

## Some uncertainties, but oversold

### Key points:

- China digital cinema installed base estimates lowered to 900, 1,600 and 2,000 in FY12/08F-10F.
- VPF agreements with major Hollywood studios may be concluded in late 2Q / early 3Q.
- Net profit estimates cut due to: 1) slower rollout in China and 2) VPF agreement delays
- We believe the counter is oversold and set our target price at HK\$0.90.

**FY12/07A results.** GDC's revenue rose 348.2% YoY to HK\$246.1m in FY12/07A. The company returned to the black with net profit of HK\$18.3m, from a loss of HK\$30.2m from a year ago, below our expectations, mainly due to the booking of HK\$57.4m in stock option expenses. Excluding this, net profit was HK\$75.7m, above our expectations. The main reason for the difference was the recognition of revenues from the installation of 450 sets of digital cinema equipment under its JV with China Film Group. Management had previously guided that under a financing agreement the installation of the digital cinema equipment in China would be treated as a capex spend. Other segments such as CG creation and production, and CG training courses came in within expectations.

**Rationalizing China digital cinema network rollout.** By end-FY12/07A, GDC installed 450 sets of digital cinema equipment in China, slightly ahead of our estimate of 400. We now expect it to have an installed base of around 900 by end-FY12/08A, down from the company's original estimate of 2,000. We believe GDC needs to slow down its rollout in China to rationalize capital resources for its pending virtual print fee (VPF) agreements and network rollout in ex-China markets. Demonstrating its commitment to digital cinema, GDC has released some of this year's biggest hits, including Tou Ming Zhuang (投名状), CJ7 (长江七号) and Assembly (集结号), in digital format. According to various reports, they so far have grossed over RMB200m each in box office receipts in China.

**VPF agreements with Hollywood studios still need time.** The company is finalizing VPF agreements with Hollywood studios for the rollout of its digital cinema equipment in overseas markets. Currently, we expect some announcements related to this deal in late 2Q or early 3Q of 2008. Once the deal is struck, we expect the scope and pace to be significant, which may place some funding pressure. At end-FY12/07A, GDC was in a net cash position of HK\$169.3m.

**Reasons for the share price collapse.** GDC's share price has collapsed since mid-Dec 2007. In our view, the reasons were: 1) delays in the announcement of the VPF agreements; 2) slower-than-expected rollout of the digital cinema equipment network in China and hence lower contributions from box office

## BUY (unchanged)

### China Media

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Kennedy Tsang / Helena Qiu

(852) 2533 3721 / 3709

kennedytsang / helenaqiu@sbi2capital.com

### Stock data

Price	HK\$0.47
Target price	HK\$0.9 (+92%)
12 mth range	HK\$0.40-3.70
Market cap.	US\$78.5m
Daily t/o, 3 mth	US\$0.2m
Free float %	38.3%
Ticker	8271.HK/8271 HK

### Financial summary

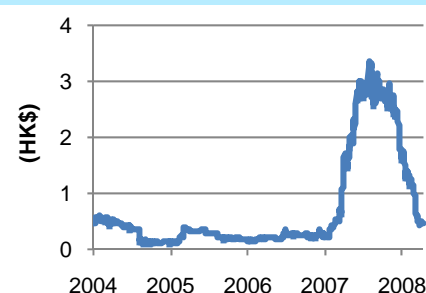
Year to Dec	06A	07A	08F	09F	10F
Turnover (HK\$m)	54.9	246.1	537.2	1260.6	1479.2
Net Profit (HK\$m)	(30.2)	18.3	73.9	158.3	247.3
EPS (HK\$m)	(0.038)	0.016	0.057	0.122	0.191
EPS Δ%	n/a	n/a	253.3	114.1	56.3
P/E (x)	(12.4)	29.1	8.2	3.8	2.5
P/B (x)	n/a	n/a	1.4	1.0	6.8
EV/EBITDA (x)	n/a	18.4	4.1	1.8	1.7
Yield (%)	-	-	-	-	-
ROE (%)	n/a	16.7	18.3	31.0	34.6
ROCE (%)	n/a	n/a	12.7	20.2	25.9
N. Gear. (%)	n/a	cash	cash	cash	cash

### Price Performance

	1 mth	3 mth	12 mth
Relative to HSI (%)	+3.0	+2.5	-10.0
Actual price changes (%)	+3.5	+2.0	-8.5

	08F	09F	10F
Consensus EPS (HK\$)	n/a	n/a	
Previous forecasts (HK\$m)	139.3	258.7	
Previous EPS (HK\$)	0.107	0.198	

### Price Chart



receipts; 3) missed opportunities in advertising revenues from its China digital cinema network during the Olympic year and 4) concerns over possible financing cost increases.

**Cutting our estimates.** We have cut our net profit forecast to HK\$73.9m (previously HK\$139.3m) for FY12/08F and HK\$158.3m (previously HK\$258.7m) for FY12/09F, and introduced our FY12/10F estimates. The revised estimates assume that GDC will have a digital cinema base of 900 in FY12/08F, 1,600 in FY12/09F and 2,000 in FY12/10F.

**Target price at HK\$0.90.** Given the near-term uncertainties, we prefer to value the company using its FY12/08F earnings. China's media sector as a whole has re-rated downward since our last report on reduced risk appetite and the new target price of HK\$0.90 is pegged at a peer average 15.8x FY12/08F P/E. After the share price collapse, we believe the counter is oversold considering its unique JV with China Film Group (CFG) and benefits from the rollout of a worldwide digital cinema network. The counter is currently undemanding at 8.2x FY12/08F P/E.

**Table 4: P&L**

Year to Dec (HK\$m)	06A	07A	08F	09F	10F
Turnover	54.9	246.1	537.2	1,260.6	1,479.2
Cost of sales	(30.1)	(165.5)	(360.4)	(884.5)	(1,003.2)
Allowance for production work in progress	-	-	-	-	-
Gross profit	24.8	80.6	176.7	376.1	476.0
Other revenues	1.1	14.4	18.0	19.8	21.8
Distribution costs	(6.5)	(7.7)	(55.1)	(112.9)	(113.7)
Administrative expenses	(38.4)	(99.9)	(29.6)	(60.8)	(61.2)
Impairment losses of assets	-	-	-	-	-
Gain on disposals	1.8	41.5	-	-	-
Operating profit/(loss)	(17.2)	28.9	110.1	222.3	322.9
Finance costs	(13.1)	(4.0)	(20.0)	(24.0)	(28.8)
Share of results from associates	-	(0.3)	-	-	-
Profit/(loss) before tax	(30.2)	24.6	90.1	198.3	294.1
Tax	-	(3.1)	(8.2)	(19.1)	(24.7)
Profit/(loss) after tax	(30.2)	21.5	81.9	179.2	269.4
Minority interests	-	(3.2)	(7.9)	(21.0)	(22.1)
Net profit/(loss)	(30.2)	18.3	73.9	158.3	247.3
%chg	n/a	n/a	303.8	114.2	56.2
Dividends	-	-	-	-	-

Source: Company data

**Disclosure of interests:** SBI E2-Capital Securities Ltd. acted as the sole bookrunner and placing agent for the GDC top-up placement of 72.0m shares at HK\$2.70 each on 4 July 2007.

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