

## JV with China Film Group moves forward

## China Media

**GDC (8271 HK, HK\$2.64)**

**BUY (unchanged)**

### Target price: HK\$4.30 (+63%)

**Announcement to acquire Shougang GDC Media Holdings.** GDC announced that they intend to acquire 100% interest in the issued share capital of Shougang GDC Media from Shougang Holding, the parent of 50.76% majority shareholder Shougang Concord Grand (730 HK, HK\$0.69, NR) for a consideration of HK\$42.0m. Shougang GDC Media is a special purpose vehicle whose sole asset is its right to participate in 49% interest in PRC Media JV, which will be principally engaged in the deployment and operation of digital cinema network in China. China Film Group (CFG) holds the remaining 51% of PRC Media JV. As we have mentioned before in *"Uniqueness deserves premium"* (26 Jul 2007), the rights to the JV would be transferred to GDC once the JV legal entity had been set up and required approvals were obtained.

**Acquisition consideration to be injected into JV.** Of the HK\$42.0m acquisition to be paid by GDC to Shougang Holding, HK\$41.5m will be injected into the Shougang GDC Media JV as an interest-free shareholder's loan. Of this, HK\$20.2m will be used as committed registered capital for its 49% stake in PRC Media JV, while the remainder will be used as working capital. The interest-free shareholder's loan will then be assigned over to GDC at completion of the acquisition at nil consideration. In effect, GDC will be taking control of Shougang Holding's 49% stake essentially for free, which is in line with our original expectations. GDC was not able to inject the HK\$41.5m directly into Shougang GDC Media as it was considered a connected transaction.

**Going through Shougang Holdings expedites JV formation process.** PRC Media JV has been approved by SARFT, though it is still awaiting several other licenses including the business license to be issued by the State Administration for Industry and Commerce. In our view, Shougang Holdings, with its base in Beijing and all of the necessary connections, is in the best position to expedite all of the necessary approvals for the JV, before transferring control to GDC. This is demonstrated by the quick manner in which the JV is able to gain approval from SARFT (just over 2 months after signing the JV). Based on our channel checks, CFG has taken up to 1 year to set up similar JVs in the past. The obtaining of the business license and other necessary approvals for the establishment of PRC Media JV are part of the conditions to the completion of the acquisition.

**Digital cinema roll out on track.** The company installed around 50 sets of digital cinema systems in Jul and will target around 20 sets in Aug. The slightly slower pace in Aug is due to the fact that this will be the first month in which integrated systems (including Barco's projectors) will be installed. Thereafter, the company is looking to ramp up installation to 100 sets in Sep, with an aim to install a total of 700 sets by the end of the year. GDC's subsidiary, GDC Tech, is currently undertaking all of the systems installation.

**2Q FY12/07A results unexciting as expected.** As expected, the company's 2Q FY12/07A results were unexciting. Revenue rose 110.7% YoY to HK\$20.4m as net loss narrowed to HK\$4.1m from HK\$8.6m a year

**Table 1: Financial summary**

Year to Dec	Net profit HK\$m	EPS HK\$	EPS	P/E x	P/B x	EV/EBITDA x	Yield %	ROE %	ROCE %	N. Gearing %
05A	(76.4)	(0.095)	42.4	na	na	na	-	na	na	na
06A	(30.2)	(0.038)	60.4	na	na	na	-	na	na	na
07F	66.5	0.071	na	37.4	na	66.4	-	14.5	9.3	300.1
08F	159.4	0.122	55.5	21.6	45.5	15.1	-	20.0	14.0	73.4
09F	257.1	0.197	61.4	13.4	10.4	9.4	-	19.8	14.8	Cash

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ago. GDC's CG animation segment was the key revenue driver during the quarter, with a 136.7% YoY increase to HK\$13.9m. Revenue from digital cinema solutions sales jumped 129.6% YoY to HK\$3.8m. Again, we are not expecting solutions sales to ramp up until late 3Q / start 4Q FY12/07F.

**Worldwide digital cinema systems roll out gaining momentum through virtual print fee model.** The roll out of digital cinema systems worldwide is gaining pace. Almost 2,000 screens in North America have been digitalized in the past year. While some of the largest cinema chains in the US have already committed to digitalizing their cinema screens next year. Meanwhile, a European-based company, Arts Alliance Media, recently signed virtual print fee contracts with Twentieth Century Fox and Universal Pictures to roll out digital cinema systems in Europe. The virtual print fee model is a means of financing the worldwide conversion to digital cinema, where both the distributor and exhibitor contribute over time towards the cost of the digital projection and server equipment. In fact, we are expecting GDC to also pursue similar agreements with Hollywood studios. Should this be the case, we may see ramp up of digital cinema solutions sales ramp up being delayed slightly as GDC seeks to secure the more lucrative virtual print fee model contracts.

**Re-iterate BUY call, maintain target price HK\$4.30.** We have revised down the company's FY12/07F net profit slightly to HK\$66.5m, but maintain our FY12/08F net profit forecast at HK\$159.4m. GDC remains a unique play in the media space with its one-of-a-kind access to a nationwide media asset in China (through its JV with CFG), ability to tap the worldwide rollout of digital cinema systems and its synergistic business segments. We re-iterate our BUY call on GDC, maintaining our target price at HK\$4.30, representing 35.0x FY12/08F P/E. The recent sell down as part of the overall market correction offers a window of opportunity for accumulating the stock.

**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 per share on 4 July 2007.**