

COMPANY NEWS

CHINA ANIMATION CHARACTERS COMPANY LIMITED 1566.HK; HK\$3.43; NOT RATED] -

Key takeaways from management presentation regarding the acquisition of a majority stake in Sega Live Creation

Market Cap: US\$386m; Free Float: 44.3%; 3-month Average Daily Turnover: US\$0.7m

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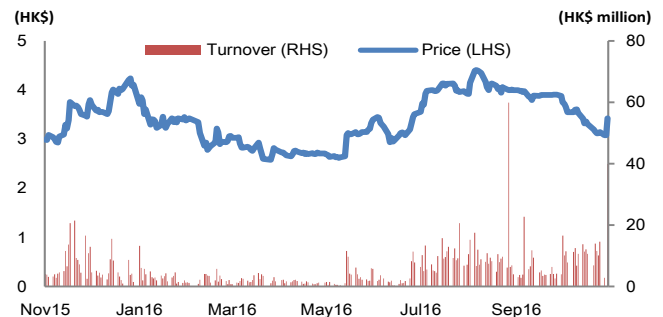
The Company. China Animation Characters Company Limited (China Animation) is involved in multi-line businesses in animation and related industries, with the primary focus on the trading of animation derivative products (mainly toys) and sourcing these products for toy companies and theme parks in Japan. The Company is also involved in the indoor animation amusement park business in China. China Animation was listed on the HKEX in Mar 2015, offering 107.3m shares at HK\$3.65 per share. China Animation aims to build a multimedia animation business in China and in this connection, it has been actively expanding its business in the past two years, including opening Shanghai JOYPOLIS, licensing proprietary animation characters and developing a multimedia animation entertainment business featuring the proprietary animation characters of the Company. China Animation issued 15m shares at HK\$3.60 per share in Sept 2016.

Acquisition of SEGA LIVE CREATIVE. China Animation announced that its wholly owned subsidiary China Theme Park Ltd. (CTP) entered into a share purchase agreement with Sega Sammy Holdings Inc. (SEGA SAMMY) [6460.JP] on 31 Oct 2016. CTP agreed to conditionally acquire 85.1% of the shares in issue of Sega Live Creation Inc. (SLC) from SEGA SAMMY. SLC was established by SEGA SAMMY through an incorporation-type split of part of the entertainment park business of SEGA CORPORATION (currently SEGA Games Co., Ltd.) on 1 Apr 2015, and has conducted the development and operation of indoor theme parks, such as "JOYPOLIS" and "Orbi." SEGA SAMMY decided to dispose of its majority stake in SLC as part of SEGA SAMMY's restructuring plan to enhance its financial structure and improve the turnover ratio of capital. The Orbi business will be split from SLC and transferred to the SEGA Group. According to China Animation management, the Orbi business is loss-making and does not fit into development of China Animation, so the Orbi business is excluded from this transaction. Apart from the JOYPOLIS business, the intellectual property (IP), such as Supersonic, patents, technology and R&D, and the manufacturing centre will be included in the transaction.

Upon completion, China Animation will own 85.1% of SLC and SEGA SAMMY will own the remaining 14.9%. The consideration for the acquisition is JPY600m (equivalent to HK\$44.51m) payable by CTP to SEGA SAMMY on the date of completion. The consideration was determined after arm's length negotiations between CTP and SEGA SAMMY. Upon completion of the acquisition, China Animation will be able to broaden its participation in operating indoor amusement parks in additional cities on a global basis: Tokyo and Osaka, in Japan; Dubai, in the United Arab Emirates; and Qingdao, in China. According to the announcement, SLC reported a net loss of JPY704.7m and JPY780.0m in FY15 and FY16 (FY end-Mar 31), respectively. The transaction is expected to be completed by end-Dec 2016.

Not a drag on operating performance. According to China Animation management, SLC reported a net loss in FY15 and FY16, which was mainly due to (a) high non-cash costs, especially depreciation charges, and (b) a cost-sharing arrangement with SEGA SAMMY. SEGA SAMMY announced it will report a loss of JPY1.4bn from the disposal of its stake in SLC upon completion of the transaction. The major portion of the disposal loss reported by SEGA SAMMY is related to provisions made for assets. Therefore, the non-cash costs of SLC will be reduced substantially going forward. After the disposal, SLC doesn't have to share the costs of SEGA SAMMY. China Animation management said that therefore the acquisition of the majority stake in SLC will not have a major negative impact on China Animation. According to China Animation management, the acquisition cost of JPY600m (HK\$44.51m) implies mid-single digit PER based on estimated net profit in FY17 provided by SEGA SAMMY. According to China Animation management, JOYPOLIS in Tokyo reported turnover of JPY2.2bn and net profit of JPY220m in FY16. SEGA SAMMY will continue its efforts to enter the Integrated Resort (IR) business (Phoenix Seagaia in Japan and Paradise City in Incheon, South Korea) and invest its management resources in various resort businesses. SLC will supply equipment and machines to the IR businesses operated by SEGA SAMMY going forward.

[China Animation Characters Company Limited]



Key Financials (in HKD m) (YE Mar)	FY13	FY14	FY15	FY16
Revenue	283.5	338.7	488.3	544.9
Gross Profit	126.4	165.5	186.9	168.1
Gross Margin %	44.6	48.8	38.3	30.9
Net Profit	85.2	130.6	75.6	110.4
Net Margin %	30.1	38.6	15.5	20.3
EPS (Basic)	0.14	0.22	0.12	0.13
ROE (%)	235.0	215.7	23.5	18.0
Dividend Yield (%)	-	-	-	0.29
PER (x)	24.50	15.59	28.58	26.38
PBR (x)	n.a.	n.a.	5.27	4.39

Source: Bloomberg, Company Data

Expansion in China. SLC will be renamed CA SEGA JOYPOLIS LTD. after completion of transaction. The Company will expand coverage of JOYPOLIS in China by adopting the asset-light model. China Animation is now in discussions with property developers in China. The property developer will pay an upfront licensing fee of about HK\$25m per project and will take a 49% stake in the JOYPOLIS project through the contribution of property. China Animation will form a consortium with other investors to contribute the remaining 51% of capital. China Animation will also charge a percentage of turnover as a licensing fee. China Animation will share the net profit if the JOYPOLIS project hits the pre-agreed KPIs. China Animation is now in discussions with property developers in Shenzhen, Changzhou and Zhuhai (Hengqin Island) to open JOYPOLIS indoor theme parks.

VR Potential. China Animation highlighted that the Company, through the relationship between SLC and Zero Latency PTY LTD, will promote a multi-player VR game, *Zombie Survival*. This is a specially tweaked version developed by Zero Latency PTY LTD. for the format in Joypolis. *Zombie Survival* is playable by up to six gamers at once, and is the first roll-out to the public. It is also the first permanent installation for Zero Latency PTY LTD. According to China Animation, the players have to pre-book *Zombie Survival* at least one month in advance to reserve positions, and they have to pay onsite.

Our view. The acquisition of SLC is in line with China Animation's strategy of searching for industry players as partners to develop new business in VR and indoor theme park-related fields. SEGA is fully committed to supporting China Animation in the development of JOYPOLIS, which will not drag down China Animation's operating performance. The shares of China Animation corrected recently which, in our view, was due to lack of news flow and a broad-based market correction. After the release of its FY17 interim results later this month and the release of further details on the acquisition of SLC, we expect China Animation to communicate more with the market regarding its latest business update, strategy and roadmap, which may attract market attention.

Catalysts. News flow on business development and partnerships with industry players.

Figure 1: Peer Comparisons

Ticker	Company	Price Lcy	Market Cap US\$m	PE			EV/EBITDA			PIB		ROE		ROA		Div yield		Share Price Performance			
				2016F	2017F	2018F	2016F	2017F	2018F	2015	2016F	2015	2016F	2015	2016F	2015	2016F	1M	3M	6M	12M
				x	x	x	x	x	x	x	x	%	%	%	%	%	%	%	%	%	%
547 HK	Digital Domain	0.62	999	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	7.8	n.a.	-33.2	n.a.	-17.1	n.a.	0.0	n.a.	1.6	19.2	-7.5	77.1
1566 HK	China Animation Characters	3.43	386	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	4.4	n.a.	18.0	n.a.	13.2	n.a.	0.3	n.a.	-12.3	-13.8	26.6	17.7
2382 HK	Sunny Optical	37.85	5,354	30.6	23.4	18.6	21.9	16.8	13.5	8.9	7.4	21.5	27.2	11.9	14.2	0.6	0.9	-1.2	22.5	57.7	113.8
732 HK	Truly International	3.02	1,132	9.7	8.4	7.1	5.5	5.1	4.4	1.2	1.1	11.9	11.8	4.0	5.5	3.3	3.3	-4.1	-32.1	-0.7	65.0
777 HK	Neltron Websoft	24.80	1,590	n.a.	105.5	51.5	493.8	39.1	21.7	2.6	2.7	-3.2	-0.3	-3.2	0.0	0.8	0.9	-8.0	-2.9	2.5	17.5
700 HK	Tencent	204.40	249,513	37.6	28.8	22.7	26.3	20.4	16.7	11.9	10.7	28.8	30.9	10.6	13.3	0.2	0.3	-4.0	10.8	28.6	38.6
8311 HK	Perfect Optronics Ltd	0.78	149	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	4.3	n.a.	11.0	n.a.	7.9	n.a.	0.6	n.a.	-16.1	-20.4	-30.4	-40.9
000829 CH	Telling Telecommunication-A	11.28	1,600	36.6	25.8	20.3	27.8	19.2	16.3	5.1	4.6	-10.9	11.9	-0.2	n.a.	0.0	n.a.	0.0	-12.9	-15.3	11.9
002189 CH	Lida Optical & Electronic -A	23.85	703	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	8.9	n.a.	3.1	n.a.	1.9	n.a.	n.a.	n.a.	-0.7	-4.6	-14.3	-4.6
002273 CH	Zhejiang Crystal-Optech -A	23.52	2,278	50.3	37.5	30.0	n.a.	n.a.	n.a.	5.5	4.5	7.3	9.0	6.7	8.3	n.a.	0.8	-4.8	3.8	14.8	56.8
002280 CH	Hangzhou Liaison Interact-A	18.01	5,799	80.0	54.6	31.1	65.6	45.4	n.a.	6.5	27.7	32.0	33.3	9.1	21.7	n.a.	0.3	-8.6	-8.6	-8.6	2.6
300431 CH	Beijing Baofeng Technology-A	58.14	2,380	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	24.9	n.a.	37.4	n.a.	19.2	n.a.	0.0	n.a.	-3.2	-1.3	-18.5	-39.3
000793 CH	Huawen Media Investment -A	11.70	3,491	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2.5	n.a.	10.6	n.a.	8.1	n.a.	n.a.	n.a.	10.6	22.9	27.9	7.3
300113 CH	Hangzhou Shunwang Tech-A	33.10	3,356	37.4	28.8	26.8	35.2	26.7	19.2	9.7	12.1	23.0	30.6	20.3	21.0	n.a.	0.4	-1.8	-3.7	-15.8	54.8
002751 CH	Shenzhen Esun Display Co L-A	56.76	1,179	276.9	236.5	283.8	121.5	113.5	107.9	18.3	17.7	11.5	3.2	3.7	n.a.	0.1	n.a.	6.7	7.3	-21.2	-3.6
300079 CH	Sumavision Technologies Co-A	8.04	1,638	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	3.3	n.a.	7.2	n.a.	5.8	n.a.	n.a.	n.a.	0.9	-1.3	-8.6	-18.0
002253 CH	Wisesoft Co Ltd -A	29.77	993	139.8	99.2	76.3	n.a.	n.a.	n.a.	5.3	4.8	3.2	3.7	2.7	n.a.	n.a.	n.a.	-4.4	-10.5	-15.7	22.9
300458 CH	All Winner Technology Co L-A	98.86	2,436	66.1	45.8	34.7	n.a.	n.a.	n.a.	10.3	9.1	10.1	15.3	8.6	14.6	0.2	0.2	23.5	13.8	39.0	8.9
002241 CH	Goertek Inc -A	30.70	6,932	28.3	21.8	19.3	17.9	14.1	12.5	4.6	4.3	14.1	16.1	6.7	8.3	n.a.	0.4	1.6	20.3	7.1	23.6
002036 CH	Lianchuang Electronic Tech-A	24.76	2,132	55.0	35.9	25.1	n.a.	n.a.	n.a.	9.4	8.7	14.8	15.6	7.7	8.6	n.a.	0.2	-6.7	29.9	21.8	41.3
	HSI Index																	-2.1	3.1	8.3	2.0
	HSCEI Index																	-0.6	4.3	6.5	-7.0
	SHCOMP Index																	3.3	4.4	5.6	-6.7

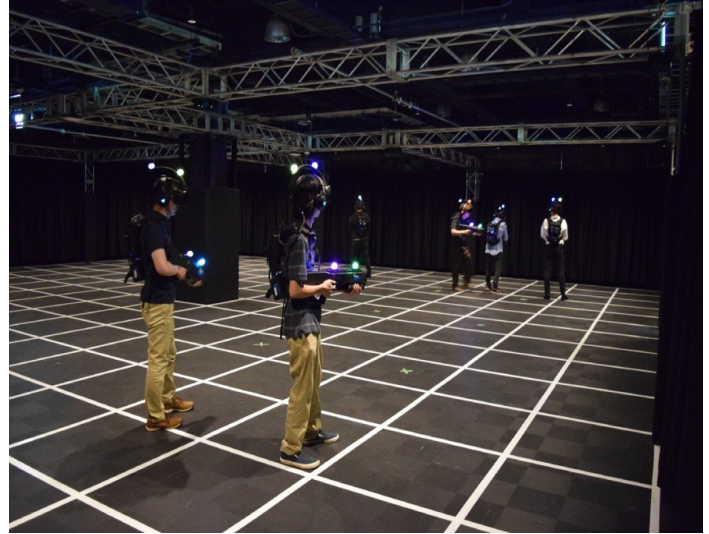
Source: Bloomberg

Figure 2: Zombie Survival by Zero Latency PTY LTD



Source: jpkedaibiao.com, CGIS Research

Figure 3: Virtual Artist Violet Game in JOYPOLIS Shanghai



Source: jpkedaibiao.com, CGIS Research

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