



Company update

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## Hong Kong Media

Reuters 2366.HK  
Bloomberg 2366 HK

### Priced on 21 February 2007

HK HSI @ 20,651.4

**12M price target** HK\$3.36

**±% up/downside** +49%

Target set on 20 Feb 07

**Market cap** US\$147m

**Shares in issue** 509.9m

**Free float (est.)** 45.8%

### 3M average daily volume

HK\$3.0m (US\$0.4m)

### 12M high/low

HK\$2.52/1.87

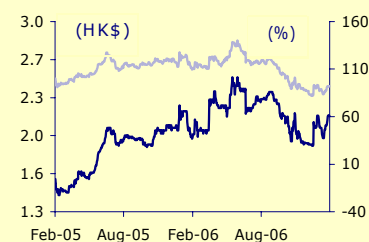
### Major shareholders

Anita Leung / Philip Wong 35.2%

Aegis plc 19.0%

### Stock performance (%)

	1M	3M	12M
Absolute	4.6	4.1	15.9
Relative	3.0	(4.1)	(12.3)
Abs (US\$)	4.6	3.8	15.1



— Qin Jia Yuan Media (LHS)  
— Rel to HSI (RHS)

Source: Bloomberg

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## Adding value

QJY Media, a HK-based media services company, is well positioned to benefit from China's growing TV advertising industry, as drama production is exchanged for ad slots; and with the recent acquisition of the ad rights to Hubei TV's drama channel. With Rmb300m committed to 600 hours of programming, we raise the number of episodes produced to 280 in FYSep07CL and 400 in FYSep08CL. The stock is at 8.1x forward earnings, a big discount to its peers and also our fair value target at 12x.

### Growing drama production capacity

QJY plans to become a major supplier of TV drama series in China. Following China's open-door policy to encourage joint investments by PRC and HK companies, QJY has collaborated with 8 TV stations in China for TV drama production, procurement and distribution. Initially Rmb300m will be spent producing and acquiring up to 600 hours of TV drama; and we now forecast QJY will produce 280 (from 230) episodes of drama in FYSep07CL and 400 (from 280) in FYSep08CL.

### Well positioned to benefit from China's growing ad industry

QJY acquired the exclusive advertising rights to the Film/TV Drama Channel of Hubei TV for Rmb63m last month. As QJY typically supplies TV drama to stations in exchange for ad slots, this deal differs as it is the first time for the company to own exclusive advertising rights for a mainland TV channel and is one of the few foreign companies to do so. In 2007, QJY will focus on acquiring more advertising rights to a variety of TV channels. We forecast this business to account for more than 20% of QJY's revenues by next year.

### Setting up a talent school with Chongqing TV station

QJY has also announced a long-term co-operative agreement with Chongqing TV Station - to jointly set up a talent/artist agency business. This will serve the production requirements of Chongqing Satellite TV, a leading TV channel in the PRC with nationwide coverage. The artist agency business will establish "QJY Chongqing Performing Arts Centre" for talent training; and will organise various contests related to sports, music, culture and entertainment.

### Valuations cheap against media sector peers

The stock is currently trading at 11.1x current and 8.1x forward year earnings against an EPS cagr of 25% for FYSep06-09CL. Valuations are also cheap compared to the average 08CL PE of 25x for other China media plays. We set our fair value at 12x FYSep08CL earnings, one standard deviation above mean PE of 10.5x to reflect its growth prospects, but still at a substantial discount to its peers, reflecting its smaller market cap and higher execution risks - translating to a HK\$3.36/share target.

### Financials

Year to 30 Sep	05A	06A	07CL	08CL	09CL
Revenue (HK\$m)	106	125	165	227	265
Rev forecast change (%)			7.9	29.9	0
Net profit (HK\$m)	66	84	104	142	165
NP forecast change (%)			(6.1)	8.1	0
EPS (HK¢)	14.1	16.4	20.5	27.9	32.4
CLSA/consensus(2) (%)	-	-	93	107	-
EPS (% YoY)	11.9	16.3	24.6	36.5	16.1
PEX (@HK\$2.26)	16.0	13.8	11.1	8.1	7.0
EV/Op Ebitda (x)	12.8	11.7	9.3	6.5	5.1
Dividend yield (%)	1.4	1.6	1.8	2.5	2.9
ROAE (%)	22.4	18.3	17.9	20.4	19.7

Source: CLSA Asia-Pacific Markets

**Co-produced TV dramas are now entitled to be broadcast during prime-time**

The PRC government has recently adopted new policies that are beneficial to Hong Kong companies engaging in TV program investment, production and distribution in the Mainland. Under these policies, TV dramas jointly produced by Chinese and Hong Kong companies will be considered domestically produced dramas and will be entitled to broadcast during prime-time.

Figure 1

**New policies under CEPA are beneficial to HK production companies**

- 1) PRC and Hong Kong joint productions are considered as domestically produced drama series, and are eligible for direct broadcast rights – including primetime.
- 2) The quota/limit of 40 episodes of jointly produced drama is removed.
- 3) Vetting of domestic productions engaging Hong Kong artists can be undertaken at first-level municipal SARFT departments.
- 4) With relevant authorization, Hong Kong cable networks are allowed to set up trial points in Guangdong for the provision of network technical services.

Source: CLSA / QJY Media

**HK production companies benefit under CEPA**

**QJY hopes to increase its market share from 4% to 15-20% by 2010**

Management estimates demand for almost 5,000 episodes/hours of prime-time TV drama in China each year; and QJY Media is aiming to increase its market share of annual TV programming from ~4% to ~15-20% (ie ~750-1000 hours) by 2010.

**QJY Media has formed alliances with 8 TV stations in China**

Since its IPO, QJY Media has expanded its collaboration base from one major Mainland TV station to eight, now including TV stations/media in Beijing, Dalian, Fujian, Guangdong, Harbin, Hubei, Jiangsu and Shanghai. This effectively forms a nationwide network for the production and distribution for TV programs.

**Growing drama production capacity**

Figure 2

**QJY – Key assumptions and drivers**

**We have raised the number of drama episodes to 280 (from 230) in 07CL and 400 (from 280) in 08CL**

<b>FYE September</b>	<b>05A</b>	<b>06A</b>	<b>07CL</b>	<b>08CL</b>	<b>09CL</b>
<b>Drama (episodes)</b>	<b>126.0</b>	<b>216.0</b>	<b>280.0</b>	<b>400.0</b>	<b>500.0</b>
<b>YoY%</b>	<b>117.2</b>	<b>71.4</b>	<b>29.6</b>	<b>42.9</b>	<b>25.0</b>
Net ad revenues (HK\$m)			32.8	54.1	57.8
EBIT margins (%)	66.3	68.0	68.4	71.2	72.1
Effective tax rate (%)	3.2	0.4	5.0	10.0	12.5
Payout ratio (%)	21.1	21.9	20.0	20.0	20.0

Source: CLSA Asia-Pacific Markets

**We expect QJY's effective tax rate to pick up following the acquisition of the PRC ad business**

**Other advertising related expansion**

**Foray into China's advertising placement business**

QJY Media's long-term goal is to become a "multimedia supermarket". Only last month, the group acquired the exclusive advertising rights to the Film/TV Drama Channel of Hubei TV at a cost of Rmb63m. The rights are for 3 years and QJY will have an option to renew for another 3 years.

**Ad rights to the Film/Drama Channel of Hubei TV station**

The Film/TV Drama Channel of Hubei TV Station broadcasts 18 hours of films and TV drama each day. There is up to 156 minutes of advertising airtime each day and based on average Rmb6,100/30 sec ad slot, management estimates up to Rmb700m in annual advertising revenues before discounting. As the owner of the exclusive advertising rights, QJY controls the pricing, discount and strategies of the channel's advertising operations and is also entitled to sponsorship income.

**Without the burden of investing in the TV stations' infrastructure, facilities and operations**

The key attraction is that QJY can enjoy the benefits of a TV channel (ie ad revenues), without substantial investments in the station's infrastructure, facilities and operation. QJY is only required to pay the advertising contract fee and the cost of enhancing program quality. The TV station is responsible for broadcasting and censorship, and meeting viewer-ship ratings.

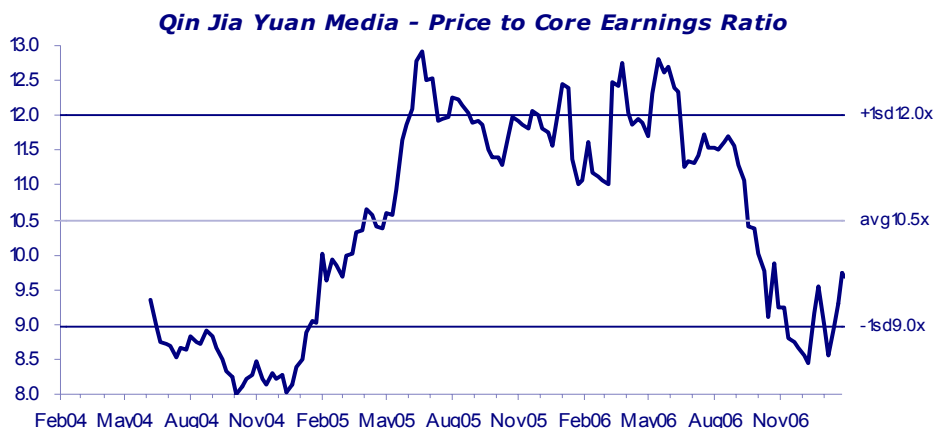
**QJY is currently trading on 11.1x current year and 8.1x forward earnings (vs a historical PE average of 10.5x)**

**Valuations cheap against media sector peers**

**Our HK\$3.36/share fair value for QJY Media is set at 12x FYMar08CL earnings, one standard deviation above historical mean PE**

Figure 3

**QJY – Historical PE valuations**

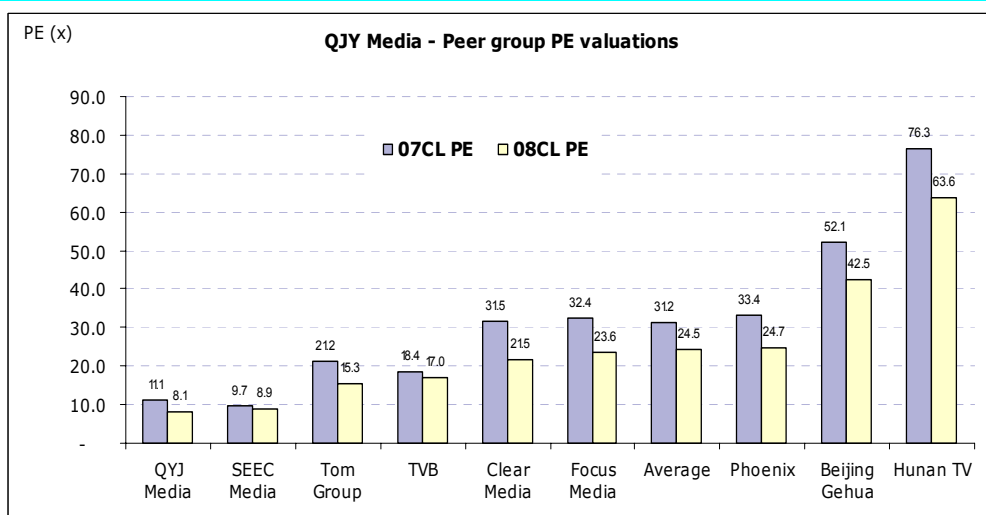


Source: CLSA Evalu@tor

Source: CLSA Asia-Pacific Markets

Figure 4

**QJY – Peer group P/E comparisons**



Source: CLSA Asia-Pacific Markets / Bloomberg / IBES

**Recommendation history - Qin Jia Yuan Media Services 2366 HK**

Date	Rec level	Closing price	Target
20 February 2007	N-R	2.16	3.36
16 May 2006	N-R	2.23	3.28

Source: CLSA Asia-Pacific Markets

**Key to CLSA investment rankings:** BUY = Expected to outperform the local market by >10%; O-PF = Expected to outperform the local market by 0-10%; U-PF = Expected to underperform the local market by 0-10%; SELL = Expected to underperform the local market by >10%. Performance is defined as 12-month total return (including dividends).

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Note: In the interests of timeliness, this document has not been edited.

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