is RMB0.4/m² for the film production base, performance stadium, theme park and temple areas (607,000m²) and RMB4.0/m² for the hotels (70,000m²).

Phase 1 temples opening in late Jul 2011. Overall development schedule is contained in table below. Project development is underway already and on track for Phase 1 commissioning of the Wong Tai Sin Temple. The project is expected to immediately generate cash flow as they have pre-sold 375,000 tickets to tourist agencies (non-refundable). This is an estimated revenue of around HK\$15.0m.

Table 1. Project Commissioning Schedule

Phase	Description	Commissioning Date
Phase 1A	Wong Tai Sin Temple	Jul 2011
Phase 1B	Ti Tsang Wang Temple	Aug 2011
Phase 2	Boutique hotel	Mar 2012
Phase 3A	Film shooting base (section 1)	Mar 2012
Phase 3B	Film shooting base (section 2)	Dec 2012
Phase 4	Performance stadium	Dec 2012
Phase 5	Theme park	Dec 2013
Phase 6	Resort hotel	Dec 2013

Source: Company data

Historical financials limited significance, potentially explosive financials on the way. As the company is in the process of transitioning into a integrated film production service provider and entertainment company, the historical financials are of limited significance. For FY12/10A, the company recorded a net loss of HK\$36.4m off a revenue base of HK\$10.5m. The company also disposed of its non-core IT business in FY12/10. Going forward however, we expect earnings to gain traction with potentially explosive growth as key sections of the Xiqiao Dreamworks project are commissioned. We have produced some preliminary, what we deem to be conservative, estimates, which are show below. Note that these are for the project only and are not consolidated accounts.

Table 2. Preliminary Estimates

Year end Dec (RMB)	FY12/11F	FY12/12F	FY12/13F	FY12/14F	FY12/15F
Revenue					
Xiqiao Wong Tai Sin Temple	25,393,750	78,922,500	108,885,000	140,675,000	174,292,500
Boutique Hotel		25,039,000	31,171,000	32,090,800	33,010,600
National Arts Dream Works			310,200,000	402,090,000	554,622,700
Performance Stadium			48,125,000	64,968,750	74,714,063
Theme Park				427,000,000	577,700,000
Resort Hotel				70,116,500	104,113,695
	25,393,750	103,961,500	498,381,000	1,136,941,050	1,518,453,558
Sales tax	(1,369,849)	(5,666,398)	(27,800,433)	(63,674,796)	(85,072,597)
	24,023,901	98,295,102	470,580,567	1,073,266,254	1,433,380,961
General expenses	(600,000)	(8,594,000)	(10,926,000)	(32,200,700)	(42,921,195)
Rental expenses	-	(1,017,500)	(2,633,500)	(7,493,500)	(7,493,500)
Depreciation	(750,000)	(5,250,000)	(15,000,000)	(34,250,000)	(34,250,000)
Direct expenses	(106,250)	(1,404,600)	(174,809,600)	(338,548,775)	(432,954,560)
Marketing expenses	(1,500,000)	(2,750,000)	(12,575,000)	(25,450,000)	(33,660,000)
Profit before tax	21,067,651	79,279,002	254,636,467	625,573,279	869,351,705
Tax	(5,266,913)	(19,819,751)	(63,659,117)	(156,393,320)	(217,337,926)
Profit after tax	15,800,738	59,459,252	190,977,350	469,179,959	652,013,779

Source: SBI E2-Capital

Macro factors. Both government and industry macros are favourable towards NA and its Xiaqiao Dreamworks development project. Growth in both the tourism and film production industry are expected to lead to an increased demand of tourism attractions such as entertainment and theme parks, and film shooting bases respectively

Government

- Guiding Opinions of the General Office of the State Council on Boosting and Developing the Film Industry (No. 9 [2010]) issued by the State Council Office in Jan 2010 focuses on support of the film production industry in the next 5 years and beyond through: 1) subsidies, 2) monetary supports to private film production companies, 3) promotion of local production services
- Guiding Opinions of the General Office of the State Council on Accelerating the Development of the Tourism Industry (No. 41 [2009]) issued by the State Council Office in Dec 2009 emphasises the development of tourism as one the mainstay of the country's economy through promotion of domestic consumption and encourages foreign investments on the tourism industry

Film/TV Industry

- Film industry in China has increased production of films from 100 movies in 2003 to 526 movies in 2010, CAGR of 29%
- Film box office receipts in China totalled RMB9.98b in 2010, up 61% YoY. It is estimated that this would grow to around RMB20.0b by 2012

Tourism Industry

- Domestic travellers increased 11% YoY to 2.1b travellers in 2010
- Domestic tourism expenditure was up 24% in 2010 to RMB1,260b

Recent fund raising history. At the end of FY12/10A, the company was in a net cash position of HK\$157.1m. The last round of fund raising was completed in early Dec 2010 when the company issued 95.0m new shares at HK\$1.1/sh, raising gross proceeds of HK\$104.5m. In Feb 2011, the company has also had a Special Mandate approved at a SGM to allow the company to place out an additional 400.0m shares.

Shareholding structure. Checkley Sin is the company's largest shareholder, with a current holding of 24.27%, though he also holds HK\$121.5m convertible bonds convertible into 110.5m shares (13.7% of existing share capital, 12.1% of enlarged share capital). Tse Young Lai is the second largest shareholder with 17.83%.

Risks. The key risks for this project is execution risk. However, it is noted that development of the Xiqiao Dreamworks project is presently ongoing with Phase 1 presently on schedule to be opened in Jul 2011. This execution risk should diminish as other phases are gradually rolled out.

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BUY : absolute upside of >10% over the next six months

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

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