

Range bound near term

China Media

GDC (8271 HK, HK\$2.68)

BUY (unchanged)

Target price: HK\$3.95 (+47%)

We have recently visited GDC's Shenzhen IDMT facility to take a look at its server assembly operations and CG animation and training studios. Key takeaways are as follows:

Infrastructure for digital cinema roll out in place. Infrastructure for the assembly of digital cinema solutions appears to be in place. At present, GDC is concentrating on the rollout of its digital cinema network in China and, since July 2007, has installed around 100 systems. According to management, its Shenzhen assembly facility currently has the capacity to assemble around 250 integrated systems per month. The key risk factor in meeting GDC's target of installing 700 digital cinema solutions by year-end remains Barco's ability to supply digital cinema projectors. We understand that Barco's current production capacity of 200 units/month will be increased to around 800 units/month in 2008. Management estimates that GDC accounts for about 80% of Barco's production.

Slight delay in ramp up of worldwide digital cinema rollout. While the DCI standard for digital cinema has already been ratified, we understand that Hollywood is still in discussions with various cinema network operators to agree on a virtual print fee (VPF) model to facilitate the rollout of digital cinema worldwide. We expect the stakeholders to agree on the terms of the VPF model by end-2007, with a major rollout starting in 2008. We see significant opportunities in this area. Currently, the US alone has about 4,000 digital cinema screens installed, with plans to add 25,000 screens in the next three years.

High potential of Golden Harvest's Cineplex in Shenzhen. We have also visited Golden Harvest's flagship Cineplex in Shenzhen, which comprises six conventional cinemas and one "gold class" cinema. According to the centre's management, the Cineplex accounts for 38% of Shenzhen's box office and is China's second largest in terms of box office takings. The complex uses GDC's full set of solutions, including: 1) digital cinema equipment; 2) cinema lobby digital display equipment and 3) network operation software. We see GDC's opportunities not only in the provision and installation of solutions, but also in the management of advertising content in cinema lobbies and in-cinema. The cinema presently shows 8-10mins of pre-show advertisement and movie trailers before each screening of feature movies.

Coca-Cola to tap cinema advertising. Coca-Cola China has recently announced its cinema marketing strategy. The company teamed up with a couple of cinema operators to launch a comprehensive advertising campaign including beverage displays, innovative marketing displays and brand-related customer services. This is the first such alliance of an international beverage giant with cinema operators in China. We reiterate our belief that the digitalization of cinema will revolutionize the platform, transforming it into an attractive out-of-home advertising media. GDC's solutions will be instrumental in this and we expect the company to tap this area once its digital cinema network in China is established.

Table 1: Financial summary

Year to Dec	Net profit HK\$m	EPS HK\$	EPS Δ %	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	46.6	0.050	na	54.1	na	236.0	-	14.5	9.3	614.4
08F	147.6	0.113	128.0	23.7	79.3	16.6	-	20.0	14.0	123.1
09F	256.0	0.196	73.5	13.7	11.7	9.8	-	19.8	14.8	Cash

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IDMT animation studio in full swing. GDC’s IDMT CG animation centre has around 300 CG animators in Shenzhen and 30 in Shanghai. The business mainly concentrates of providing outsourcing services to North American CG animation studios. At present, it is working on a number of titles, including Bratz and Ben & Izzy.

Earnings estimates cut to reflect developments. GDC’s fundamentals remain strong but we have cut our FY12/07F and FY12/08F estimates to account for: 1) slower-than-expected rollout of its China digital cinema operation network and 2) delay in the ramp up of worldwide digital cinema rollout to 2008 from 4Q 2007. We now forecast FY12/07F net profit at RMB46.6m (from RMB66.5m), assuming that only 600 sets of digital cinema solutions will be installed in China by end-FY12/07 (instead of 700) and that sales contributions from digital cinema solutions will be lower than originally expected. For FY12/08F, we have revised down our net profit estimate by 7.4% to RMB147.6m.

Maintain BUY call, new target price at HK\$3.95. With most of the business ramp up now expected in FY12/08F, we believe that the counter will remain range bound near term. However, with GDC’s fundamentals still intact we maintain our BUY call. Our revised target price of HK\$3.95 (from HK\$4.30) represents 35.0x FY12/08F P/E. The counter remains our top pick in China’s media sector.

Chart 1: Assembly of digital cinema solutions



Source: Company data

Chart 2: CG animation studio



Source: Company data

Chart 3: Golden Harvest flagship Cineplex (1)



Source: Company data

Chart 4: Golden Harvest flagship Cineplex (2)



Source: Company data

Table 2: P&L

Year to Dec (HK\$m)	05A	06A	07F	08F	09F
Turnover	32.2	54.9	104.6	962.3	1,243.1
Cost of sales	(34.8)	(30.1)	(73.8)	(608.0)	(755.9)
Allowance for production work in progress	(24.7)	-	-	-	-
Gross profit	(27.4)	24.8	30.9	354.3	487.2
Other income and gains	0.6	1.1	12.0	15.0	16.5
Selling and distribution costs	(2.0)	(6.5)	(13.0)	(101.0)	(111.1)
Administrative expenses	(37.4)	(38.4)	(9.6)	(54.4)	(59.8)
Impairment losses recognized in respect of PPE	(2.4)	-	-	-	-
Finance costs	(7.7)	(13.1)	(11.0)	(13.2)	(15.8)
Exceptionals	-	1.8	40.3	-	-
Profit/(loss) before taxation	(76.2)	(30.2)	49.5	200.7	316.9
Taxation	(0.2)	-	(1.5)	(21.7)	(28.4)
Profit/(loss) after tax	(76.4)	(30.2)	48.0	179.0	288.6
Minority interests	-	-	(1.4)	(31.4)	(32.6)
Profit/(loss) attributable to shareholders	(76.4)	(30.2)	46.6	147.6	256.0
% <i>chg</i>	41.8	60.5	-	216.7	73.4
Dividends	-	-	-	-	-

Source: SBI E2-Capital, 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 per share on 4 July 2007.