

Clear Media 100

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by

gvinvesting

			2013	2014
Price:	5.75	EPS	\$0.41	\$0.41
Shares Out. (in M):	529	P/E	14.0x	14.2x
Market Cap (in \$M):	392	P/FCF	9.7x	11.0x
Net Debt (in \$M):	-166	EBIT	43	41
TEV (\$):	226	TEV/EBIT	5.3x	5.0x

Description

Quick Summary: Clear Media (100:HK) is a HK-listed majority-owned subsidiary of Clear Channel Outdoor (CCO:US) that operates the largest bus shelter advertising network in mainland China. The Company is well positioned to be a beneficiary of long-term consumption and advertising growth in China. Despite the 40% run-up in the share price over the past three months on the back of record financial results and an increased dividend payout, the shares are still reasonably priced at less than 6x EV/FCF for a high quality business consistently growing revenues at rates in the low teens. The Company currently has over 40% of its market cap in net cash, providing significant downside protection.

Wait a second, not another Chinese outdoor advertising fraud!

It's true; this space in particular has been plagued with poor corporate governance and outright fraudulent activity, which has been well documented on VIC and in the major financial press, and this is undoubtedly weighing on the share price. Before we go further into analyzing the business, we should first address why we believe Clear Media does not deserve to be tarred with the same brush as the troubled FMCN and confirmed fraud CCME.

- Clear Media is a legal Wholly-Owned Foreign Enterprise, with no Variable Interest Entity in the corporate structure, and as such shareholders have direct legal ownership in the assets of the operating subsidiary in China.
- Apart from Clear Channel's initial acquisition of the bus shelter business and subsequent capital injection into the White Horse Advertising Joint Venture (operating subsidiary in China) in 1998, growth has been entirely organic. There have been no dilutive capital raises over the Company's 11 year public history, and the Company recently increased the dividend payout to 36% of net income with the stated intention of growing the dividend over time.
- Clear Channel has executive representation on the board of directors, setting the Company apart from the rest of the space in terms of corporate governance. The new Executive Chairman, Mark Thewlis, was formerly the Director of Finance for Clear Channel

International and previously represented Clear Channel on the board of directors. The original founders are also still on the board of directors. One of the founders is currently the CEO and is still involved with day-to-day operations in Guangzhou. If there was a problem with the accounts, it's highly likely that Clear Channel would have discovered it by now.

A Decade of Growth

Clear Media's bus shelter business was originally founded by two brothers in Guangzhou in order to complement an advertising agency, which they also founded (One of the brothers, Han Zi Dian, still manages this agency). Realizing the importance of a first mover advantage and the capex-intensive nature of the business, the brothers went looking for investors and were introduced to Clear Channel, which pumped in cash and became the largest shareholder in 1998.

Clear Media operates bus shelters on long-term contracts with various municipalities in Mainland China. The Company does not actually own the physical shelter, only the right to advertise on that shelter over a given period of time. During this time, the Company is responsible for maintenance, including cleaning, repairs, and lighting. Contracts typically last 10-15 years, and are typically secured with an upfront lump sum followed by a fixed annual rent per shelter. Over the life of the contract, Clear Media will work with the municipality to construct new shelters as the municipality grows and adds new bus routes. In the past, the local governments have typically been willing to renew contracts 2-3 years prior to expiry so that Clear Media will continue to build shelters.

Over the past decade, the Company has grown its network from 15,000 to 37,000 shelters in 28 cities, which puts it well ahead of its nearest competitor (P.E.-run Long Fan with 8,000 shelters). This allows the Company to benefit from economies of scale both in the form of lower operating costs and a more attractive offering to customers that demand national coverage for advertising campaigns. As a result, the Company claims to generate as much as 50% more revenue per shelter than its competitors at attractive margins. This enables the Company to outbid competitors on new concessions and creates the possibility for value-adding acquisitions.

Recent Developments

In recent years, the Company has generated significant free cash flow while continuing to grow its bus shelter revenues at low-teen annual rates. Capex/Revenue has dropped as panel growth has slowed in conjunction with an increasing average selling price (ASP) and relatively stable utilization rates. There are two key factors that have to be taken into account when analyzing the Company's financial performance over the last five years:

- Shenzhen Bus Body Business – This non-core concession was acquired in 2007 and disposed at the end of 2011. The business never achieved the necessary scale to become profitable, and as a result the consolidated financials mask the true profitability of the core

bus shelter business. From 2007 to 2011, the bus body business generated average annual revenue of HK\$86m and roughly broke even over that time frame.

- Shanghai World Expo Format Change – In preparation for the 2010 World Expo, the Shanghai government requested that approximately 2,900 old shelters be removed and replaced with a newly designed format. The Company had to take a one-off noncash charge, which adversely affected reported EBITDA and earnings.

As a result of the growing free cash flow generation, a significant amount of cash has been piling up on the balance sheet. The Board has taken the first steps towards returning this excess cash to shareholders by initiating a dividend in 2011 and increasing the payout to 36% of net income for 2012.

Future Prospects

While we have long been wary of the impact of the internet on traditional media advertising revenues, we believe that outdoor advertising is relatively sheltered from this trend, as it provides one of the few remaining opportunities for mass brand marketing. Clear Media's shelter network is one of the only mediums available to advertisers who wish to run a national campaign in China (Coke or P&G). Clear Media appears to have significant room for growth in its existing network and through securing additional concessions via bids or acquisitions. Revenue growth will be driven by the following factors:

- Panel Growth – This factor will be driven by continued urbanization in municipalities where Clear Media already operates, as well as potential acquisitions of competitors or new concessions. Acquisitions have the potential to be quite accretive to earnings, as the Company is able to generate much higher revenue per panel than its smaller competitors. Mark Thewlis recently stated in the annual results presentation that the Board feels the market is ready for consolidation.
- Utilization Rates – In developed markets, utilization rates normally run at 75-85%. There is significant room for improvement in Clear Media's overall utilization rate of 59%. The lower rate is mainly a function of the physical growth of Chinese cities and the Company securing concessions when they become available ahead of demand. The utilization rate is only 50% in Shanghai due to the Expo format change, but this number is now improving. In certain Tier-2 cities where the shelter networks are not growing as fast, utilization rates have approached 90%. Any improvement in utilization will result in increased profit margins, as the Company's cost base is largely fixed.
- Average Selling Price – The Company was able to increase ASP by 14% in 2012 and has increased ASP by an average compound rate of 6.9% over the past five years. The Company is planning another increase in ASP by 5-8% in 2013.
- Digitization – One of the reasons Mark Thewlis was recently appointed as the Executive

Chairman is that he has personal experience building a digital bus shelter network in Singapore. This network consists of 30 high-traffic, premium locations and was able to attract premium advertisers that would not normally advertise on bus shelters, such as luxury brands. The payback period is slightly shorter than a traditional shelter, and a digital shelter can generate four to five times more revenue than a traditional shelter. Capex requirements are significantly higher than traditional shelters, but the technology costs are constantly dropping and the initial rollout will be relatively small. Although we have yet to see the economics of digital in China proven, we take some comfort in the fact that the Company can apply lessons learned in other markets and has historically been a good steward of capital.

Risks

Clearly, the main risk here is that all operations are located in Mainland China, which is cause for a number of concerns:

- Weak rule of law and corruption could adversely affect Clear Media's ability to bid on and renew concessions. The worst outcome would be the loss of a major concession in one of the Tier 1 cities, which would hit revenues significantly. The three biggest cities account for 56% of total revenues. On average, these concessions do not come up for renewal for another 6 years. We do not see this as a likely outcome, given Clear Media's scale advantage over local operators and good working relationship with the local government authorities.
- Economic hard landing results in a significant drop in advertising spending. For now, China appears to be avoiding the hard landing scenario, but we would not rule out the possibility. In 2009, the Company did record a drop in revenues; however, this was partly due to the Shanghai Expo format change. The Company continued to generate satisfactory free cash flow during the downturn. The large contribution from less cyclical sectors such as Food & Beverage and Telecom should also mitigate revenue declines in the event of a prolonged recession.
- Poor capital allocation. There is a risk that the Company will overpay for acquisitions. In the past, the capex committee has maintained a 15% DCF threshold for any major expenditure.
- Fraudulent accounts. All cash is held in RMB in Chinese banks. We are told that the cash balances are regularly checked at the regional branch level (the smoking gun for CCME). The controlling shareholder, Clear Channel, implements regular training programs to strengthen internal controls.

Model and Valuation

As the core shelter business now accounts for 100% of Clear Media's revenues, I have adjusted

the last five years of financials to reflect this change. I have also added back the one-time charge for the Shanghai Expo format change. The following model presents the normalized financial results for the core bus shelter network:

(HK mil)	2008	2009	2010	2011	2012	Avg.
Revenue	1,147	1,034	1,173	1,361	1,522	
Rev. Growth	26%	-9.9%	13.4%	16%	11.8%	10.8%
EBITDA	469	380	460	547	619	
EBITDA Margin	40.9%	36.8%	39.2%	40.2%	40.7%	39.5%
Net Income	180	97	151	185	219	
Net Margin	15.7%	9.4%	12.9%	13.6%	14.4%	13.2%
FCF	148	160	235	303	343	
Net Cash	266	471	706	1,018	1,289	

The following table shows the underlying panel growth, ASP and utilization rates:

(HKD)	2008	2009	2010	2011	2012	Average
Avg. Panels	29,296	30,143	29,443	30,400	33,300	
Panel Growth	9%	2.9%	-2.3%	3.3%	9.5%	4.4%
Rev/Panel	39,152	34,303	39,839	44,769	45,705	
Utilization	59%	57%	61%	66%	59%	60%
ASP	66,359	60,181	65,311	67,833	77,467	
ASP Growth	19.5%	-9.3%	8.5%	3.9%	14.2%	6.9%

Assuming below-average panel growth of 4%, ASP growth of 5%, and a flat utilization rate of 59%, revenue growth will average 9.2% annually.

	2013	2014	2015	2016	2017
Revenue	1,662	1,815	1,982	2,164	2,363

EBITDA	665	726	793	866	945
EBIT	316	345	377	411	449
Net Income	216	236	258	281	307
Capex	288	302	317	333	350
FCF	277	315	357	403	454
Dividend	86	106	129	155	169
Net Cash	1,487	1,716	1,966	2,240	2,539

This model will result in the following forward valuations, based on the current stock price of HK\$5.75:

	2013	2014	2015	2016	2017
P/E	14.1	12.9	11.8	10.8	9.9
P/FCF	11	9.6	8.5	7.5	6.7
EV/FCF	5.6	4.2	3	2	1.1
EV/EBITDA	2.4	1.9	1.4	1.0	0.6
EV/EBIT	5.0	3.9	2.9	2.0	1.2
Div. Yield	2.8%	3.5%	4.2%	5.1%	5.6%

Despite strong financial performance and growth potential, Clear Media is trading at a significant discount to its listed peers:

	Market Cap	Net Debt (Cash)	P/FCF	EV/FCF	EV/EBITDA	EV/EBIT
JC Decaux (EUR)	4.6 bil	213 mil	17.4x	18.2x	8.4x	14.6x
Clear Channel Outdoor (USD)	2.7 bil	4.4 bil	33.7x	88.5x	10.1x	23.3x
Stroer (EUR)	358 mil	340 mil	15.6x	30.3x	5.4x	21.8x
Lamar (USD)	4.2 bil	2.0 bil	15.9x	23.6x	12.2x	29.0x
Avg ex-CM			20.6x	40.1x	9.0x	22.2x

<i>Clear Media (HKD)</i>	<i>3.0 bil</i>	<i>(1.3 bil)</i>	<i>9.6x</i>	<i>5.5x</i>	<i>2.8x</i>	<i>5.2x</i>
Avg w/CM			18.4x	33.2x	7.8x	18.8x

If we assume an exit valuation of 10x EV/FCF (about 5x EV/EBITDA) at some point within 5 years, we get the following annualized returns:

(HK mil)	2013	2014	2015	2016	2017
IV (Cash+Div+ 10xFCF)	4,347	5,058	5,854	6,744	7,723
IV/Share	8.16	9.49	10.98	12.65	14.49
IRR	43%	29%	25%	23%	21%

The efficient use of excess cash for acquisitions, digital panels, or share repurchases could generate additional upside to our model.

I do not hold a position of employment, directorship, or consultancy with the issuer.

I and/or others I advise hold a material investment in the issuer's securities.

Catalyst

Continued revenue growth in core bus shelter business, driven by higher utilization, ASP and panel growth as the Chinese economy rebalances towards domestic consumption

Cash flow generation that will exceed the current enterprise value within five years

Increased dividend (Possibly due to the heavily indebted parent company's capital needs)

Accretive acquisition

Successful execution of digital strategy

Messages

Subject Where is cash? Trading vols?
Entry 03/02/2013 03:06 PM
Member nha855

CCO has lent most of its cash to Clear Channel and it may get wiped out if the parent files for bankruptcy. Is the same true here? If clear channel goes bankrupt willl Clear Media essentially just have an unsecured claim?

Also, what's the average volume traded here?

Subject RE: Where is cash? Trading vols?
Entry 03/03/2013 09:56 PM
Member gvinvesting

The cash is all RMB and is held in several Chinese banks. There are no loans to the parent. I think the only way we will see CCO get their hands on this cash is through dividend payments.

I'm not sure what you're talking about regarding CCO loaning cash to it's parent... just looking at the balance sheet it appears that CCO has a significant amount of debt but no major shareholder loans or anything of that nature on the asset side.

Liquidity is an issue, as the float is being gradually locked up by International Value Advisors, who have accumulated 20% of the shares outstanding over the past several years. On some days it will trade very thin or not at all; on some days 3m shares will change hands. Average volume is about 400k shares. We have found that if you put a big buy order in you will eventually get filled. This is a long term holding for us, so we are willing to take the liquidity risk.

Subject New Chairman Interview
Entry 04/14/2013 09:55 AM
Member gvinvesting
http://www.thestandard.com.hk/news_detail.asp?we_cat=16&art_id=132608&sid=39416976&con_type=3&d_str=&fc=1

Subject RE: New Chairman Interview
Entry 04/15/2013 03:23 PM
Member briarwood988

GVinvesting, looks like this is their plan for their cash balance I wonder how extensive the digitalization program is going to be...

"I plan to digitalized our panels to create an interactive advertising medium. We should invest today in tomorrow's products."

A renovation plan is in the pipeline as its existing traditional panels are expected to be updated with LED screens. The firm also hopes digitalized products will attract more clients, including luxury retailers.

Subject contracts
Entry 04/17/2013 07:34 AM
Member Griffin
 tx for interesting idea

The company generates 56% of revenue with just 3 cities. What's the remaining life of these licenses and how confident are you that these licenses will be renewed?

Subject RE: RE: New Chairman Interview

Entry 04/18/2013 05:08 AM

Member gvinvesting

Our understanding is that digitization will be targeted at premium locations in order to attract high-end advertisers such as luxury brands that would not otherwise advertise on bus shelters. We are also encouraged by the fact that a digital display requires additional government approvals which should slow the rollout of digital panels.

One digital shelter costs RMB250,000 (vs. RMB70,000 for traditional), or about HKD314,000. The company is generating about HKD200m of FCF in excess of average capex (both maintenance and new traditional panels) and after regular dividend payments. This means that the company could build 600 digital shelters per year and not put a dent in the current cash balance. This seems high given that the rollout in Singapore was limited to 30 locations.

Furthermore, the company estimates that digital displays generate 5x the revenue of traditional panels and have a slightly faster payback. So hopefully, as the company slowly rolls out digitization, revenue and FCF will continue to ramp up as well. We are leaning towards a special dividend as a likely outcome, even as the company invests more in growth going forward.

Subject RE: contracts

Entry 04/18/2013 05:15 AM

Member gvinvesting

Good question. In subsequent discussions with the company, we discovered that within each city there are actually many contracts, which can be as small as 50-100 shelters. The contracts are auctioned off as cities expand their bus routes, so they are pretty well staggered.

We are told that the bulk of the BJ/SH/GZ contracts expire after 2020, with some as far out as 2024.

Subject RE: RE: contracts

Entry 04/18/2013 06:53 AM

Member Griffin

interesting, tx

any views on why the ROE for the company and the peers has been low for the last 5 and 10 years?

Subject RE: RE: RE: contracts

Entry 04/19/2013 12:58 AM

Member briarwood988

Gvinvesting can expand but one quick answer would be the large excess cash balance. If that was dividended out the ROE last few years would be much higher.

Subject RE: RE: RE: RE: contracts

Entry 04/19/2013 03:04 AM

Member gvinvesting

Yes, the net cash on the balance sheet is a big factor in this. If the Company took on about 1x EBITDA of net debt at 6% interest and paid out a HK1.9B special dividend, ROE would be about 13%. If they took on 2x EBITDA, the ROE would be

18%.

The other thing to think about is the nature of the business. For any given contract, you have large upfront capital outlays that are depreciated in a straight line over the life of the contract. the DA in EBITDA stays the same but earnings should increase over time with improvements in utilization and ASP. At the same time, the intangible asset on the balance sheet will gradually drop to zero. If you keep the cash off the balance sheet, ROE should rise over the life of the contract. Clear Media is a younger company than its larger peers, and it has built much of its network in the past decade, so this may be a factor as well.

Subject Special Dividend Announced

Entry 08/04/2013 10:50 PM

Member gvinvesting

http://www.clear-media.net/investor/statutory_publications/E%20Aug%201,%202013%20-%20Interim%20Results%20Announcement%20for%20the%20Six%20Months%20Ended%2030%20June%202013.pdf

Revenue up 9%, EBITDA up 8%, EBIT up 12%, HK\$1.32 per share special dividend announced.

This is an encouraging step towards aligning returns on shareholders equity with the business' above average returns on capital. The results are in line with our assumptions. While the stock is approaching our estimate of fair value, we think there is more long-term value here. The company's willingness to pay out a substantial special dividend should be a sign they will increase the regular payout ratio going forward.

Subject Update

Entry 11/05/2013 02:13 AM

Member gvinvesting

Clear Media is approaching our conservative price target for 2013 when adjusted for the special dividend, but is still only trading at 4x EV/EBITDA. Given the high quality of the business and a commitment to returning more cash to shareholders going forward, we think fair value is at least 8x EV/EBITDA, at the low end of its peer group. If the company were to change hands, Clear Channel Outdoor would probably not take anything less than 10x EBITDA, given their own valuation and debt covenants.

There is still 78% upside to 8x EV/EBITDA, and the business is still growing at double digit rates. 37% in 8 months is not too bad, but we are not closing this idea yet as we feel there is still a lot more upside left to come.

Subject fraud allegations earlier this year?

Entry 04/26/2018 11:42 AM

Member puppyeh

hi gvinvesting - are you still involved in this one? it has been quite a while and you may have moved on. was just wondering what you made of the fraud allegations and if you worry this is now another cautionary tale from this sector. thanks

Subject Re: fraud allegations earlier this year?

Entry 04/27/2018 06:31 AM

Member gvinvesting

Not involved since 2015 and was not following too closely before the halt. Had a good dialogue with the chairman then about capital allocation, sold in part because

he left but mainly because the stock had rerated nicely after the change in dividend policy.

This situation looks different from your average Chinese fraud.

I have no doubt that the business exists and is roughly the size they say it is, and that's not being contested from what I understand. The strongest piece of evidence we have are the special and regular dividends that have come out since 2012. Their physical presence in Beijing, Shanghai, and Guangzhou is undeniable. The financial models make sense and don't veer too far from global comps. The controlling shareholder is a Western corporate that has as much to lose as minority shareholders if it is a fraud... Unlike homegrown frauds where the founders are just in it for whatever they can raise in share offerings abroad. In simple cases of embezzlement that I have seen in small listed companies elsewhere (Korea, Taiwan), yes some of the cash may disappear but the earnings still remain.

My guess is that the reason they put the initial announcement out on January 2 is that they were trying to keep it out of the Annual Results for 2017, which makes you wonder how long they were actually sitting on the information. Not the most trustworthy move on mgmt's part, but perhaps they were in part trying to avoid the halt for shareholders. I have not talked to them about it, this is just speculation.

Clear Media mgmt always said they keep their cash balances at several different banks. This makes it more likely that this situation is contained to just the one incident, as the bank manager would likely have been colluding with the perpetrator to fake the cash balance.

I don't know how long this will take, but my sense is that there could be a good buying opportunity after it opens again if no other problems are found, which I think is the likely scenario. It may be tainted for a long time to come, but you could collect a good dividend yield while you wait. Also possible that this motivates the parent to take the subsidiary private? Maybe they take it private while it's halted?