
INDUSTRY OVERVIEW

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THE CULTURE AND ART INDUSTRIES IN CHINA

Overview

We are a leading culture and art enterprise in China with diversified business operations. We operate within the large and steadily growing culture and art industries. According to the *Culture and Related Industry Classification (2012)* (《文化及相關產業分類(2012)》) issued by the National Bureau of Statistics in 2012, China's culture and art industries include the following industries:

- Broadcasting, TV and film services
- Culture and art services
- Culture information services
- Culture creation and design services
- Culture and leisure entertainment services
- Crafts production
- Auxiliary culture product manufacturing

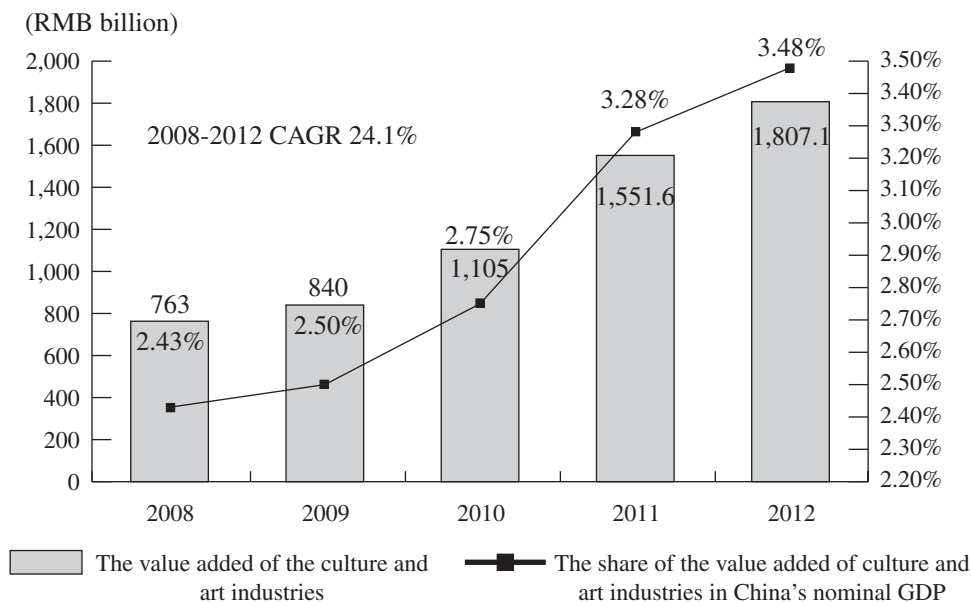
Since the initiation of reform and opening-up policy in the late 1970s, China has progressively developed an integrated, competitive and highly regulated market for a broad range of culture and art products and services, including, among other things, entertainment, performing arts, audiovisual products and services, movies, artworks and on-line culture products and services. During the 11th Five-Year Plan Period (2006-2010), China has experienced an increase in culture and art consumption, strong investment sentiment in the culture and art industries and further diversification and development of culture and art products and services in the market, particularly in the entertainment, artworks and cultural

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tourism industries. From 2008 to 2012, CAGR of the value added of the culture and art industries outpaced that of China's nominal GDP, indicating the potential of the culture and art industries to grow into pillar industries of the national economy in the future.

The following diagram indicates the development of China's culture and art industries since 2008. As shown in the diagram, the value added of the culture and art industries increased from RMB763 billion in 2008 to RMB1,807 billion in 2012, representing a CAGR of 24.1%, while its share in China's nominal GDP during the same periods rose from 2.43% to 3.48%.

Value added of the culture and art industries and its share in China's nominal GDP



Source: NBSC

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Key Drivers for the Culture and Art Industries in China

Rapid growth of China's economy and per capita disposable income

China has experienced rapid economic growth since implementing its reform and opening-up policy in the late 1970s. From 2008 to 2012, China's nominal GDP grew at a CAGR of 13.4%, and annual per capita disposable income of Chinese urban households grew at a CAGR of 11.7%. The following table sets out the relevant information:

	2008	2009	2010	2011	2012	CAGR (2008- 2012)
Nominal GDP (RMB billion)	31,404.5	34,090.3	40,151.3	47,310.4	51,894.2	13.4%
Nominal GDP growth rate (%)	18.1	8.6	17.8	17.8	9.7	
Per capita disposable income of urban households (RMB)	15,781	17,175	19,109	21,810	24,565	11.7%
Growth rate of urban households' per capital disposable income (%)	14.5	8.8	11.3	14.1	12.6	

Source: China Statistical Yearbooks 2008-2012; Statistical Communiqué of the People's Republic of China on the 2012 National Economic and Social Development

Favorable PRC government policies

The PRC government puts great emphasis on the development of the culture and art industries. It has introduced a number of policies and regulations which aim to encourage the development of the culture and art industries and support the further restructuring of China's economy. These policies also help to enhance the international competitiveness of Chinese enterprises engaging in the culture and art industries and improve the influence of Chinese culture in the global market.

The State Council promulgated the *Revitalization Plan for the Culture Industry* (《文化產業振興規劃》, the “*Revitalization Plan*”) in September 2009 and, later in October 2011, the central government set forth developing culture and art industries as a national strategy. In February 2012, the Ministry of Culture introduced the *Doubling Plan for the Culture Industry during the 12th Five-Year Plan Period* (《文化部“十二五”時期文化產業倍增計劃》, the “*Doubling Plan*”), according to which, the PRC government proposed to achieve an average annual growth rate of 20%, and as such, at least double the value added of the culture industry from 2010 to 2015. The *Doubling Plan* also set detailed targets for some networks: for the performance industry, it proposed development of trans-regional performance circuits to be led by large performance and theatre management groups, expanding from theatres in first tier cities to those located in the second and third tiers cities; for the artwork industry, it set targets of achieving total art trading turnover of RMB200 billion in China by 2015, establishing two to three artwork industrial clusters with global influence and developing China into a predominant artwork trade center in the world.

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Ample and increasing capital investment

The PRC government has consistently increased its direct spendings on the culture and art industries. Since 2010, the MOF has set up the *Special Fund for Development of the Culture Industries* (文化產業發展專項基金) to promote development of the culture and art industries and stimulate the reform and restructuring of the Chinese economy. According to *China Statistical Yearbook* (《中國國家統計年鑒》), the direct government spendings on culture and art industries grew at a CAGR of 16.6% from RMB24.8 billion in 2008 to RMB39.3 billion in 2011.

Moreover, a number of policies also aim to attract social capital to invest in the culture and related industry. For example, the State Council proposed setting up a Chinese culture and art industries investment fund in the *Revitalization Plan*, which was subsequently initiated by the MOF in a total value of RMB20 billion. The investment fund provides equity funding to culture enterprises as strategic investors, and aims to accelerate consolidation and structural adjustments of cultural resources through market-orientated operations. On the Sixth Plenary Session of the 17th CPC Central Committee, the central government officially encouraged various forms of social capital to invest in the culture and art industries. According to ChinaVenture, with the favorable policies, 92 culture and art industries investment funds have been established in China during the period from 2007 to April 2013, raising a total of RMB46.6 billion. With ample capital resources, China's culture and art industries have seen accelerating development and market integration.

Technological advancement

Technologies, in particular, information communication technologies, act as catalysts in promoting the development of the culture and art industries. The *Revitalization Plan* put forward plans to promote culture and art industrial upgrades by adopting new technologies such as digital and internet technologies. Advances in information communication technology started from reforms in data and methods of data transmission, which in turn stimulated the demand for transmitted contents. The *Report on Development of New Media in China 2013* (《中國新媒體發展報告(2013)》), issued by the China Academy of Social Sciences, set out that new culture patterns and forms that have emerged from new media communication channels such as Weibo and WeChat. This in turn raised the quest for higher quality culture program contents, especially for aesthetic subjects such as culture and art. The integration between technology and content has been profound in the film industry. According to statistic data, a total of 36 3D movies were released in China in 2012 which only represented 11% of the total movies released yet contributed 40% of Chinese cinema box office income.

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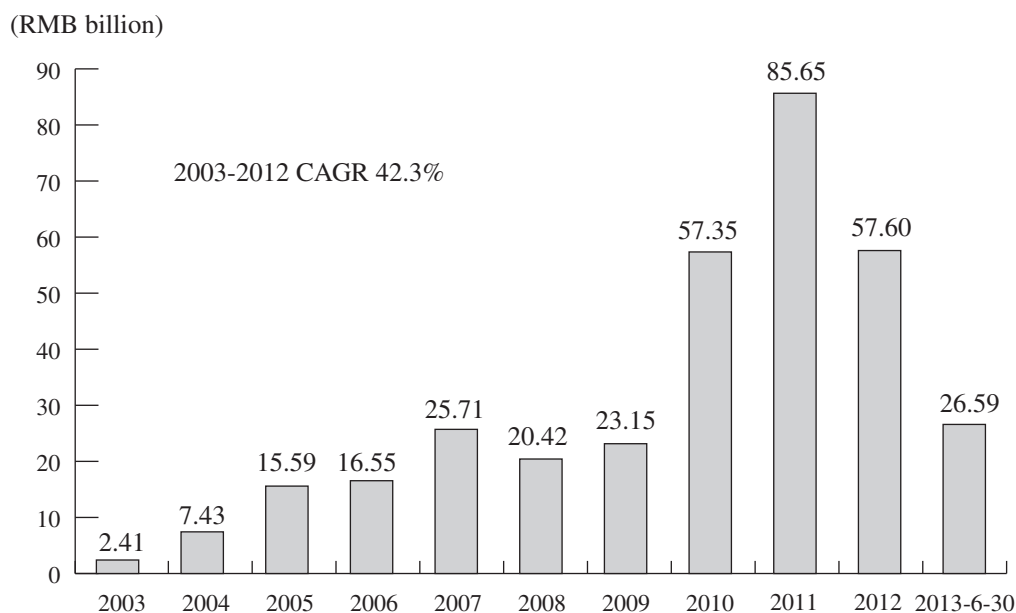
THE ART BUSINESS AND AUCTION INDUSTRY IN CHINA

Overview

The artwork market usually comprises of the primary market (or art retail market), secondary market (or art auction market) and artwork expositions. The primary market mainly includes art galleries and antique shops and the secondary market mainly includes art auction houses. Artwork expositions serve to bridge the trade and communication gaps between the primary and secondary markets.

The artwork market in China has achieved stable growth. The auction sector, despite times of volatility, dominates the artwork market and its performance comprehensively reflects the current market developments and trends. The following figures show the total art auction turnover in China (including Hong Kong) over the past ten years:

Total art auction turnover in China (including Hong Kong)

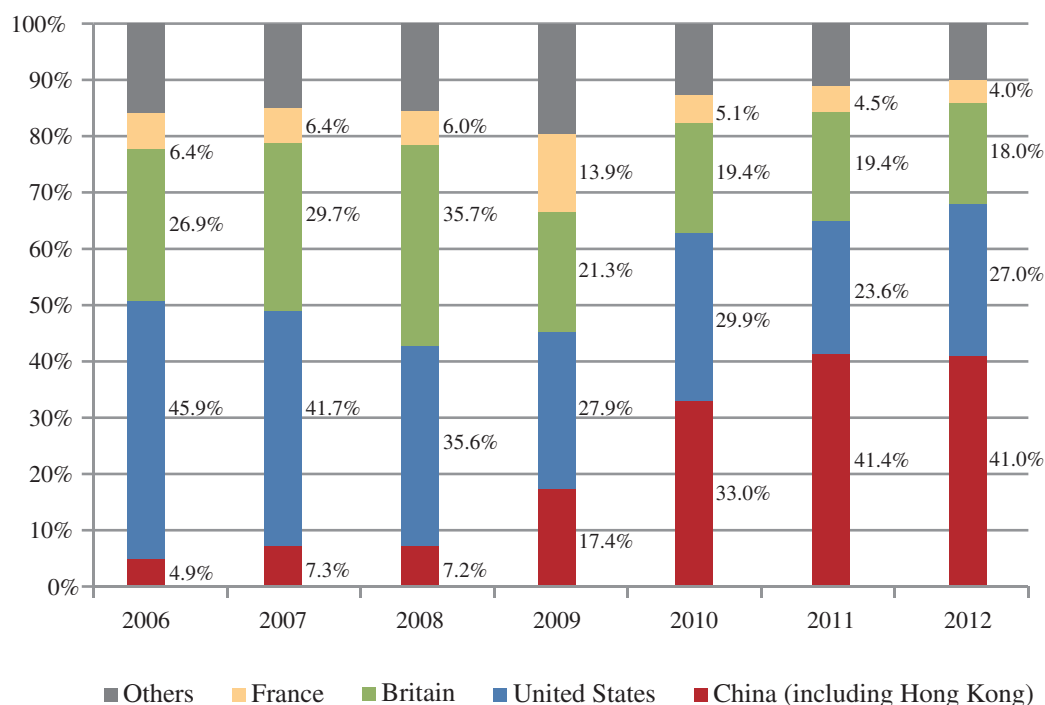


Source: For 2003-2009 statistics; ARTRON, *Market Data Collection of Chinese Art Auction Market for 20 years*; for 2010-2013 statistics; ARTRON, *Chinese Art Auction Market Reports*.

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The total art auction turnover in China (including Hong Kong) has achieved a CAGR of 42.3% by 2012 compared to 2003 when the market first experienced accelerating growth. Despite some volatility during the period, the size of the market expanded at a steady pace. As globalization continues, the art industry began to transcend national boundaries; the investment and consumption focus of the global artwork market slowly shifted from developed countries to emerging markets. In such a trend, China has gradually grown to be an important part of the global art market. From 2010, China (including Hong Kong) has become the largest auction markets in the world for fine art (including paintings, sculptures, drawings, photographs, engravings, watercolours, and installations, excluding antiques and furniture) in terms of auction turnover, with Beijing and Hong Kong being the two dominating centers. Beijing has become one of the world's art business and auction hubs for Chinese artworks.

Country breakdown of global auction turnover for fine art



Source: Artprice.com and ARTRON, *The Art Market Trends Reports 2006-2011* and *The Art Market in 2012*.

In 2011, the annual art auction turnover in China (including Hong Kong) reached RMB85.65 billion, 49.4% higher than that of 2010. In 2012, it slipped 32.8% due to sluggish global and domestic economies. The market has seen stabilization in the first half of 2013. Demand for scarce, high quality artworks is increasing yet the supply has been very limited, pushing art auction houses to devote more resources in artwork sourcing and marketing, continuously improve client services, and develop new artwork categories for future growth. The following table sets out an overview of the Chinese art auction market from 2010 to the first half of 2013.

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Overview of the Chinese art auction market

Item	2010 Spring	2010 Autumn	2011 Spring	2011 Autumn	2012 Spring	2012 Autumn	2013 Spring
Number of art auction houses	141	204	219	295	224	283	240
Number of auctions	205	300	295	409	296	367	336
Number of artworks put up for auction	162,580	259,381	250,970	347,247	234,877	292,433	243,997
Number of artworks sold at auction	88,685	133,631	122,984	142,005	112,991	129,540	112,643
Total art auction turnover (RMB billion)	20.14	37.21	42.84	42.81	28.16	29.44	26.59

Source: ARTRON, Chinese Art Auction Market Report, Spring 2013.

For most art auction houses, Spring Auction and Autumn Auction are the two principal events of the year, which contribute to a major proportion of their annual art auction turnover. The Spring Auction normally takes place between April and July and the Autumn Auction normally takes place between September and December. During periods other than the two principal auction seasons, art auction houses would also hold boutique auctions.

China's art business and auction market is characterized by unique ethnic traditions and cultures from different regions, which create different demands and aesthetics for artworks in different areas in China. At present, some major cities, including Beijing, Shanghai, Guangzhou, and Xi'an, with higher population densities, stronger purchasing power and higher art appreciation level, have become regional centers for artwork trading. Among them, Beijing has become a world-renowned art business and auction center for Chinese artworks and is expanding its domestic presence and global reach.

The art auction market is influenced by the overall strength and stability of the economy and performance of the financial markets. When there is enough liquidity in the market, prices of artworks will rise, and sellers and buyers will be more willing to carry out transactions, as the result, art auction turnover will increase. Conversely, amid economic recessions or political instability, willingness of trade among artwork sellers and buyers will be negatively affected, and the art auction turnover may slump. For example, the macroeconomic downturns in 2012 resulted in the first negative growth in China's art auction market since its explosive development from 2009. In 2012, Chinese art auction market experienced turnovers of only RMB28.16 billion and RMB29.44 billion in the Spring Auction season and the Autumn Auction season respectively, representing year-on-year declines of 34.27% and 31.23%, respectively.

According to ARTRON, in 2013, the total art auction turnover of Spring Auctions in China amounted to approximately 26.6 billion. During our 2013 Spring Auction, there were over 180 pieces of artworks sold with an art auction turnover of over RMB10 million each. The improvement of the art auction market in China, including Hong Kong, could also be evidenced by improved performance of auction houses in Hong Kong. According to ARTRON, in October 2013, Sotheby's Hong Kong conducted its 2013 Autumn Auction where it recorded a total

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auction turnover of approximately HK\$4.2 billion, representing an increase of 105.2% from the total auction turnover of its 2012 Autumn Auction. Poly Auction Hong Kong successfully recorded a total auction turnover of approximately HK\$989.1 million for its 2013 Autumn Auction, representing an increase of 90.6% from the total auction turnover of its 2012 Autumn Auction. Based on these factors, we are of the view that the art auction turnover in China will keep improving in 2014.

Prices for different categories of artworks may undergo fluctuations as consumers' preferences and tastes change from time to time. Though auction prices of artworks may increase in the long term, the prices may fluctuate in response to changes in market preferences and general economic conditions. Please also see section headed "Risk Factors – The demand for artworks is unpredictable and may materially and adversely affect our ability to obtain and sell artworks, our business, financial condition and results of operations".

Challenges to the development of the art auction market in China

Certain challenges also arise together with the rapid development of the art auction market in China, including failure of certain buyers to make timely payment after the auction sales which led to undue delays in settlement and the difficulties for investors to accurately authenticate and estimate value of Chinese artworks. Relevant PRC authorities, different auction industry institutions and leading PRC auction houses have been jointly working to address these issues to ensure the further development of art auction market in China. For instance, in recent years, China Association of Auctioneers has established standards to evaluate performance of PRC auction houses and issued various practice rules for relevant enterprises to follow. PRC auction houses generally allow buyers of auctioned artworks with high value to enjoy a longer credit period or make payment through installment. These measures, together with other internal control and risk management approaches were able to help improving the settlement of auction sales in China. Furthermore, PRC auction houses also engage professional parties and experts to provide reliable opinion on authenticity of artworks through strict procedures. Please also refer to section headed "Risk Factors – Our business, financial condition, results of operations and prospects and the value of your investment may be materially and adversely affected as a result of negative media coverage relating to us, our personnel, our Controlling Shareholder or the PRC auction industry".

Key Drivers for the Art Business and Auction Industry in China

Rapid expanding high-net-worth population in China

In recent years, the increasing purchasing power of Chinese art collectors is a major contributor to the rising shares of China in the global art auction market. The annual per capita disposable income of Chinese urban households rose from RMB15,781 in 2008 to RMB24,565 in 2012, representing a CAGR of 11.7%. According to *China Private Wealth Report 2013*, there were more than 700,000 high-net-worth individuals in 2012 – defined as individuals with at least RMB10 million in investable assets – in China. The total individually possessed investable assets were more than doubling since 2008. The number of high-net-worth individuals in China is estimated to further increase to 840,000 in 2013.

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Influx of institutional capital

Artworks are distinctive from traditional asset classes such as real estate, stocks and bonds, which provide an additional and important option for domestic and international investors to diversify asset allocation in their investment portfolio, which in turn bring in continuous inflow of domestic and foreign capital into the Chinese artwork market. Since the financial crisis in 2008, investment value in artworks has been rediscovered, attracting more institutional investors, who usually favor rare and exclusive artworks with profound cultural heritage and able to deliver high investment returns. In China, some trust companies and securities firms, e.g. SDIC Trust Co., Ltd., together with and advised by auction houses, e.g. Poly Culture, China Guardian, innovatively set up trust plans to provide artwork investment and financing opportunities to investors. This has in turn driven the continuous appreciation of the investment value in artworks. The increasing capital influx from institutional investors has guaranteed a more sustainable development of China's artworks market.

Rich diversity of Chinese artworks

With long history and broad landscape, China is home to numerous and diverse artworks, including many exquisitely made antiques that embody the depth of Chinese history and culture. Global collectors have increasing appreciation and demand for Chinese artworks. As a result, a great amount of looted relics and folk artworks have been discovered and put up for sale or auction. In addition, Chinese contemporary art market has also seen rapid growth, which further enriches the diversity of Chinese artworks. These channels have provided ample artworks for trade and auction in relevant markets in China.

Competition in the Art Auction Market in China and Hong Kong

The art auction market in China has been opened to domestic private capital with no restrictive license monopoly, which presents a high level of marketization. In addition, since artworks may be originated from a variety of places, sellers and buyers may participate in auctions held domestically or overseas, hence exposing domestic auction houses to global competition. The current *PRC Law on Protection of Cultural Relics* (《文化保護法》) prohibits foreign and joint venture enterprises to engage in auction of cultural relics, hence foreign and joint venture auction houses could only engage in the auction of fewer classes of artworks such as Chinese contemporary art.

In the art auction market of China (including Hong Kong), the two global powerhouses, Sotheby's and Christie's still account for notable market shares. However, following the substantial adjustments in the global art auction market after the financial crisis in 2008, two domestic art auction houses, Poly Auction and China Guardian have achieved significant growth in auction turnover and surpassed Sotheby's and Christie's in this region. Other local art auction houses, such as Beijing Council, Beijing Hanhai, also delivered outstanding auction performances. In 2012, despite macro market deterioration, Poly Auction continued to retain its leading position in the art auction market in China (including Hong Kong). It claimed the largest market share in terms of total art auction turnover, and by hosting more boutique auctions than most of its competitors, it demonstrated strong capability in sourcing artworks and organizing auctions. The following table shows the rankings of art auction houses in China (including Hong Kong) in terms of total art auction turnover for the year ended December 31, 2012 and the six months ended June 30, 2013.

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Top five art auction houses by auction turnover in China (including Hong Kong) for the six months ended June 30, 2013

<u>Ranking</u>	<u>Name of art auction house</u>	<u>Number of auction sessions</u>	<u>Total auction turnover</u> (RMB million)
1	Poly Auction	75	3,813.4
2	China Guardian	75	3,327.1
3	Christie's Hong Kong	12	2,494.5
4	Sotheby's Hong Kong	18	2,067.9
5	Beijing Council	20	1,411.2

Top five art auction houses by auction turnover in China (including Hong Kong) in 2012

<u>Ranking</u>	<u>Name of art auction house</u>	<u>Number of auction sessions</u>	<u>Total auction turnover</u> (RMB million)
1	Poly Auction	120	6,495.5
2	China Guardian	123	5,161.6
3	Sotheby's Hong Kong	26	3,677.0
4	Christie's Hong Kong	15	2,283.1
5	Beijing Council	35	2,208.4

Notes:

- (1) Poly Auction data includes Poly Auction Beijing and Poly Auction Hong Kong; China Guardian data includes Guardian Beijing and Guardian Hong Kong.
- (2) Total art auction turnover includes hammer price and buyer's commission.
- (3) Due to factors such as late transaction settlement of domestic auction lots and breach of contract by buyers, it is difficult to collect accurate statistical data for settled sales of each auction house, which may be significantly different from the auction turnover statistics.

Primarily based on ARTRON as at June 30, 2013

Both Chinese and foreign art auction houses are actively expanding the geographic coverage of their business. Foreign art auction houses, such as Sotheby's and Christie's, have in recent years placed greater focus on developing their presence in the Chinese market. In September 2012, Sotheby's and Beijing Gehua Art Company established Sotheby's (Beijing) Auction Co. Ltd. and became the first foreign art auction house to start operations in mainland China. In April 2013, Christie's became the first foreign art auction house to obtain a license for independent operations in China and planned to hold auctions in Shanghai from autumn 2013. Although foreign and joint venture auction houses are prohibited from engaging in auctions of cultural relics according to the current *PRC Law on Protection of Cultural Relics* (《文化保護法》), their entrance has still intensified the competition in the art auction market in China.

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On the other hand, Chinese art auction houses have also started to expand their operations in overseas art auction markets such as in Hong Kong. In May 2011, China Guardian set up China Guardian (Hong Kong) International Auction Company which hosted its first auction in Hong Kong in autumn 2012. We established Poly Auction Hong Kong in October 2012 and hosted our first auction in Hong Kong in the same year.

For the years ended December 31, 2010, 2011 and 2012 and the six months ended June 30, 2013, our market share in China (including Hong Kong) in terms of art auction turnover was 15.8%, 14.1%, 11.3% and 14.3%, respectively. The slight decrease in our market share from 2010 to 2011, mainly because the art auction turnover in China (including Hong Kong) increased significantly from 2010 to 2011, which in turn attracted more competitors enter into this market. In 2012, our market share further declined, primarily because the PRC artwork auction market experienced a correction due to market concerns on liquidity. Although the Hong Kong artwork auction market was relatively less affected by this trend in 2012, our operations in Hong Kong were still at an early stage then. For the six months ended June 30 2013, our market share increased to 14.3%, mainly because of the stabilized performance of PRC artwork auction market, the implementation of our adjusted business strategy in line with this industry trend and the expansion of our auction operations in Hong Kong.

Development Trends of the Art Business and Auction Industry in China

Constant structural adjustment of market participants

At present, China's artwork secondary market (or art auction market) is relatively more developed as compared to the primary market (or art retail market). As China's artwork market continues to develop, the major market participants of the artworks market will experience constant structural adjustment and optimization. In the future, domestic artwork expositions, art galleries and antique stores will become more mature through branding development, joint academic research and improvement on services to collectors. Meanwhile, Chinese auction houses will continue to actively develop innovative business models and new artwork categories to enhance their competitiveness. Structural adjustment and optimization of the artwork market in China is expected to continue.

Continuing trends of industrialization and capitalization

As increasingly more institutions and individuals engaged in art business and auction, the artwork market in China gradually industrialized and capitalized. Artworks are considered as an important investment asset class, and ample capital from financial institutions, including banks and trusts, provides strong financial support for sustainable development of the artwork market. As marketization deepens, the mechanisms of transaction, authentication and evaluation of artworks will further improve and the valuation of artworks will further rationalize.

Internationalization of Chinese artworks

Ancient Chinese artworks have always been a favorable target for international artwork collectors. As the Chinese economy continues growing, Chinese modern and contemporary artworks have been gradually acknowledged as well. In addition, Chinese buyers, who now

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have increasing purchasing power, show distinct interest in artwork investments which cater to their own taste. These factors attributed to the explosive growth in China's art auction market after 2003. According to Artprice.com and ARTRON, China (including Hong Kong) has been the world's largest auction market for fine art since 2010; in 2012, it accounted for 41% of the global market share compared with 27% for the United States and 18% for Britain. We anticipate that China will continue to be one of the world's largest artwork markets, which in turn will further stimulate internationalization of Chinese artworks.

THE PERFORMANCE AND THEATRE MANAGEMENT INDUSTRY IN CHINA

Overview

Theatres are venues for hosting a diverse lineup of culture performances, including dramas, plays, musicals, operas, ballads, ballet and others. In particular, the performance and theatre management industry in China serves both commercial and social purposes. Therefore, apart from striving to be commercially profitable and sustainable by showing culture performances, they also bear the responsibility of satisfying residents' demand for culture products as well as improving the culture well-being and art appreciation level of the society.

The performance and theatre management industry in China has experienced a rapid growth along with the overall culture industry. According to National Bureau of Statistics of China, 7,321 performing arts troupes presented a total of 1,350,200 shows in 2012, covering 828.1 million mass audiences in China. Revenue from performances rose from RMB1.33 billion in 2008 to RMB6.41 billion in 2012 with a CAGR of 48.2%.

Year	2008	2009	2010	2011	2012
Number of performing arts troupes . . .	5,114	6,139	6,864	7,055	7,321
Number of performances (1,000). . .	905.3	1,201.6	1,371.5	1,547.2	1,350.2
Number of audiences viewing domestic performances (million audiences)	631.9	817.2	884.6	745.9	828.1
Revenue from performances (RMB billion).	1.33	2.88	3.43	5.27	6.41
Number of performance venues . . .	1,944	2,137	2,112	1,956	2,364

*Source: Ministry of Culture, Statistical Yearbook of China's Culture and Cultural Relics 2008-2013
National Bureau of Statistics of China*

The rapid growth in the numbers of performance troupes and revenue from performances require an additional supply of performance venues, which has grown from 1,944 in 2008 to 2,364 in 2012, including 985 theatres and 776 movie theatres.

Within the performance and theatre management industry, grand theatres and fine art performances are usually concentrated in economically developed areas, with high per capita GDP and strong financial support from local governments, including the first tier cities (such as Beijing and Shanghai), second tier cities (such as Wuhan and Chongqing) and pilot cities to

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carry out the national culture system reform (such as Changzhou, Wenzhou and Qingdao). These cities usually have high quality theatre infrastructure and stable demand for theatre performances, so the local culture markets are more mature in supporting arrangements of larger performance projects. Demand for theatre performances is generally higher in the second half of the year and peaks during holiday season, especially from September to October (Mid-Autumn Festival and China's National Day holidays) and from December to January (Christmas and New Year).

Key Drivers for the Performance and Theatre Management Industry in China

Government promotion for fine art

The PRC government strives to promote fine art and improve culture wellbeing of the public. The *Revitalization Plan* issued by the State Council in 2009 has specially stated that establishing theatre networks in major cities for culture and art performances would be one of the major tasks to build a modernized culture and art market in China. Supported by greater fiscal capabilities, central and local governments have advocated the construction of theatres and the supply of culture performances as part of social welfare programs.

Most of the theatres in China are constructed by the local governments and assume social responsibility. Theatre management companies typically sign theatre management agreements with local governments which set an annual average price ceiling for performance tickets to ensure that citizens will be able to enjoy a certain number of theatre performances at reasonable cost. Many local governments also subsidize tickets for performances and performing troupes who are dedicated to promote fine art. The government measures have effectively promoted taste and demand for fine art performances in China.

Increasing urbanization level making city lifestyle prevail

According to the National Bureau of Statistics, China's urbanization rate has reached 52.57% in 2012. The country is rushing into the era of urbanization in which urban economies and city lifestyle prevails. Urban households usually spend more on culture-related consumption. According to the *China Statistical Yearbook*, an average Chinese urban household allocated 12.2% of its total cash spending on culture, education and entertainment activities in 2011, while the figure for an average rural household was only 8.4%. Theatre performances, being a typical type of urban culture consumption activity, will benefit from the expected continuing urbanization.

Improving education level of population

The compulsory education system in China has significantly raised the average education level of the population. According to the 6th population census results released by the National Bureau of Statistics, 8.9% of China's total population received tertiary education or above in 2010, which marked a 5.3% increase from the 5th population census in 2000. A better educated population will have more interests and demand in fine art, which in turn provides wider customer base for performance and theatre management industry.

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Competition in the Performance and Theatre Management Industry in China

Theatres in China are mostly constructed and financed by the local government authorities, and later administered by local culture or publicity departments. They differ largely in location and scale, resulting in a relatively low market concentration. For each single theatre, those set up in less-developed regions may benefit from the absence of vigorous competition, while those located in economically developed areas, such as Beijing, Shanghai, Chongqing and Shenzhen, may face more intensive competition due to increased supply of performance venues.

To separate government administration and enterprise operations, and improve market-orientated operational capacity of theatres, some local governments, or authorized theatre owners, have entrusted the theatre management and operations to professional third parties by paying a certain amount of theatre management fees. A professional theatre management company can help to enhance operational efficiency of the theatre, thus being able to provide more performances to the public, assisting the government to fulfill its targets of improving public culture taste and promoting fine art.

Theatre management companies in China generally adopts two types of managerial structures, namely a directly managed theatre network, or a franchised theatre alliance. This allows trans-regional integration for resources and standardization of management operations, which in turn enhances brand value of the theatre management companies. There are two major directly managed theatre networks in China, namely Poly Theatre network and CPAA Theatres, five trans-province alliances (China Northern Theatre Alliance, China East Region Theatres Alliance, Western Show Alliance, Yangtze River Delta Performing Arts Alliance and Pearl River Delta Performing Arts Alliance) and a number of provincial performance alliances (NTCC Beijing Theatre Alliance, Sichuan Theatre Alliance, Anhui Performance Alliance and Jiangxi Theatre Alliance). Competition concentrates on aspects such as performance sources and theatre management.

We are one of the largest theatre management companies in China in terms of number of theatres in operation. As of October 31, 2013, we managed 31 high-end theatres in 29 cities across China. Compared with loosely managed franchised theatre alliances, directly managed theatre networks enjoy competitive advantages in contracting new theatres, arranging large performance tours and providing standardized theatre management.

Development Trends of the Performance and Theatre Management Industry in China

Continuing marketization of theatre management operation

Current level of marketization and concentration in the performance and theatre management industry in China is still relatively low. Following government policies to promote the reform of marketization in the culture and art industries, more theatres will entrust their operations to professional third parties, enabling theatre operations and performance arrangements to be led by experienced and effective market players.

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Theatre networks becoming the mainstream of market practice

Development of theatre performance market and increasingly diversified tastes of audiences have required changes in management patterns of theatres. Traditionally, venue rentals from conferences and private performances accounted for a major portion of a theatre's revenue. However in order to achieve both commercial value and social benefits, the theatres need to shift to focus on integration of resources, branding and sale of self-arranged, public performances. Theatre networks, whether in a direct management pattern or a franchise pattern, enhance the effectiveness and profitability of performance and theatre management across different regions, attracting more domestic and international performing troupes to deliver their shows. Moreover, some theatre networks intend to build an integrated industry chain, covering production, distribution and showing of performances, and provide capital assistance to theatres. These measures may get them well prepared for further expansion in both domestic and international markets.

Prospering growth of original repertoires

Competition for high quality performance resources continues to intensify among theatres. While increasingly more foreign performances are introduced into China, many Chinese enterprises strive to develop original repertoires with independent intellectual property. In 2012, 4,035 original repertoires debuted in China, including 1,152 traditional Chinese operas, 948 operas, dance, musicals and light orchestras, 147 dramas and child dramas, and 1,220 produced by comprehensive performing troupes.

THE CINEMA INVESTMENT AND MANAGEMENT INDUSTRY IN CHINA

Overview

Following the rapid growth of Chinese economy and increases in average per capita disposable income, the cinema investment and management industry in China has seen rapid growth in recent years. According to the former State Administration of Radio, Film, and Television, the gross cinema box office income of China's movie industry reached RMB17.07 billion in 2012, of which RMB16.63 billion were contributed by urban cinema circuits, representing a CAGR of 43.9% since 2008.

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The chart below shows key indicators of urban cinema circuits in China from 2008 to 2012.

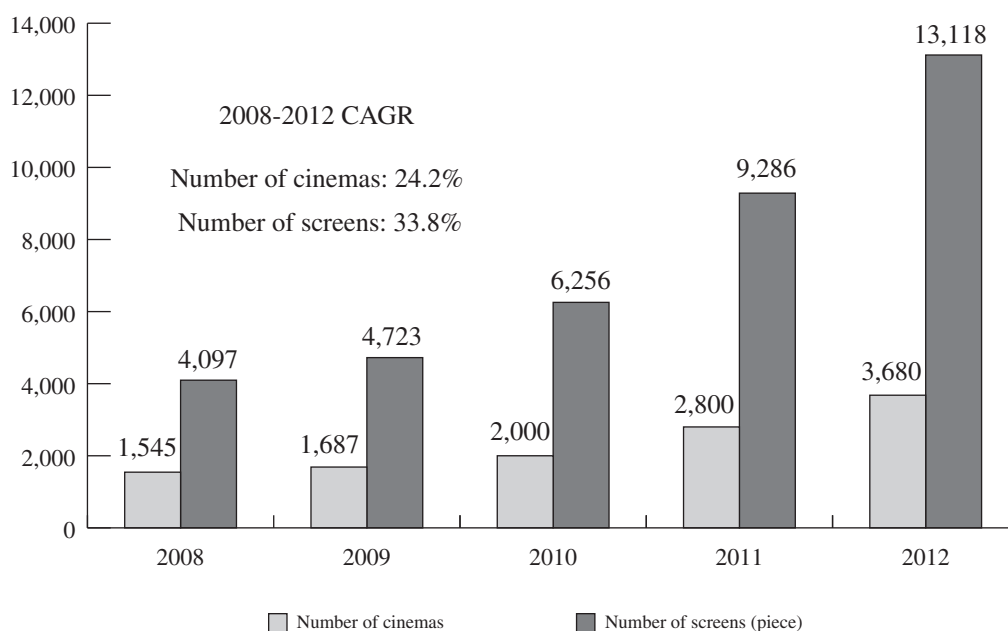
Key indicators of urban cinema circuits in China

	2008	2009	2010	2011	2012	CAGR (2008- 2012)
Number of screenings (‘000)	4,896.4	5,947.9	8,452.4	13,120.1	18,987.3	40.3%
Number of audience visits (million).	140.7	200.4	281.0	354.8	465.7	34.9%
Cinema box office income (RMB million).	3,883.5	6,019.0	9,749.3	12,431.4	16,627.6	43.9%

Source: Industry Research Center of China Film Association, China Film Industry Research Report 2012.

Furthermore, the number of cinemas in China continue to grow rapidly. By 2012, there were 3,680 cinemas and 13,118 screens in China. The following chart shows the growth in the number of cinemas and screens in Chinese cities from 2008 to 2012.

The number of cinemas and screens in China



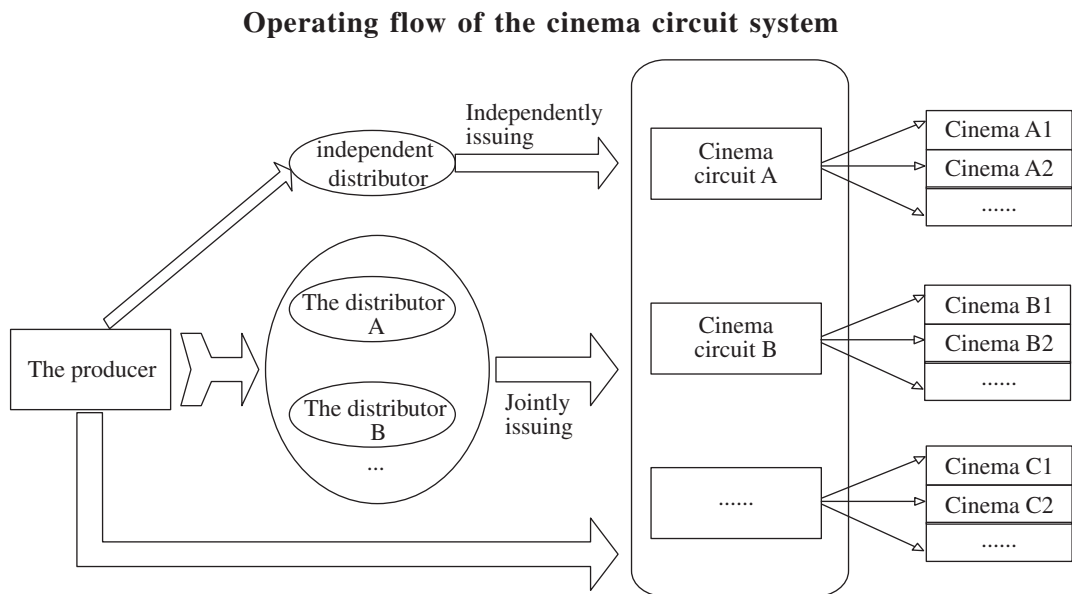
Source: EntGroup

INDUSTRY OVERVIEW

The cinema circuit system

China has adopted an internationally recognized cinema circuit system since 2002. The system provides that the movie producers and distributors supply film prints to the cinema circuits, who then distribute film prints under a unified distribution system to the franchised cinemas. The cinema circuits have generally become a unified distribution channel for imported and major domestic movies.

The following chart shows the operating flow of the cinema circuit system:



After deducting statutory contribution to the special movie fund and taxes, the net cinema box office income is shared by movie producers, distributors, cinema circuits and cinemas. In order to protect the development of domestic movie production industry, as guidance, the former State Administrative of Radio, Film, and Television suggests a minimum allocation of 43% of net cinema box office income to producers of domestic movies. However, in practice, due to the relatively strong bargaining power of cinema circuits and cinemas, cinemas will normally receive 50%-55% of the net cinema box office income, being the gross cinema box office income net of 3.3% tax and 5% special movie fund levy, and cinema circuits will normally receive 1%-5% of the net cinema box office income, while the remainder will be divided between movie producers and distributors. The final income-sharing varies on factors such as types of movies and bargaining power of the parties involved.

Industry characteristics

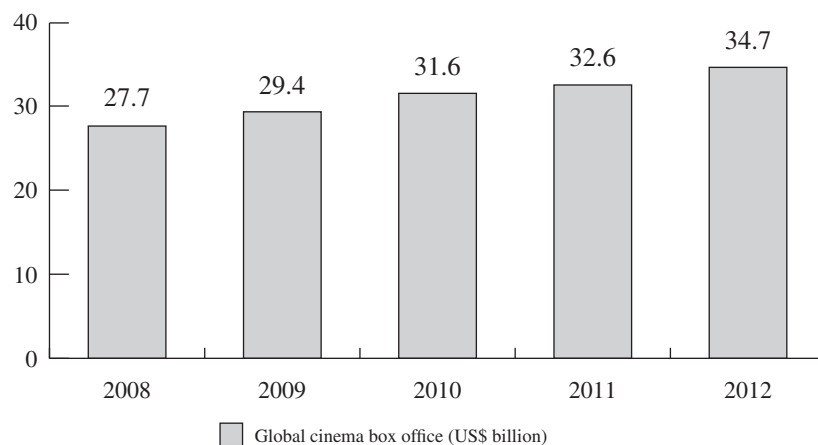
Cinema box office income is closely associated with local economic development levels, consumption of local residents, their movie viewing interests and population density. According to the former State Administrative of Radio, Film, and Television, 68.77% of China's total cinema box office income in 2012 came from the top ten regions, namely, Guangdong, Beijing, Jiangsu, Zhejiang, Shanghai, Sichuan, Hubei, Liaoning, Shandong, and Chongqing.

Economic cycles have dual influences on the film industry. On one hand, the cinema box office income is closely correlated to national economic development and per capita GDP growth. The film industry would grow rapidly during economic booms. On the other hand,

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during economic recessions, people's income and expectations for future economic growth are lowered; hence they may first cut luxury spending and allocate more of their budget to affordable culture and entertainment spending, such as movies. Meanwhile, movies provide spiritual comfort to people during recessions. Therefore, cinema box office income tend to stay resilient during economic downturns. For example, according to MPAA, the global cinema box office income maintained a growing trend from 2008 to 2012, unaffected by the financial crisis.

Global cinema box office income



Source: MPAA, *Theatrical Market Statistics 2012*.

The cinema investment and management industry in China usually records good performance in its cinema box office income during statutory and traditional holidays, such as Spring Festival, Labor Day, China's National Day, Christmas and New Years, when cinemas and movies are most popular.

Competition in the Cinema Investment Management Industry in China

At present, national and regional cinema circuits co-exist in China. Particularly, the construction and development of national cinema circuits are given top priority and their business expands nationwide. At the same time, some regional cinema circuits benefit from long operating histories in local markets, and have the capacity to expand into other regions.

As of October 31, 2013, we had 14 self-operated cinemas, all of which joined Poly Wanhe Cinema Circuit. By total cinema box office income, Poly Wanhe Cinema Circuit is the 15th largest cinema circuit in China in 2012, with an annual cinema box office income amounting to RMB338.8 million, or 2.04% of the total cinema box office in the country. By the same measurement, our Shenzhen Poly Cinema City was the 16th largest cinema in China and the 2nd largest cinema in Shenzhen in 2012. The following table sets out China's top 20 cinemas by cinema box office income in 2012.

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China's top 20 cinemas by cinema box office income in 2012

Ranking	Name of Cinema	Cinema box office Income (RMB mn)	Ranking	Name of Cinema	Cinema box office Income (RMB mn)
1	Beijing Yaolai	81.69	11	Guangzhou Zhengjia	59.33
2	Shenzhen Jiahe	77.86	12	Harbin Wanda, Zhongyang	59.31
3	Capital Huarong	76.99	13	UME, Jiangbei, Chongqing	55.65
4	Shanghai Wanda, Wujiaochang	74.04	14	Wuhan Zhongying	53.21
5	Beijing UME, Huaxing	67.03	15	Tianhe	52.74
6	Beijing UME, Shuangjing	63.84	16	Chengdu Wanda, Jinhua	52.74
7	Shanghai Yonghua	63.57	17	Shenzhen Poly	51.83
8	Beijing Wanda, CBD	63.26	18	Guangzhou Qinggong	51.71
9	Guangzhou Wanda, Baiyun	61.41	19	Beijing Stellar	51.67
10	Guangzhou Feiyang, Zhengjia	59.99	20	Shanghai Heping	50.96
				Ningbo Wanda, Yinzhou	50.32

Source: China Film Market Report 2012

Development Trends of the Cinema Investment and Management Industry in China

Growing number of cinemas

In recent years, the volume of Chinese movie production has continued to rise; however, the number of movies that were screened in cinemas did not see a sharp increase. For example, according to EntGroup, 893 domestic movies were produced in 2012, but only around 231 domestic movies were screened in cinemas. The growth in Chinese movie production requires an increase in the number of cinemas as distribution channels.

Meanwhile, following the rapid development of information technologies such as internet and mobile communications, audiences can easily obtain movie information, screening schedules and purchase movie tickets from the internet, making it more convenient to go for cinemas. The rise of 3D movie screen technology has also intensified the difference in viewing experiences for audiences and enhanced the willingness of audiences to watch movies in cinemas.

Compared with developed countries, China still has huge potential in the cinema industry. As of the end of 2012, China had a total of 13,118 screens, while the United States had 39,918 screens. Every one million people in China owned approximately 10 screens in 2012, while every one million people the United States owned approximately 127 screens.

Due to strong market demand and development potentials, coupled by the guidance and encouragement of government policies, the number of cinemas and screens in China is predicted to continue to grow in the next few years.

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Shortening investment payback period for new cinemas

The investment payback period for newly developed cinemas in China is estimated to range between 10 to 15 years. However, the strong market demand and increasingly efficient operations under the cinema circuit system has shortened the payback period and the profitability of cinemas has been largely enhanced.

Self-operated cinemas have relatively high and stable profitability and are largely isolated from the fluctuations of movie production. Judging from the current policy orientation and market momentum, cinema investment management will continue to be one of the most promising sectors in China's film industry.

Strengthening cooperation with commercial property developers

The cooperation between cinema investors and commercial property developers to develop cinemas in central business districts has become one of the biggest highlight and a major trend of the current cinema industry in China. For example, leveraging its advantage in commercial property development, Wanda Cinemas adopts standardized circuit management to develop self-operated cinemas nationwide. This model has been adopted by many other cinema circuits. Cinemas can attract a greater amount of foot traffic and boost the profitability of other businesses within the same commercial property complex, and at the same time, by cooperating with commercial property developers, cinema investors can lower their rental cost. The synergies between commercial property development and cinema investment can partially set off operational risks and create win-win benefits for both businesses.

Increasing focus on technological advancement

The introduction of digital display technology in 1999 has ushered in a new era of movie digitization. Especially in 2005, the unification of technical specifications and standards of digital cinema has stimulated rapid development of digital cinemas worldwide and transition towards digitization of the film industry. In relation to digital screens, 3D digital screens have developed rapidly, and China is now the fastest-growing market in the 3D digital screens in the world.

Following the continuous improvement in quality of movie shooting and production, there is an increasing number of movies which can be screened on huge screens and deliver intensified visual impact to audiences. All these lead to the rebound of huge screen projection technology. Since its introduction in 1967, the IMax movie system has built a monopolistic leading position in huge screen industry. However, many Chinese cinemas and research institutions strived to develop and launched self-patented huge screen projection systems in recent years, including DMax developed by the China Science Institute and China Film Group, Poly-Max developed by Poly Films and X-Land developed by Wanda. Delivering good performance with comparatively low operating costs, these domestic huge screen projection technologies progressively expand their market shares in China.