

Hong Kong, the 12<sup>th</sup> of July 2013

Dear Sirs,

We would like to address the Board regarding the upcoming board meeting and decision on the interim dividend policy.

Clear Media's bus shelter advertising network has continually proven to be a resilient business through a wide range of economic conditions in China over the past decade, and we are quite pleased with the Company's strong financial results over the past several years. On the corporate front, we were also glad to see the meaningful dividend increase on the back of record earnings in 2012.

Our attendance at the Annual General Meeting and further discussions with members of the Board made it clear to us that the Company is actively considering a number of strategic options regarding capital allocation which can be summarized as follows:

- **Dividends:** The Company plans to pay a regular dividend going forward and is considering the possibilities of a special dividend and an increased payout ratio depending on the Company's capital requirements.
- **Share Repurchases:** Although the Company's shares are significantly undervalued, share repurchases would be difficult to implement at this stage due to the HKSE listing requirement to maintain a minimum free float of 25%.
- **New Investments:** The Board has been reviewing a number of investment opportunities that could offer attractive returns, including panel digitization, new concession bids, and potential M&A activity in what is still a very fragmented market.
- **Concessions Renewals:** Finally, the Company would like to maintain a strong balance sheet with the flexibility to renew expiring concessions.

While we certainly appreciate the importance of maintaining a strong balance sheet, we are also wary of the fact that allowing too much cash to accumulate in low interest bank deposits hurts return on equity and can ultimately damage shareholder value. Over the past five years, Clear Media's net cash balance has ballooned from less than HK\$200m in 2007 to approximately HK\$1.3B at the end of FY2012. This trend is set to continue due to ongoing improvements in the cash collection process, depreciation and amortization charges that exceed maintenance and growth capital expenditures, and a dividend payout ratio at only 36% of net income.

While returns on capital during the period were generally in the range of 10-12%, the excess cash on the balance sheet has dragged down returns on equity to an unacceptably low range of 6-7%. Shareholders will continue to suffer from subpar returns on equity unless the Company makes a concerted effort to deploy this excess cash through increased investment or distributions to shareholders.

In order to determine the appropriate amount of cash that the Company should hold on its balance sheet, we have analyzed the Company's potential financial commitments, which can be broken down as follows:

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- **Maintenance Capex:** HK\$50m/year on average which we expect to grow at a similar rate to the number of panels in the bus shelter network.
- **New Concessions/New Shelters:** The Company has put together an outstanding track record of generating consistently satisfactory returns from investments in this area. In recent years, annual expenditure on new concessions and new shelters has run between HK\$200m and HK\$250m. We commend the Board for their discipline and expect that further investment in this segment will continue to be limited to projects with satisfactory returns. Accordingly, the **annual expenditure on new concessions and new shelters going forward should not exceed HK\$250m.**
- **Concession Renewals:** When determining cash levels to be reserved for this purpose, it is important to consider the staggered nature of the Company's concessions, the growth in annual cash flow from new and existing concessions, the Company's scale advantage over competitors in bidding for concessions, and the ability to take on debt to finance predictable returns. Furthermore, it is our understanding that the majority of the Company's Tier 1 concessions are not due for renewal until after 2020. Given these factors, **it is not necessary at this stage for the Company to hold a significant amount of cash earmarked for renewals.**
- **Digitization:** This is an attractive initiative with the potential to offer higher paybacks and revenues than traditional panels. However, in order to attract premium advertisers, this network must be exclusively located in high-traffic, premium locations. Accordingly, we expect that the initial rollout will not exceed 100 panels per year. At an estimated cost of HK\$300,000 per panel, **the annual capital expenditure would only be about HK\$30m.**
- **Acquisitions:** Given Clear Media's dominant competitive position and superior scale, it is unnecessary for the Company to overextend itself by chasing overpriced acquisitions. The wiser strategy, to which the Board has rightfully alluded, is to wait for subscale competitors to walk away from their concessions and selectively acquire and add value to these concessions at attractive rates of return. We assume that **these types of acquisitions will be staggered and small enough to be financed by operating cash flow.**

If the opportunity arises to acquire one of the larger competitors at an attractive price, the relative size and financial position of Clear Media suggest that the Company could raise debt on attractive terms to partly finance such an acquisition. Furthermore, there is no guarantee that such an opportunity will present itself, and holding cash indefinitely for this purpose is a highly inefficient use of shareholder capital. **Therefore, it is inappropriate for the Company to earmark a significant amount of cash for a potential acquisition that may never materialize and could be financed more efficiently through leverage.**

In FY2012, the Company generated HK\$526m of normalized operating cash flow (HK\$219 net income+HK\$307 depreciation and amortization). Our expectation for FY2013 is as follows:

HK\$580m Operating Cash Flow

(HK\$50m) Maintenance Capex

(HK\$250m) New Concessions/Shelters, Acquisitions

(HK\$30m) Digital Panels

**= HK\$250m Operating Free Cash Flow**

According to our estimates, annual operating cash flow is more than sufficient to execute the Company's investment strategy in the near and mid-term, making the current cash position of HK\$1.3B simply unnecessary. Any further increases in the cash position will only erode future returns on shareholder equity.



**We therefore recommend that the Board pay a special dividend of up to HK\$1B.** This would have the immediate effect of bringing the Company's return on equity in line with its return on capital while still maintaining a more reasonable net cash balance of HK\$300m.

**We also recommend that the Board target a dividend payout ratio of 100% of net income over the coming years.**

The adoption of such a policy will send an important message to the market about the strength of Clear Media's free cash flow capabilities and its Board's capital allocation skills while still generating an additional HK\$250m of annual free cash flow to be reinvested.

**We strongly encourage the Board to take the important first step towards a higher payout ratio with the initiation of an interim dividend following the results for the period ended June 30, 2013.** A healthy interim dividend will highlight for investors the non-seasonal, non-cyclical nature of Clear Media's business and will set Clear Media apart from other businesses with more volatile working capital requirements and less operating visibility in China.

We look forward to discussing our letter with members of the Board via a conference call at your earliest convenience, ideally before the upcoming board meeting if your schedules allow.

Best regards,

Two handwritten signatures in black ink. The first signature on the left is 'Edouard Mercier' and the second signature on the right is 'Andrin Bachmann'.

Edouard Mercier and Andrin Bachmann

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