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1HFY07 RESULTS REVIEW

CURRENT PRICE: HK\$ 3.04
12-MONTH TARGET PRICE: 3.43

FINANCIAL SUMMARY – ANNUAL (HK\$ min)				
FY SEP.	2006	2007F	2008F	2009F
Revenue	125.1	187.0	267.6	322.7
EBITDA*	92.1	134.6	178.2	217.3
Net profit after Minority Interests	83.6	121.4	161.0	197.8
EPS after Minority Interests (HK\$)	0.17	0.24	0.32	0.39
DPS (HK\$)	0.04	0.05	0.07	0.09
PER (x)	13.7	12.8	9.6	7.8
Dividend yield (%)	1.5	1.7	2.3	2.8
*Earnings before net interest expense, tax, depreciation, amortization and any other adjustments deemed appropriate by the analyst				
**Share price is based on last close on 05-17-07				

Source: Company data, S&P Equity Research

Highlights

- S&P Equity Research fairly values Qin Jia Yuan Media Services (QJY) at HK\$3.43/share based on a combination of discounted cash flow (DCF) and relative valuation (EV/EBITDA). This offers a potential upside of 12.8% from the current price.
- QJY's 1HFY07 (Sep.) net profit came in above expectations, making up 59.3% of our original full-year FY07 net profit forecast. QJY recorded a 45.5% YoY jump in net profit in 1HFY07 on the back of a slightly higher 47.6% YoY rise in revenue. The rise in revenue was largely achieved on the back of a 213.8% YoY jump in the number of TV drama serial hours completed in 1HFY07, a 109.5% YoY rise in marketing-related income and a 94.2% YoY rise in public relations-related income. The slightly lower YoY rise in net profit was due mainly to lower operating profit margin and higher finance costs.
- QJY proposed an interim dividend per share of HK2.5 cents (1HFY06: HK1.8 cents). We expect QJY to declare a final dividend of HK2.7 cents bringing the total dividend for the year to HK5.2 cents (2006: HK3.6 cents). This translates to a payout ratio of 22% (from 21.9% in FY06) and dividend yield of 1.7% for FY07.
- We have revised our earnings forecasts upwards by 14.4% for FY07 and 20.4% for FY08, taking into account contributions from QJY's Hubei TV channel management agreement, higher contributions from its public relations division, an increase in other income stemming from forex gains, a reduction in administrative expenses and a reduction in effective tax rate for FY07.
- All in, we expect QJY's net earnings CAGR over the next three years (FY06-FY09) to be 33.2% (from 23.2% previously), driven mainly by TV program-related and marketing-related services, given the sharp increase in the pipeline of projects for the next three years.
- Risks to our target price and recommendation include the long settlement cycle for receivables, earnings volatility given that earnings are project-based, reliance on key management, regulatory risk and tax risk given the new Enterprise Income Tax (EIT) law.

RESULTS REVIEW

QJY's 1HFY07 (Sep.) net profit came in above expectations, making up 59.3% of our original full-year FY07 net profit forecast.

The main reasons for the discrepancies were:

- (i) higher-than-expected public relations income of HK\$17.7 mln in 1HFY07 (versus our original FY07 projection of HK\$12.2mln), which was due to the higher level of sponsorship booked in for current drama projects;
- (ii) higher-than-expected other net income representing foreign exchange gain of HK\$6.9 mln in 1HFY07 (versus our original FY07 projection of HK\$5.2 mln);
- (iii) lower-than-expected administrative expenses of HK\$15.2 mln, comprising 16% of revenue in 1HFY07 (versus our original FY07 projection of 18% of total revenue); and
- (iv) lower-than-expected effective tax rate of 1% in 1HFY07 (versus our original FY07 forecast of 2%).

This was slightly offset by lower-than-expected gross profit margin of 79% in 1HFY07 (versus our original FY07 projection of 82%).

QJY recorded a 45.5% YoY jump in net profit in 1HFY07 on the back of a slightly higher 47.6% YoY rise in revenue. The rise in revenue was largely achieved on the back of a 213.8% YoY jump in the number of TV drama serial hours completed in 1HFY07 to 139 hours, a 109.5% YoY rise in marketing-related income and a 94.2% YoY rise in public relations-related income. We believe this was achieved on the back of an improving market share (to an estimated 5.6% (annualized) from about 4% in FY06) coming from its strengthening brand presence in China as well as the one-month contribution from QJY's Hubei TV channel management contract, which was completed in Feb. 2007.

The slightly lower YoY rise in net profit was due mainly to the:

- (i) lower operating profit margin of 71.6% in 1HFY07 (from 72.5% in 1HFY06); coming from, we believe, increased spending on promotional activities for Hubei TV; and
- (ii) higher finance costs of HK\$3.5 mln in 1HFY07 (versus HK\$2.2 mln in 1HFY06), due to higher debt levels of HK\$142.5 mln (up from HK\$79.5 mln in 1HFY06).

QJY continues to be in a net cash position, albeit at a lower level of HK\$10.3 mln as at 1HFY07 (versus HK\$75.3 mln as at end-FY06), due to, we believe, the higher funding required for the larger number of TV dramas completed during the period.

QJY proposed an interim dividend per share of HK2.5 cents (1HFY06: HK1.8 cents).

S&P Equity Research received compensation for conducting this valuation research. Such compensation, which ranges from US\$30,000 to US\$75,000 p.a., was based upon the time and effort required to determine the valuation and was paid by Qin Jia Yuan Cultural Assets (Hong Kong) Company Limited.

OUTLOOK

We have revised our earnings forecasts upwards by 14.4% for FY07 and 20.4% for FY08. This is to take into account: (i) contributions from QJY's Hubei TV channel management agreement which was completed in Feb. 2007; (ii) an increase in revenue contributions from QJY's public relations operations; (iii) an increase in other income stemming from forex gains; (iv) a reduction in administrative expenses; and (v) a reduction in the effective tax rate to 1.5% (from 2%) for FY07.

All in, we expect QJY's net earnings CAGR over the next three years (FY06-FY09) to be 33.2% (from 23.2% previously).

Earnings will continue to be driven by TV program-related and marketing-related services, given the sharp increase in the pipeline of projects for the next three years. QJY currently has a pipeline of 19 TV drama projects, consisting of 610 programming hours with estimated assured investment agreements for about HK\$300 mln that are expected to be completed over the next few years.

QJY's newly signed collaboration with Chongqing TV station in Feb. 2007 brings the total number of collaborations with TV stations to nine, giving QJY national coverage in China. We expect these nine collaboration ventures to start contributing to the number of TV dramas produced within the next few months.

QJY has also signed a cooperation agreement with Mandarin Films Ltd (9 HK, HK\$0.86, Not Ranked) in Feb. 2007 to produce and distribute five projects of package production of movies and TV drama series aimed to be completed within a two-year period. Mandarin Films would be mainly involved in the production and distribution of the movies while QJY would be mainly involved in the production and distribution of the TV drama series. The first project is a package production of the movie and TV drama series of "Wonder Woman" (adapted from a novel written by Dr. Anita Leung, the major shareholder of QJY), which would reflect the adversities Hong Kong has encountered in the 10 years after Hong Kong was returned to China. "Wonder Woman" has already attracted sponsorship from health drink maker, "Wanglaoji", a brand of Guangdong Jiaduobao Drink & Food Company Ltd, covering a substantial portion of the production cost. It is estimated that sponsorship fees per drama series are between HK\$2 mln and HK\$3 mln, although this can rise to as high as HK\$8 mln for specific drama series produced for special events like this and the 2008 Olympics. "Wonder Woman" is due to be completed by end-June 2007.

In May 2007, QJY announced a collaboration with SGL Entertainment Ltd, a subsidiary of media and entertainment company STAR Group to explore opportunities in the global Chinese TV drama market. The first collaboration will be the production and distribution of a Mandarin-language TV drama series based on the science fiction novel series under the name "Wesley" written by Mr. Ni Kuang, a well-known author. QJY, which has the exclusive global adaptation rights for "Wesley" novels into TV drama serials, movies and other media forms, will produce the TV drama series and distribute it in and around China. STAR will have the exclusive broadcast and distribution rights for Taiwan and anywhere else outside China for a period of five years. While QJY will bear the majority of the costs associated with the production of the TV drama series, it will benefit from the sharing of the revenue from STAR's overseas distribution. QJY expects this project to increase its revenue from overseas distribution by at least 50% per episode.

In view of the above recent developments which would help to sustain a strong pipeline of TV drama projects going forward, we continue to expect revenue growth from TV programming to remain robust over the next three years. Our earnings model assumes that QJY's programming hours will increase to about 250 hours in FY07 and to 300 hours in FY08 (from 216 hours in FY06), while assured investment agreements will increase to about HK\$175 mln in FY07 and HK\$210 mln in FY08 (from HK\$153 mln in FY06), driven by higher volume as well as higher average revenue due to better quality and larger-scale dramas. It is estimated by

management that the demand for prime-time Chinese TV drama serials in China is up to 5,000 hours per annum, and QJY's market share as at FY06 was only 4.3%. With the establishment of collaborations with the nine TV stations, QJY targets to produce 1,000 hours of TV drama serials by FY10, which will give it a market share of 20%. Our programming hour assumptions are more conservative than QJY's targets given the lack of details on funding and stakes in the TV programs. To reach its target of 1,000 hours, QJY would require additional funding and/or hold lower stakes in the TV programs.

QJY has recently obtained approval for the establishment of an advertising agency, Qin Jia Yuan (China) Advertising Company Limited, in China. It is expected that it will receive the approval to start the advertising agency operations during the second half of 2007. The issuance of the advertising licence will enable QJY to save on the fees (of about 15%) it would normally have to pay to its usual advertising agencies and to exercise the agreement with its Tianjin-QJY Advertising JV to acquire the rights of a number of long-term advertising contracts, which will provide a stable stream of revenue. QJY is still formulating its strategy for this venture and may only kick off operations towards end-2007 (versus its previous target of 1HFY07). We have not imputed this development into our forecasts.

Going forward, revenue from QJY's traditional marketing-related activities is expected to continue to be strong, given our projected upward trend of TV programming hours and after we include the planning and marketing income to be earned from the sale of advertising airtime under the Hubei TV agreement. As QJY has yet to obtain the approval to start the advertising agency operations, it has not decided on the proportion of advertising agency work it will take on through its own advertising agency versus the amount it will outsource to external advertising agencies. Therefore, we have only included revenue from the planning and marketing of Hubei TV's operations in our projections. QJY will earn a minimal fixed sum for the first year of operations in FY07. In subsequent years, it will earn a share of the advertising income obtained by the advertising agencies for the sale of airtime.

It should be noted that in mid-March 2007, a new resident tax law was introduced which taxes companies not registered in the PRC but are managed and controlled from the PRC at the Enterprise Income Tax (EIT) rate of 25%. This new law is to take effect on Jan. 1, 2008. Given that no details are available as yet on the structure of this new law, QJY has not been able to estimate the impact this would have on its financials. Nevertheless, it believes that there should not be a significant impact as QJY's subsidiaries that are registered outside China are also managed and controlled from outside China. QJY has a few subsidiaries registered in the British Virgin Islands and Macau that have been enjoying low effective tax rates of between 0.4% and 3.3% over the past three years. This development may only affect QJY's earnings once it obtains the approval to start the advertising agency operations and decides to take on all the advertisement agency work on its own rather than outsource to external advertising agents. This scenario is unlikely, however, given that QJY would not have access to all the advertisers in the industry and would still need to outsource a certain portion of the advertisement placements to external agencies. Nevertheless, QJY believes that the higher margin obtained from doing the advertisement placement on its own would offset the effect of the 25% tax rate, resulting in an overall neutral impact on earnings. Pending further details about the structure of this new tax law, we maintain our effective tax rate assumptions at below 5% for the next few years.

We have projected QJY to declare a final dividend of HK2.7 cents bringing the total dividend for the year to HK5.2 cents (2006: HK3.6 cents). This translates to a payout ratio of 22% (from 21.9% in FY06) and dividend yield of 1.7% for FY07.

VALUATION

We have increased QJY's fair value to HK\$3.43 (from HK\$2.58), after our earnings revision and updating of our valuation parameters. Our fair value is based on a combination of DCF and relative valuation.

EXHIBIT 1: FAIR VALUE (HK\$/SHARE)

Intrinsic Value	3.51
Relative Value	3.25
Average Value	3.38
Add: DPS	0.05
S&P Equity Research Estimated Fair Value	3.43

Source: S&P Equity Research

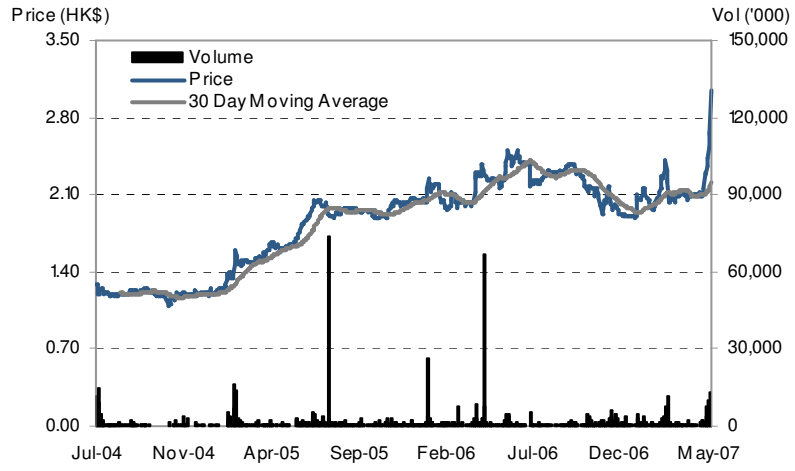
Our DCF valuation (unchanged key assumptions: cost of equity of between 10.5% and 12%, risk-free rate of between 4% and 5.5%, and equity risk premium of 7.2%) of HK\$1,635.5 mln is based on explicit forecasts of free cash flow to equity for three years from FY07 to FY09, followed by stable growth of 15% p.a. from FY10 to FY15, 5% growth p.a. for FY16 to FY20 and terminal growth of 3% thereafter. Our stable growth assumption for FY10 to FY15 of 15% p.a. implicitly assumes strong contributions from QJY's new income stream from TV channel management. Adding cash (including pledged deposits) of HK\$152.7 mln as at end-1HFY07, our intrinsic value for QJY is HK\$3.51 per share (from HK\$2.26 previously).

We have used EV/EBITDA for our relative valuation analysis based on QJY's TV media peers' FY07 average of 13.6x (previously 14.5x). Peers include Phoenix Satellite TV (8002 HK, HK\$1.40, 3-STARS), Television Broadcasts Ltd (TVB) (511 HK, HK\$57.00, 3-STARS), and i-Cable Communications (1097 HK, HK\$1.75, Not Ranked). To account for QJY's smaller size and higher risk, we have attached a 10% (from 20% previously) discount to its peers to arrive at a relative valuation for QJY. We lower our discount to 10% given QJY's stronger EBITDA growth of between 30% and 45% for the next two years compared with its peers' average growth of between 10% and 25%. Based on a target FY07 EV/EBITDA of 12.2x (previously 11.6x), we derive a fair relative valuation of HK\$3.25 per share (from HK\$2.81 previously).

RISKS

Risks to our recommendation and target price include: (i) collection risk for receivables (given the lengthy credit terms of between six months and a year) and for advances to kick-start production (which are only reimbursed after at least 18 months of commencement of projects); (ii) regulatory risk, given that media content is tightly controlled and media laws in China are still developing; (iii) project risk, as QJY's revenue is dependent on the successful completion of projects and it does not receive progress payments; (iv) TV channel management risk, given that this is still a new area of business for QJY; and (v) tax risk, given the new Enterprise Income Tax (EIT) law which is to take effect on Jan. 1, 2008.

EXHIBIT 2 : SHARE PRICE PERFORMANCE



Source: Bloomberg, S&P Equity Research

EXHIBIT 3: INCOME STATEMENT

FY Sep./HK\$ mln	2005	2006	2007F	2008F	2009F
Revenue	106.3	125.1	187.0	267.6	322.7
EBITDA	75.5	92.1	134.6	178.2	217.3
EBITDA margin	71.1%	73.7%	72.0%	66.6%	67.3%
Depreciation & Amortization	(5.1)	(7.1)	(7.7)	(7.1)	(6.8)
EBIT	70.5	85.1	127.0	171.1	210.5
Net interest expense	(2.0)	(1.1)	(3.7)	(5.1)	(5.6)
Pre-tax income	68.5	84.0	123.3	166.0	204.9
Tax	(2.2)	(0.4)	(1.8)	(5.0)	(7.2)
Tax Rate	3.3%	0.4%	1.5%	3.0%	3.5%
Minority interest	0.0	0.0	0.0	0.0	0.0
Net profit	66.2	83.6	121.4	161.0	197.8
Net profit pre-gw and EI	66.3	83.6	121.4	161.0	197.8
Net margin	62.3%	66.9%	64.9%	60.2%	61.3%

Source: Company data, S&P Equity Research

EXHIBIT 4: BALANCE SHEET

FY Sep./HK\$ mln	2005	2006	2007F	2008F	2009F
Cash	117.1	144.7	136.7	167.2	207.1
Pledged deposits	40.3	45.3	40.0	40.0	50.0
Current assets	353.5	511.2	491.9	595.8	732.1
Fixed assets	22.6	30.0	37.4	40.3	38.5
Intangible assets	19.0	70.4	77.5	85.2	89.5
Other Assets	70.5	87.4	220.4	258.4	296.4
Total assets	465.6	699.1	827.2	979.7	1,156.4
Interest bearing debt	61.3	114.7	136.1	146.1	151.1
Other liabilities	24.6	51.4	58.6	66.8	76.2
Total liabilities	85.9	166.1	194.7	212.9	227.3
Common equity	36.7	39.8	39.8	39.8	39.8
Total shareholders' equity	379.7	533.0	632.5	766.8	929.2

Source: Company data, S&P Equity Research

EXHIBIT 5: CASH FLOW STATEMENT

FY Sep./HK\$ mln	2005	2006	2007F	2008F	2009F
Cash flow from operations	(71.9)	(56.4)	13.0	70.1	95.1
Cash flow from investing	(13.1)	(31.0)	(18.8)	(14.4)	(5.2)
Cash flow from financing	116.8	115.0	(2.1)	(25.2)	(50.1)
Net Cash flow	31.8	27.6	(8.0)	30.5	39.8
Cash	117.1	144.7	136.7	167.2	207.1
Capex (fixed assets & licence rights)	(13.5)	(35.0)	(22.0)	(17.7)	(9.3)
Free cash flow to firm	(85.3)	(91.4)	(9.1)	52.3	85.9

Source: Company data, S&P Equity Research

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