



Rating
Hold

Company
Huayi Brothers

Date
24 March 2016

Asia
China

Consumer
Hotels / Leisure /
Gaming

Reuters 300027.SZ Bloomberg 300027 CH Exchange SHZ Ticker 300027

Forecast Change

Price at 23 Mar 2016 (CNY)	27.99
Price target - 12mth (CNY)	35.00
52-week range (CNY)	63.58 - 22.67
HANG SENG INDEX	20,615

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Mixed results – strong revenue but disappointing earnings; maintain Hold

2015 core earnings fell 10% yoy to RMB574m; maintaining Hold

Huayi Brothers has reported 2015 results. We maintain our Hold rating with a new target price of RMB35 (from RMB40). Reported net profit rose 9% yoy to RMB976m, on investment gains from Ourpalm, Guru Online and Yaolai Theatre. Excluding non-recurring items, core net profit declined 10% yoy to RMB574m on a margin contraction on unfavorable product mix change and higher finance costs. We remain cautious on the name given the extreme high uncertainty in the return of upstream movie production, especially after an earnings decline in 2015 despite strong performance of its core business.

Strong core business drove revenue growth

Revenue increased 62% yoy to RMB3.9bn, driven by a 136% yoy increase in the entertainment business to RMB2.8bn. We believe this could be attributable to the strong box office of movies including “Mojin – The Lost Legend”, “Dragon Blade” and “Mr. Six”, and the consolidation of Dongyang Haohan and Dongyang Meila. Revenue from brand licensing declined 76% yoy to RMB56m, due to the high base in 2015. Internet gaming grew 11% yoy to RMB861m.

Unfavorable product mix change led to margin contraction and earnings decline

EBIT margin declined 13ppts yoy to 24% in 2015, due mainly to an unfavorable change in product mix – revenue contribution from high-margin business segments (i.e. brand licensing and internet gaming) decreased from 43% to 23%. EBIT contraction coupled with increasing finance cost (up 44% yoy) led to a 10% yoy decline in core net profit.

Lowering earnings estimates by 11%/12% in 2016/17

We adjust down our EPS estimates by 11% to RMB0.71 in 2016 and by 12% to RMB0.89 in 2017. Despite production pipeline, we revise down our brand licensing estimates, given the uncertainty in gaining new projects.

Valuation and risks

We derive our new target price of RMB35 on DCF-based valuation (8.5% WACC and 4% terminal growth rate, unchanged). Downside risks include lower-than-expected return from films, and production delay. Upside risks include better-than-expected box-office performance.

Forecasts And Ratios

Year End Dec 31	2014A	2015A	2016E	2017E	2018E
Sales (CNYm)	2,389.0	3,873.6	5,038.0	6,340.9	7,901.1
Reported NPAT (CNYm)	896.7	976.0	990.6	1,244.0	1,504.4
DB EPS FD(CNY)	0.52	0.45	0.71	0.89	1.08
OLD DB EPS FD(CNY)	0.52	0.59	0.80	1.02	–
% Change	0.0%	-24.3%	-11.3%	-12.1%	–
DB EPS growth (%)	45.8	-14.3	59.2	25.6	20.9
PER (x)	47.4	83.5	39.6	31.5	26.1
DPS (net) (CNY)	0.10	0.10	0.10	0.13	0.15
Yield (net) (%)	0.4	0.3	0.4	0.5	0.5

Source: Deutsche Bank estimates, company data

¹ DB EPS is fully diluted and excludes non-recurring items

² Multiples and yields calculations use average historical prices for past years and spot prices for current and future years, except P/B which uses the year end close

Key changes

Price target	40.00 to 35.00	↓	-12.5%
Sales (FYE)	4,439 to 5,038	↑	13.5%
Op prof margin (FYE)	33.9 to 27.2	↓	-19.9%
Net profit (FYE)	1,114.5 to 990.6	↓	-11.1%

Source: Deutsche Bank

Price/price relative



Performance (%)	1m	3m	12m
Absolute	-0.9	-34.6	-11.5
HANG SENG INDEX	7.4	-6.9	-15.5

Source: Deutsche Bank

Deutsche Bank AG/Hong Kong

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Model updated: 24 March 2016

Running the numbers

Asia
China
Hotels / Leisure / Gaming

Huayi Brothers

Reuters: 300027.SZ Bloomberg: 300027 CH

Hold

Price (23 Mar 16) CNY 27.99
Target Price CNY 35.00
52 Week range CNY 22.67 - 63.58
Market Cap (m) CNYm 39,129
USDm 6,022

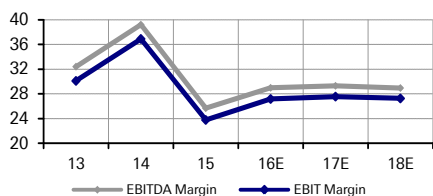
Company Profile

Huayi Brothers, was founded in 1994 by Mr. Wang Zhongjun and Mr. Wang Zhonglei. It is a leading private company in China's upstream film industry, and it currently operates three main business segments, including media entertainment (involves mainly in the production and distribution of films and TV dramas), brand licensing and internet online entertainment.

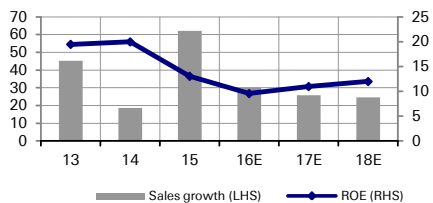
Price Performance



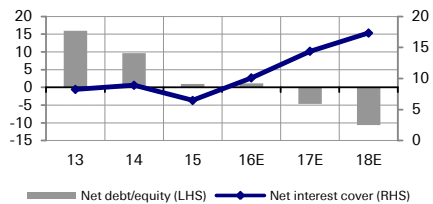
Margin Trends



Growth & Profitability



Solvency



Fiscal year end 31-Dec

Financial Summary

	2013	2014	2015	2016E	2017E	2018E
DB EPS (CNY)	0.36	0.52	0.45	0.71	0.89	1.08
Reported EPS (CNY)	0.49	0.73	0.76	0.71	0.89	1.08
DPS (CNY)	0.10	0.10	0.10	0.10	0.13	0.15
BVPS (CNY)	3.3	4.1	7.1	7.8	8.5	9.5
Weighted average shares (m)	1,210	1,226	1,284	1,392	1,392	1,392
Average market cap (CNYm)	22,035	30,319	47,946	39,129	39,129	39,129
Enterprise value (CNYm)	19,617	29,029	42,951	34,155	33,432	32,542

Valuation Metrics

P/E (DB) (x)	50.9	47.4	83.5	39.6	31.5	26.1
P/E (Reported) (x)	37.3	33.8	49.1	39.6	31.5	26.1
P/BV (x)	8.47	6.48	5.81	3.64	3.30	2.97
FCF Yield (%)	1.9	nm	0.9	0.7	2.6	3.1
Dividend Yield (%)	0.5	0.4	0.3	0.4	0.5	0.5
EV/Sales (x)	9.7	12.2	11.1	6.8	5.3	4.1
EV/EBITDA (x)	30.0	31.0	43.1	23.4	18.0	14.2
EV/EBIT (x)	32.3	32.9	46.6	24.9	19.1	15.1

Income Statement (CNYm)

Sales revenue	2,014	2,389	3,874	5,038	6,341	7,901
Gross profit	1,008	1,455	1,948	2,647	3,356	4,158
EBITDA	653	937	995	1,461	1,860	2,289
Depreciation	44	50	59	73	88	106
Amortisation	2	6	14	18	23	28
EBIT	607	882	922	1,370	1,749	2,156
Net interest income/(expense)	-73	-99	-142	-135	-121	-124
Associates/affiliates	0	0	0	0	0	0
Exceptionals/extraordinaries	-84	-30	-18	0	0	0
Other pre-tax income/(expense)	349	526	735	315	318	322
Profit before tax	797	1,279	1,496	1,550	1,946	2,353
Income tax expense	200	245	278	288	362	438
Minorities	8	138	242	271	340	411
Other post-tax income/(expense)	0	0	0	0	0	0
Net profit	590	897	976	991	1,244	1,504
DB adjustments (including dilution)	-158	-257	-402	0	0	0
DB Net profit	433	639	574	991	1,244	1,504

Cash Flow (CNYm)

Cash flow from operations	511	-21	527	405	1,162	1,396
Net Capex	-99	-72	-105	-126	-146	-166
Free cash flow	413	-93	422	279	1,015	1,230
Equity raised/(bought back)	0	277	3,636	0	0	0
Dividends paid	-164	-220	-267	-139	-141	-177
Net inc/(dec) in borrowings	579	296	1,351	-965	387	466
Other investing/financing cash flows	-331	427	-2,807	-160	-152	-162
Net cash flow	496	687	2,336	-985	1,110	1,356
Change in working capital	144	-754	1,111	-812	-315	-366

Balance Sheet (CNYm)

Cash and other liquid assets	1,137	1,829	3,662	2,676	3,786	5,143
Tangible fixed assets	317	354	755	809	867	927
Goodwill/intangible assets	355	1,560	3,637	3,629	3,621	3,613
Associates/investments	3,067	2,479	5,897	5,897	5,897	5,897
Other assets	2,336	3,596	3,943	4,602	5,255	6,002
Total assets	7,212	9,819	17,894	17,613	19,426	21,582
Interest bearing debt	1,770	2,376	3,769	2,803	3,191	3,657
Other liabilities	1,484	1,763	3,395	3,225	3,548	3,911
Total liabilities	3,254	4,139	7,164	6,029	6,738	7,568
Shareholders' equity	3,942	5,037	9,935	10,786	11,889	13,216
Minorities	16	643	795	795	795	795
Total shareholders' equity	3,958	5,680	10,730	11,582	12,684	14,011
Net debt	633	547	107	127	-596	-1,486

Key Company Metrics

Sales growth (%)	45.3	18.6	62.1	30.1	25.9	24.6
DB EPS growth (%)	97.1	45.8	-14.3	59.2	25.6	20.9
EBITDA Margin (%)	32.4	39.2	25.7	29.0	29.3	29.0
EBIT Margin (%)	30.1	36.9	23.8	27.2	27.6	27.3
Payout ratio (%)	20.5	13.7	13.2	14.3	14.3	14.3
ROE (%)	19.5	20.0	13.0	9.6	11.0	12.0
Capex/sales (%)	4.9	3.0	2.7	2.5	2.3	2.1
Capex/depreciation (x)	2.1	1.3	1.4	1.4	1.3	1.2
Net debt/equity (%)	16.0	9.6	1.0	1.1	-4.7	-10.6
Net interest cover (x)	8.3	8.9	6.5	10.1	14.4	17.3

Source: Company data, Deutsche Bank estimates

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Earnings review

FY15 earnings review

Huayi Brothers reported 2015 net profit of RMB976m, a yoy increase of 9%. Core net profit, excluding non-recurring items but including government subsidies, decreased 10% yoy to RMB574m, because of EBIT margin contraction and increase in finance expenses.

Strong revenue increase thanks to Huayi's core business

Revenue increased 62% yoy to RMB3.9bn, driven by strong performance of Huayi's core entertainment business which contributed 73% of the overall revenue in 2015.

- Revenue from traditional entertainment (including movies, TV drama, talent agency and cinema operation) grew strongly by 136% yoy to RMB2.8bn, which is attributable to strong box office performance of four movies and the consolidation of Dongyang Haohan and Dongyang Meila.
 - Huayi Brothers released 16 movies in 2015, including "Mojin – The Lost Legend" (box office RMB1.4bn in 2015), "Dragon Blade" (box office RMB744m), "Mr. Six" (box office RMB469m in 2015), and "Running Man" (box office RMB434m.) Total box office of the 16 movies reached RMB4.3bn in 2015.
 - In the downstream cinema operation, Huayi Brothers had 15 cinemas under operation as of 2015. Cinema operation should have benefited from China's overall box office growth.
- Revenue from brand licensing & location-based entertainment decreased 76% yoy to RMB56m from the high-base of RMB234m in 2014, as only two new projects were signed in 2015. As of 2015, Huayi Brothers had signed 13 projects.
- Revenue from internet gaming increased 11% yoy to RMB861m.

Margin contraction and finance cost led to a decline in bottom line

Gross margin declined 11ppts yoy to 50% in 2015, compared to 61% in 2014 and 50% in 2013. The contraction is due mainly to an unfavorable change in the product mix – revenue contribution from high-margin businesses – brand licensing (100% gross margin) and online entertainment (80% gross margin) – decreased to 23% in 2015 from 43% in 2014.

As gross margin contraction trickled down, EBIT margin decreased 13ppts yoy to 24% in 2015.

In 2015, Huayi Brothers' debt borrowing almost doubled to RMB1.5bn from RMB830m in 2014. As a result, finance expense increased 44% yoy to RMB142m, which negatively impacted the company's bottom line performance.



Figure 1: 2015 movie lists

	Film	电影	Release date	Box office (RMBm)
1	Love on the Cloud	微爱之渐入佳境	24-Dec-14	141.03
2	Kung Fu Hustle	功夫 3D	15-Jan-15	25.59
3	Running Man	奔跑吧兄弟	30-Jan-15	434.27
4	Dragon Blade	天将雄师	19-Feb-15	744.10
5	The Wonderful Wedding	大囍临门	05-Mar-15	7.76
6	Lost and Love	失孤	20-Mar-15	216.15
7	The Ark of Mr.Chow	少年班	19-Jun-15	50.68
8	Forever Young	栀子花开	10-Jul-15	379.00
9	Only You	命中注定	24-Jul-15	67.93
10	The Crossing: Part 2	太平轮·彼岸	30-Jul-15	51.04
11	Tale of Three Cities	三城记	27-Aug-15	12.24
12	Ulterior Motive	别有动机	17-Sep-15	11.88
13	Ex-Files 2	前任 2 : 备胎反击战	06-Nov-15	252.00
14	Bad Guys Always Die	坏蛋必须死	27-Nov-15	46.99
15	The Mojin - The Lost Legend	寻龙诀	18-Dec-15	1,373.36
16	Mr. Six	老炮儿	24-Dec-15	468.94

Source: Deutsche Bank, Company data

Note: Box office of Love on the cloud, The Mojin and Mr.Six is only for 2015

Figure 2: Huayi Brothers – 2015 earnings review

RMB m	2014	2015	yoy %	Our estimates	Diff.
Revenue	2,389	3,874	62%	3,389	14%
Gross profit	1,455	1,948	34%	2,030	-4%
SG&A	(573)	(1,026)	79%	(884)	16%
EBITDA	937	995	6%	1,226	-19%
EBIT	882	922	5%	1,146	-20%
Pre-tax profit	1,279	1,496	17%	1,791	-16%
Net profit	897	976	9%	1,202	-19%
Core net profit	639	574	-10%	776	-26%

Source: Deutsche Bank estimates, Company data

Note: Core net profit excluding non-recurring items



Outlook and forecast changes

Huayi Brothers' fifth "H Plan"

On 20 March 2016, Huayi Brothers announced its fifth H Plan – "No Brothers, No Huayi", and released the movie pipelines for 2016 and 2017.

International partnerships

- Huayi has formed a strategic alliance with Korean movie producer Showbox, and plans to produce six or more movies together over the next three years.
- Huayi and STX entertainment signed a three-year cooperation agreement in 2015, and aims to release no fewer than 18 movies by the end of 2017.

New business subsidiary for animation production

On 14 March 2016, Huayi established a wholly owned subsidiary, Wink Animation (点睛动画), to focus on developing high-quality animation and special-effect movies.

- Joe Aguilar, previously the producer of DreamWorks and 20th Century Fox, is appointed as the CEO of the company.
- Markus Manninen, known for his work on "Kung Fu Panda", is appointed as the Artistic Director.
- The company intends to produce four animations each year, and the first animation movie is expected to be released in 2017.

Investment in HB Entertainment

China Jiu hao Health Industry Corporation (0419.HK, NR, CP HKD1.00) announced that it is investing KRW42bn (RMB230m) in Korea-based HB Entertainment for 70,000 shares in the company. HB Entertainment is famous for its TV drama production – "You who came from the stars" (来自星星的你). After the investment, Huayi Brothers will indirectly hold 5.5% stake in HB Entertainment.

Movie pipeline

Huayi Brothers also announced the movie pipelines for 2016 and 2017.

- Mr. Feng Xiaogang's "I'm not Pan Jinlian" (我不是潘金莲), which features Ms. Fan Bingbing, is expected to be released during the 2016 National Day holiday season.
- Mr. Feng's Dongyang Meila plans to produce movies including "Cell Phone 2" (手机 2), "Marriage Test Room" (婚姻实验室) and "Remembered" (念念不忘).
- Jackie Chen's "Kungfu Yoga" (功夫瑜伽) and "The Foreigner" (龙震天下) are expected to be released in 2017.



Figure 3: 2016/17 H Films projects

	Film	电影
2016		
January	Mr. Six	老炮儿
February	Run for Love	奔爱
April	The Boy	灵偶契约
April	New York New York	纽约纽约
May	The Nice Guys	The Nice Guys
June	Warcraft	魔兽
July	Beautiful Accident	美好的意外
July	Rock Dog	摇滚藏獒
Summer Holiday	The Wasted Times	罗曼蒂克消亡史
National Day	I'm not Pan Jinlian	我不是潘金莲
2017		
Spring Holiday	Kungfu Yoga	功夫瑜伽
NA	Lawyer and Killer	律师与杀手
NA	Xiao Ye	小爷
NA	Gaming Hero	电竞英雄
NA	Ex-Files 3	前任 3
NA	Blazing Samurai	刀锋剑客
NA	Tian Lingling	天灵灵系列
NA	Eight Hundred Revelation	八百启示录
NA	Death Cycle	死亡循环
NA	The Foreigner	龙震天下
NA	Thunderbolts	雷霆特工
NA	Detective Dee and Four Heavenly Kings	狄仁杰之四大天王

Source: Deutsche Bank, Company data

1Q16 guidance

Management guides to a 0-20% yoy increase in 1Q16 net profit to RMB244m-RMB293m. Core net profit may decline in 1Q16, due to the fewer number of movies released in 1Q16 compared to 1Q15, and the decline in the TV drama business.

2016/17 forecast changes

We revise down our earnings estimates by 11% to RMB0.71 in 2016 and 12% to RMB0.89 in 2017, for lower-than-expected growth in brand licensing and internet gaming, as well as the increase in finance expenses.

We increase our revenue estimate by 14% to RMB5.0bn in 2016 and 12% to RMB6.3bn in 2017, on the movie pipelines.

We cut our EBIT margin expectation by 7ppts to 27% in 2016 and by 6ppts to 28% in 2017, as we lower our forecasts on the high-margin brand licensing business, as we do not expect the business to experience another significant growth leg, as it did in 2014.

As a result, we revise down EBIT estimates by 9% to RMB1.4bn in 2016 and RMB1.7bn in 2017.



Figure 4: Huayi Brothers – our 2016/17 forecast changes

RMB m	Old		New		Difference	
	2016E	2017E	2016E	2017E	2016E	2017E
Revenue	4,439	5,669	5,038	6,341	14%	12%
Gross profit	2,664	3,402	2,647	3,356	-1%	-1%
SG&A	(1,158)	(1,478)	(1,277)	(1,607)	10%	9%
EBITDA	1,608	2,048	1,461	1,860	-9%	-9%
EBIT	1,506	1,923	1,370	1,749	-9%	-9%
Pre-tax profit	1,681	2,130	1,550	1,946	-8%	-9%
Net profit	1,114	1,413	991	1,244	-11%	-12%
Core net profit	1,114	1,413	991	1,244	-11%	-12%
EPS (RMB)	0.80	1.02	0.71	0.89	-11%	-12%
Core EPS (RMB)	0.80	1.02	0.71	0.89	-11%	-12%

Source: Deutsche Bank estimates



Valuation and risks

Lowering our target price to RMB35

We derive our new target price of RMB35 on DCF-based valuation, down from our previous RMB40. Our key assumptions remain unchanged (8.5% WACC and 3% terminal growth rate).

Figure 5: Huayi Brothers – our key DCF assumptions

Our assumptions

Equity as % of capital structure	70%
Beta	1.1
Risk-free rate	3.9%
Equity risk premium	5.6%
Cost of equity	10.2%
Debt as % of capital structure	30%
Cost of debt	6.0%
Tax rate (for discount rate calculation)	25%
Terminal growth rate	4.0%
WACC	8.5%

Source: Deutsche Bank

Figure 6: Huayi Brothers – our DCF analysis

RMB m	Share Value
Discounted FCF	50,694
Discount Rate	8.5%
Net Cash	127
Minority Interest	(2,386)
Equity Value	48,181
Shares Outstanding (m)	1,392
Value per Share (RMB)	35

Source: Deutsche Bank

Risks

Downside risks

- Removal of favorable tax policies and/or government subsidies.
- Intensified competition from small studios.
- Lower-than-expected return from films.
- Delay in production.

Upside risks

- Higher-than-expected box office.



Appendix 1

Important Disclosures

Additional information available upon request

Disclosure checklist

Company	Ticker	Recent price*	Disclosure
Huayi Brothers	300027.SZ	28.18 (CNY) 24 Mar 16	NA

*Prices are current as of the end of the previous trading session unless otherwise indicated and are sourced from local exchanges via Reuters, Bloomberg and other vendors. Other information is sourced from Deutsche Bank, subject companies, and other sources. For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at <http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr>.

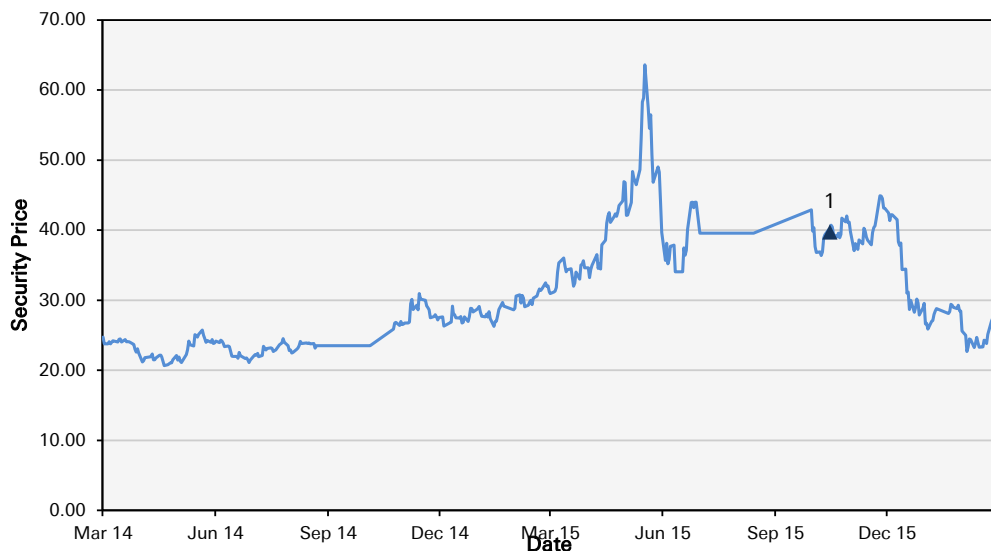
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Analyst Certification

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Historical recommendations and target price: Huayi Brothers (300027.SZ)

(as of 3/24/2016)



Previous Recommendations

- Strong Buy
- Buy
- Market Perform
- Underperform
- Not Rated
- Suspended Rating

Current Recommendations

- Buy
- Hold
- Sell
- Not Rated
- Suspended Rating

*New Recommendation Structure as of September 9, 2002

1. 10/11/2015: Upgrade to Hold, Target Price Change CNY40.00



Equity rating key

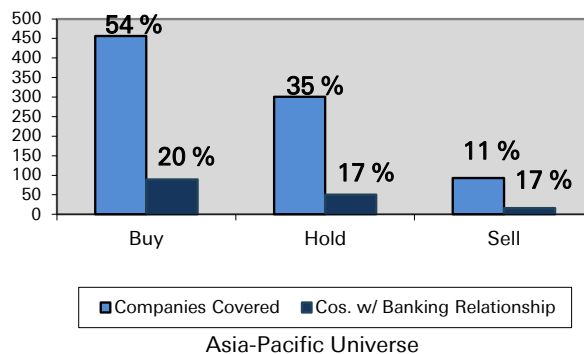
Buy: Based on a current 12-month view of total share-holder return (TSR = percentage change in share price from current price to projected target price plus projected dividend yield), we recommend that investors buy the stock.

Sell: Based on a current 12-month view of total share-holder return, we recommend that investors sell the stock

Hold: We take a neutral view on the stock 12-months out and, based on this time horizon, do not recommend either a Buy or Sell.

Newly issued research recommendations and target prices supersede previously published research.

Equity rating dispersion and banking relationships



Regulatory Disclosures

1. Important Additional Conflict Disclosures

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