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Italian Trade Commission

Overview of China Film Market

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TABLE OF CONTENTS

INTRODUCTION	3
EXECUTIVE SUMMARY	5
CHINA FILM MARKET	8
Overview of Chinese film industry.....	8
Annual film production.....	10
- <i>Key production companies</i>	10
- <i>Production financing structure</i>	12
- <i>Co production</i>	16
Film distribution analysis.....	18
- <i>Distribution market and structure</i>	18
- <i>Key players analysis</i>	20
2010 box office review.....	22
- General overview.....	22
- Overview of key players.....	23
- Popular genres.....	25
- Overview of key 2010 films (foreign & domestic).....	25
- Analysis of new technologies.....	26
- Ticket pricing analysis.....	27
Imports & export analysis.....	29
REGULATORY ANALYSIS	34
KEY MARKET DYNAMICS	38
CONSIDERATIONS FOR ITALIAN PLAYERS	41
Potential opportunities in the China film market.....	41
Potential challenges in the China film market.....	42
Practical options for Italian players approaching the market.....	43
CONCLUSIONS	46
APPENDIX	47
Appendix 1. Events / Film Festival.....	47
Appendix 2. Definition of Glossaries.....	48

INTRODUCTION

Objectives

- The key objective of this briefing is to provide Italian players with a high-level overview of the Chinese film market, with a key emphasis on opportunities and challenges
- In addition, an overview of China's film regulatory environment has been included as well as considerations for Italian players interested in approaching the Chinese market

Doing market research in China and our methodology

- Generally speaking, conducting market research in China is different and significantly more challenging than it is in developed countries because of 1) the size and diversity of the country; 2) lack of fully reliable centralized/official information databases; 3) the change is constant and extremely rapid - the whole China economic system is far from being in equilibrium, therefore a solid market research work must be based on multiple resources and activities
- Our general methodology leverage a combination of resources/activities such as:
 - All relevant background information (existing available information, etc.)
 - Significant secondary research (in Chinese, English and Italian), from proprietary databases to access to associations or magazines, etc.
 - Primary research, which include access to external business network, interviews with experts and key insiders, possible visits to trade show or selected companies, etc.
 - Collective China knowledge/sector expertise/market research expertise with over 300 consulting projects executed in and outside China

Format of this report

- The report is organized in such a way to provide different level of details in different places – executive summary, overviews, and paragraphs in the body of the report, summaries, and appendixes; we have also used bullet points throughout the entire report to make reading easier
- We have used abbreviations for recurring terms; see the appendix section for a glossary of terms used

Information sources

- Key sources of information for this report include
 - All background information
 - Many secondary sources
 - Interviews with industry insiders and experts
 - Our ongoing analysis of all key facts and data collected
- In the report, sources are mentioned for chart, tables and key data; secondary sources include dozens of Chinese sources (news reports, magazines, publications, government statistics, etc.) as well as several English sources, as well as all companies' web sites, press releases from various magazines, etc.
- In total about 20 mini-interviews were carried out for this report with a variety of industry insiders and production companies
- Ongoing analysis and re-elaboration of all data collected is key to cross-check data and information and identify key trends and industry dynamics

EXECUTIVE SUMMARY

China Film Market

- There are three main parts along China's film industry chain: 1) production; 2) distribution; and 3) exhibition (see the chart in "Overview of China Film Industry")
- Volume of China's film production in 2010 reached 526 with 15% growth from 2009; however, 110 of these were released in theaters
- China's film market experienced fast development in 2010 with US\$ 1.5 billion in box-office revenues; a 64% increase from 2009
- Box-office revenue was divided by domestic films and imported films with 56% : 44% respectively in 2010
- There were 38 cinema circuits¹ in China by 2010, 760 cinemas and 6,200 screens
- New exhibition channels (e.g. online videos) are further developed to provide more opportunities to the films especially those that are not able shown in cinemas
- The market is dominated by several large domestic film players (e.g. *China Film Group*, *Huayi Brothers*, *PolyBona*), which participate in the entire industrial chain from production, distribution to exhibition
- Foreign players enter into China market mainly through direct import and co-production due to restrictions on setting up a legal entity (see details in next section "regulatory analysis")
- China imported 47 films in 2010, including 20 revenue-sharing films, 20 flat-fee films and 7 special imported films (e.g. 3D & IMAX films)
- Imports are dominated by American films, both in terms of volume and value; 16 out of 20 revenue-sharing films are from US
- 3D/IMAX films have become more popular, with 77% of imported film revenues coming from 3D/IMAX films in 2010; it is expected that the trend will continue
- Average ticket price increased to ~RMB 40 (US\$ ~6) in 2010 from RMB 31 (US\$ 4.5) in 2009; in large cities e.g. Beijing & Shanghai, ticket price is normally 2 or 3 times of tier 2 & 3 cities

¹ Cinema circuits: definition of cinema circuits and other relevant film glossaries can be found in Appendix 2

Regulatory analysis

- All film's production, distribution & exhibition are supervised by *The State Administration of Radio Film and Television* (here after "SARFT")
- *China Film Co-production Company*, a subsidiary of *China Film Group*, is the only company authorized by SARFT to manage co-production businesses
- *China Film Import & Export Company*, a subsidiary of *China Film Group*, is the only company authorized to import films
- *Huaxia Film Group* and *China Film Distribution Company* of *China Film Group* are the only two companies authorized to distribute imported films, but they normally sub-contract to other distribution companies
- Foreign players are still restricted in film production and distribution legal setup; only co-production and representative offices are allowed, but WFOE and JV are forbidden
- Foreign players are not allowed to set up cinema circuits
- However, foreign players can set up jointed cinemas with a minority stake (<49% share) in most of tier 2 & 3 cities; Only in several trial cities including *Beijing, Shanghai, Guangzhou, Chengdu, Xi'an, Wuhan, and Nanjing* can they have a controlling stake of up to 75%
- *Hong Kong & Macau* players are exceptions for foreign companies setting up in China, which are allowed to set up distribution company and/or cinemas 100% wholly owned
- Current imported quota: 20 share-revenue sharing films, 20 flat-fee films and no restriction on special films; quota limitations are expected to be increased or canceled gradually
- *12th Five-Year Plan* will develop cultural industry as a strategic industry of China, making cultural industrial production value accounts for 5% of GDP from the current 2.5% by 2015
- China's central government will also strengthen regulations on copyrights; e.g. on April 2011, "*2011 Implementing Plan for National Intellectual Property Strategy*" was issued by *State Council* to promote intellectual property protection
- Unlike US and most other European countries, China does not have rating system for films (e.g. G, PG, R, etc.)
- SARFT issued a statement that rating system is still not suitable for China's current film market; however, they will keep improving management, reforming current situation, and trying to develop a system fitting China's film market

Key market dynamics

- China's film market has significant potential and will be developing fast in the near future; tier 2 and tier 3 city markets will become key growth areas
- Government will continue to provide support to the film industry at least in the next five years (2011-2015) through various policies and financing
- With totally different visual experience, Chinese consumers are willing to pay a premium for IMAX and 3D films, which will be expected to have a further development in the future
- To strengthen the competitiveness and take more market share, many large film companies had expanded their businesses to upstream or downstream and cover the overall industrial chain
- Digital films have replaced traditional films as the dominant form in the market with its lower cost and convenience of copy and transport
- With developing technology, especially the connection of internet, telecom network, and broadcast-TV network, more and more platforms appeared for films exhibition, e.g. paid TV / IPTV and online video on demand

Consideration for Italian players

- Challenges exist as well, e.g. fierce competition especially from US, low awareness of Italian films, copyright problem, and restriction on foreign invested legal entity etc.
- However, there are opportunities for Italian players, especially in co-production and film imports
- There are three key ways in which Italian players can co-produce films in China as detailed in the table below:

Table: Coproduction Options

Type	Description
1) Joint production	<ul style="list-style-type: none"> • Chinese and Italian production companies jointly invest (capital, labor and equipment) • The co-production parties jointly produce the film and jointly share the profit as well as the risks
2) Assistance production	<ul style="list-style-type: none"> • Italian production company funds the film and films in China • The Chinese party provides equipment, location, labor and other forms of assistances
3) Commission production	<ul style="list-style-type: none"> • The Italian production company commissions the Chinese party to film in China

Source: JLJ Analysis on multiple sources

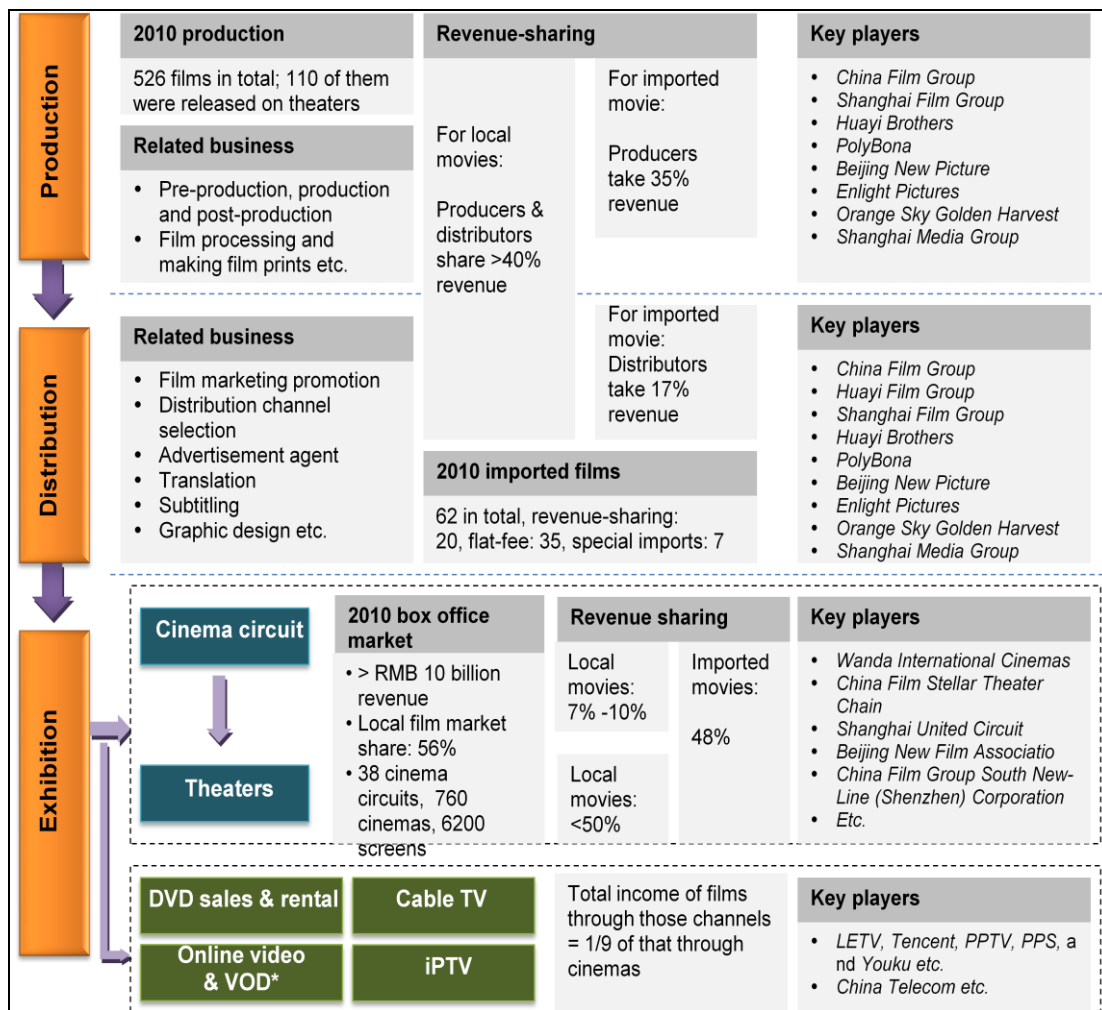
- Other areas of investment include cinemas and internet video on demand

CHINA FILM MARKET

Overview of Chinese Film Industry

- China's film industry developed fast in 2010 with total box office revenues exceeding RMB 10 billion (~US\$ 1.5 billion), a 64% increase from 2009; domestic films accounted for 56%
- There were 38 cinema circuits by 2010, 760 cinemas and over 6,200 screens
- Production in 2010 reached 526 films, which is a 15% increase from 2009; however, only 110 of the films were released in theaters
- 17 of the 110 films released in theaters contributed half of the revenue generated
- New exhibition channels (e.g. online videos) are further developed to provide more opportunities for films, especially those not shown in cinemas
- China imported 47 films in 2010; there are two main import models used as well as a "special" import process for films, which are:
 1. Revenue-sharing model: box office revenues are shared – 20 films imported in 2010 used this model
 2. Flat-fee model: A flat fee is paid for the rights to show the film – 20 films imported in 2010 used this model
 3. Special Imports (e.g. 3D & IMAX films): special arrangements are made for these types of films – 7 films imported in 2010 used this model
- China's film market is dominated by several large players (e.g. *China film Group*, *Huayi Brothers*), which are involved in multiple aspects of the film production chain - from production to distribution and exhibition

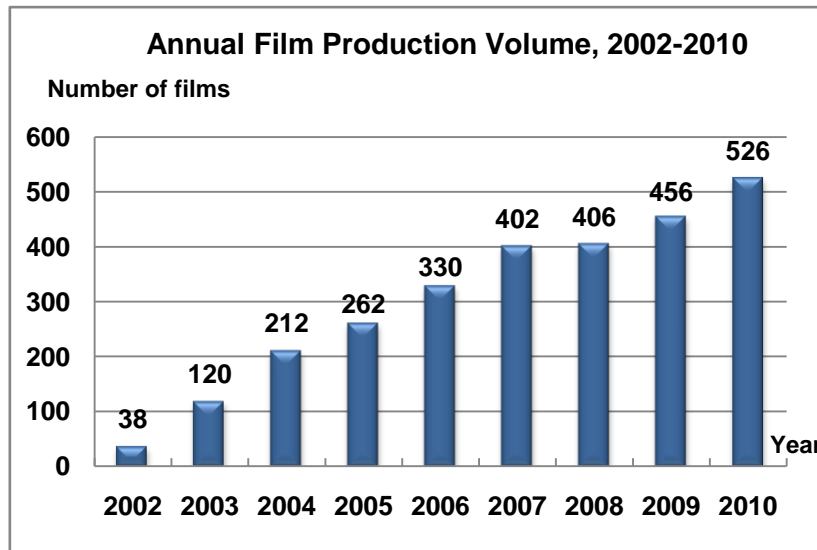
- The graphic below gives brief of different parts on Chinese film industry chain:



Source: JLJ analysis based on multiple sources; Note: VOD – Video on demand

Annual Film Production

- China's film production has been growing at a compound annual growth rate (CAGR) of ~39% from 2002-2010
- In 2010, China produced 526 story films (15% increase from that in 2009), 16 cartoon films, 16 documentary films, 54 scientific & educational films, and 9 special films
- The chart below indicates annual film production from 2002 to 2010:



Source: JLJ analysis based on multiple sources

Key production companies

- Production companies are mainly divided into two categories by ownership: 1) state-owned; and 2) privately owned
- Any forms of production companies (except rep. office) are forbidden for foreign players (including *Hong Kong* and *Macau*); and only co-production are encouraged
- In 2004, China's central government allowed foreign players to set up JV or cooperative production companies with local players; however, they soon reverted back to restricting investment again in 2005
- Top 2 state-owned players are *China Film Group* and *Shanghai Film Group*; others include *August 1st Film Studio* and smaller local players e.g. *Changchun Film Studio*, which mostly focus on education, military and countryside films
- Key domestic private players include *Huayi Brothers*, *Polybona*, *Beijing New Picture*, *Enlight Pictures*, *Stellar Megamedia* and *Golden Harvest Company*
- Large production companies typically do not only focus on production, but also extend businesses to distribution and even exhibition to form a completed industry chain

- E.g. *Huayi Brothers*, besides of production & distribution, it has set up its own cinemas from 2010 (3 in total by end of 2010)
- With policies support, more production companies such as *China Film Group*, *Shanghai Film Group* and *Enlight Pictures* have plan to go to list in 2011
- The table below shows key film production companies in China

Table: Key film production companies

Company	Role on the chain	Year established in China	Location (HQ)	Description	Representative film produced in 2010
State-owned					
China Film Group	Production + distribution + exhibition	1999	Beijing	<ul style="list-style-type: none"> • Formed 7 cinema circuit and contracted >400 cinemas with ~1/2 box office market • The only company with film import rights • Owns CCTV-6, the unique national level movie channel 	<ul style="list-style-type: none"> • <i>Let the Bullets Fly</i> (No.1* domestic film) • <i>Aftershock</i> (No. 2) • <i>Go la la go!</i> (No.14) • <i>Confucius</i> • <i>Future x-cops</i> • <i>Love in disguise</i>
Shanghai Film Group	Production + distribution + exhibition	2001	Shanghai	<ul style="list-style-type: none"> • Has 24-hour movie channel – East Movie Channel • Owns <i>Shanghai United Circuit</i> with 125 cinemas in 2010 	<ul style="list-style-type: none"> • <i>Sacrifice</i> (No.6) • <i>14 Blades</i> (No.10) • <i>True Legend</i>
Domestic private					
Beijing New Picture	Production + distribution	1997	Beijing	<ul style="list-style-type: none"> • Long-term cooperation with Director Zhang Yimou • Has invested and produced around 7 films directed by Zhang Yimou 	<ul style="list-style-type: none"> • <i>Under the Hawthorn Tree</i> (No.9)
Enlight Pictures	Production + distribution	2006	Beijing	<ul style="list-style-type: none"> • Owned by <i>Enlight Media</i> – set up in 1998 • Started film production from 2009 • Not involved in cinema circuit yet 	<ul style="list-style-type: none"> • <i>Legend of the Fist: The Return of Chen Zhen</i> (No.11) • <i>City Under Siege</i> • <i>All's Well, Ends Well 2010</i>
Huayi Brothers	Production + distribution + exhibition	1994	Beijing	<ul style="list-style-type: none"> • Listed on SZ Stock Market in 2009 • Revenue in 2010: RMB 1.07 billion, 77% increase year-on-year • Started to set up cinemas from 2010, and will have 11 by 2011 	<ul style="list-style-type: none"> • <i>Aftershock</i> (No.2) • <i>If You are the One 2</i> (No.3) • <i>Detective D</i> (No.4) • <i>Hot Summer Days</i> (No.13) • <i>The Stool Pigeon</i>
Orange Sky Golden Harvest	Production + distribution + exhibition	2006	Beijing	<ul style="list-style-type: none"> • Listed company in HK Stock Market • <i>Beijing Orange Sky</i> controlled 89% shares of <i>Hong Kong Golden Harvest</i> • Has produced 600 films • Run 24 cinemas in Southeast Asia, including China Mainland 	<ul style="list-style-type: none"> • <i>You Deserve To Be Single</i>
PolyBona	Production + distribution + exhibition	2003	Beijing	<ul style="list-style-type: none"> • Listed on NASDAQ Stock Market in 2010 • Core business is distribution; started production from 2006 • Has invested 15 cinemas from 2005 	<ul style="list-style-type: none"> • <i>Little Big Soldier</i> (No.7) • <i>Just Call Me Nobody</i> (No.8) • <i>Triple Tap</i> • <i>Just Another Pandora's Box</i> (No.12)

Table continued→

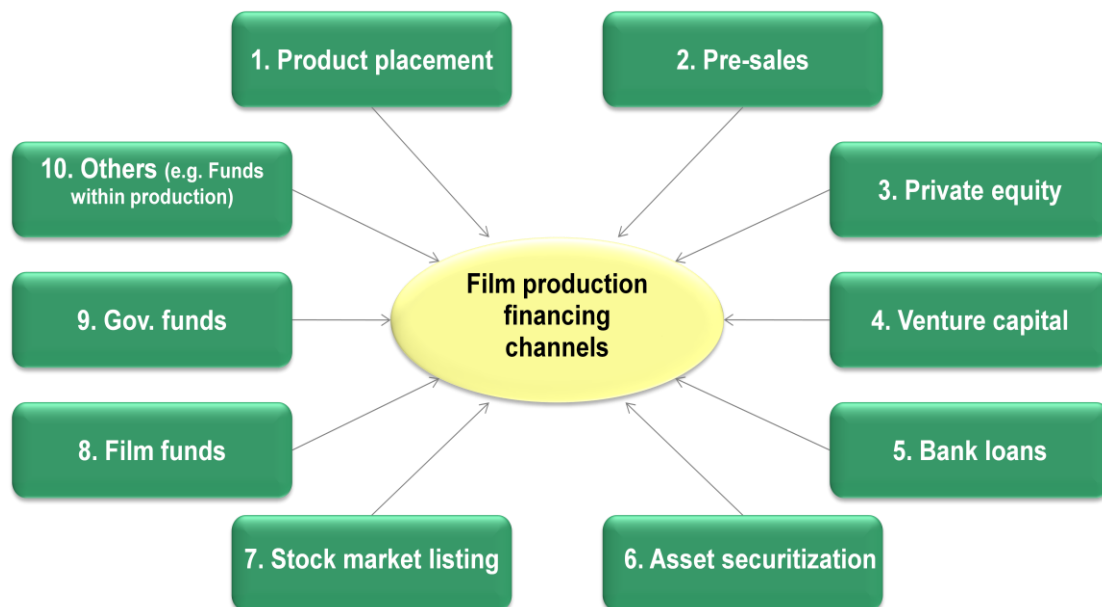
→Table continued

Company	Role on the chain	Year established in China	Location (HQ)	Description	Representative film produced in 2010
Shanghai Media Group	Production + distribution	2001	Shanghai	<ul style="list-style-type: none"> State owned corporation Multimedia group covers radio, film and TV program production; publish & press; Internet media service and etc. 	<ul style="list-style-type: none"> <i>Pleasant Goat, Big Big Wolf 2 (No.15)</i> <i>East Wind Rain</i> <i>Severn Arhat</i>
Stellar Megamedia Group	Production + distribution + exhibition	2001	Beijing	<ul style="list-style-type: none"> Owns Stellar cinema circuits and 18 cinemas Is planning to go to list in US 	<ul style="list-style-type: none"> <i>Sacrifice (No.6)</i>

Source: JLJ analysis based on multiple sources including company websites; Note: *rank of films in this table, i.e. No.1-10 is based on box office income in 2010 among only domestic films; others without rank # are behind of No. 10

Production financing structure

- Proportion of films financed from a single (or few) sources is becoming smaller and smaller; multiple and mixed financing sources are becoming the main way films are financed
- In addition to traditional financing channels, other channels such as stock market listing and PE/VC are becoming more and more popular, and new financing channel (i.e. asset securitization) was developed as well
- There are 10 key financing channels currently for film production, which are illustrated and discussed below:



Source: JLJ analysis based on multiple sources

1. Product placement

Investors: companies of all different kinds of industries

- Product placement refers to the placement of a product or its iconic visual image or even its service into the images of a film
- it is a marketing and advertisement strategy that aims to give the viewers impression of the product or brand thus creating the effect of advertisement
- Product placement has become a very important part on the industry chain
- Mr. Feng Xiaogang, Chinese well-know director cooperating with *Huayi Brothers* for over 10 years, is regarded as the first person using product placement in movie
- “If You Are The One 2”, new movie in 2010 directed by Mr. Feng, has received RMB 60 million finance support from product placement

2. Pre-sales

Investors: film distributors & exhibitors

- Pre-sales is the process of raising capital through copyright sales to both domestic and oversea distribution and exhibition companies before exhibition of the movie
- It is still a common traditional financing channel with Japan being the main pre-sales market

3. & 4. Private equity & Venture capital (PE & VC)

Investors: privates and companies

- PE & VC have become new powers in film industry financing; they developed fast in the last two years and many have set up funds to invest in film production
- Between 2005-2009, there were 28 occurrences of PE & VC investment in the film industry; each occurrence was about US\$ 9.8 million
- Some representative PE / VE funds include *One Foundation, The Weinstein Asian Foundation, IDG and Sequoia Capital* etc.
- One Foundation, established in 2007 by well-known movie star Jet Li, is the first private fund successfully transform from private fund to public fund

5. Bank loans

Investors: commercial banks (e.g. Bank of Beijing, China Merchants Bank)

- Bank loans were regarded as the “best financing channel” by Wang Zhongjun, president of *Huayi Brothers*, due to its relatively low cost
- The first bank loan to private film company was in 2004 – *Shenzhen Development Bank* loaned out RMB 50 million to *Huayi*
- The first bank loan without guarantee to film production was on Aug 2006 – *China Merchants Bank* loaned out RMB 50 million to the movie *Build-up*

- Other banks also involved in movie financing, for example, *Bank of Beijing* has cooperated with more than 20 big film companies (e.g. *Huayi*, *Bona* and *Enlight Pictures*) and accumulated investment by April 2010 reached RMB 1.5 billion
- Central and local government support for bank loans to film industry is another factor; Central government announced that it will provide 50%-100% of discount loans to cultural & creative industry from 2008

6. Asset securitization

Investors: privates and companies of different kinds of industries

- Development of a new financing channel was encouraged by the central government through “*Guideline on Promoting Cultural Industry by Financial Support*”, issued in March 2010
- This new channel was first used in May 2011 by the movie *Da Tang Xuan Ji Tu*, raising funds through *Shenzhen Qianhai Financial Asset Exchange*
- It takes the expected future earnings as foundation, and raises the funds for film production through transferring the shares of benefit rights carried out by exchange and dealers
 - 1) i.e., this method sells films the same as selling stocks shares; shares of benefit rights can be traded freely at exchange during listing period
 - 2) Exchange & dealers have the right to appoint institutions, supervise the whole production process, and at the end incomes after returning capital are allocated to share owners

7. Stock market listing

Investors: private and companies of multiple industries

- With the success of *Huayi Brothers*, more film companies started to look for capital for film production through listing on stock markets (domestic or overseas)
 - 3) E.g. *PolyBona*, investing in and producing “*just another Pandora’s box*” in 2010, listed on NSDAQ on December 2010 and became the first film company listed overseas
- China’s central government also encouraged qualified state-owned and state holding film companies to list on stock exchanges, according to “*Guideline on Promoting Cultural Industry by Financial Support*”, issued on March 2010
- More film companies of either production, distribution or cinema circuits are preparing to list in 2011 or within the next 3 years
 - 4) They include *Shanghai Film Group Corporation*, *China Film Group Corporation*, *Enlight Pictures* and *Wanda International Cinemas* etc.

8. Film funds

Investors: governments, privates, organizations and companies

- The most representative Film fund is *China Film Foundation*, a non-profit organization founded in 1989 by *Ministry of Civil Affairs* and guided by *The State Administration of Radio Film and Television (SARFT)*
 - 5) *China Film Foundation* aims to provide funds for films & televisions production of positive social meaning, especially about countryside and children
- Some new funds were set up in 2010 by governments, commercial banks or companies
- E.g. *Chinese Film and TV Publishing Industry Investment Fund*, which set up on September 2010 by *China Construction Bank* and relevant government departments to invest non-listed cultural companies through equity investment
- Additionally, the *Chinese Culture Industrial Investment Fund*, established on May 2010 by *Financial Department, BOC International* and *CCTV*
- There are also many local funds such as *Shaanxi Culture Fund* and *Suzhou Culture Fund*

9. Government funds

Investors: central & local governments

- Both central and local governments provide financial support for film development in both domestic market and for film exports
- *Aftershock*, the 3rd film ranking by box office income in 2010, received RMB 60 million (1/2 of total investment) from Tangshan government
- Since 2009, the central government has given financial awards to qualified exported films according its box office income: 2‰ of oversea box office income to the films domestically produced, and 1% to co-production films

10. Others

Investors: film production companies and other film companies of both domestic and overseas

- Other financing channels include funds within production companies and joint investment
- E.g. “*Aftershock*”, besides of funds from local government, was jointly invested by *Huayi Brothers* and *China Film Group* with 45% and 5% proportion respectively



Co-production

- Co-production is defined as cooperation on film production between Chinese players and foreign players (including those from Hong Kong and Macau), which are divided into three categories:

Table: Overview of 3 co-production types

Type	Description
1) Joint production	<ul style="list-style-type: none"> • Chinese and foreign production companies jointly invest (capital, labor and equipment) • The co-production parties jointly produce the film and jointly share the profit as well as the risks
2) Assistance production	<ul style="list-style-type: none"> • Foreign production company funds the film and films in China • The Chinese party provides equipment, location, labor and other forms of assistances
3) Commission production	<ul style="list-style-type: none"> • The foreign production company commissions the Chinese party to film in China

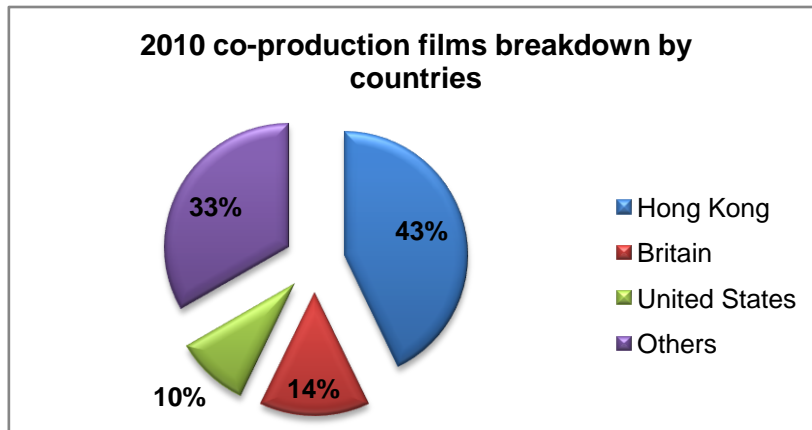
Source: JLJ analysis based on multiple sources

- *China Film Co-production Company*, a subsidiary of *China Film Group*, is the only company authorized by *SARFT* to manage co-production businesses
- Chinese party needs to apply for the “Chinese-foreign cooperative filmed movies license” from *SARFT*, then sign the contract with foreign partner; this license is valid for 2 years
- The chart below shows the co-production filming procedures:



Source: JLJ analysis based on multiple sources including “Regulations on Management of Co-production Films”

- In the past 30 years, *China Film Co-production Company* has approved 757 co-production films and more than 700 documentation films, and cooperated with companies from more than 30 countries
- In 2010, *China Film Co-production Company* approved 84 co-production films with foreign players from 11 countries and regions
- The table below shows the shares of co-production films breakdown by countries; 43% with 36 films co-produced with *Hong Kong*, 12 with *UK*, and 8 with the *US*



Source: JLJ analysis based on multiple sources; others include films from Italy

- Top two Chinese players are *China Film Group*, and *Huayi Brothers* who will keep cooperate with 20th Fox to film sequel for *Hot Summer Days* in 2011
- “*Italy Holiday*” was a coproduction between a *Beijing Ciwen Films* and *Italian Dreams Factory S.R.L*
- Following table gives the key co-production films in 2010

Table: 2010 Key co-production films with key countries

Country	Film example(s)	Domestic partner	Foreign partner	Distributor
Hong Kong	Ip Man 2	DSIM	Mandarin Films	China Film Group
	Little Big Soldier	Polybona	JCE	Huaxia Film Group/ Polybona
	Triple Tap		EEG	Polybona
	Legend of the Fist	Enlight	Media Asia	Enlight
	City under Siege		Universe Films	Enlight
	All's Well, Ends Well		Mandarin Films	Enlight
	Hot Summer Days1	Huayi Bros.	Star Television	Huayi Bros.
The Stool Pigeon	EEG		Huayi Bros.	
USA	Hot Summer Days1	Huayi Bros.	20th Fox	Huayi Bros.
	Shanghai		Weinstein	Huayi Bros.
	Go Lala Go!	China Film Group	DMG	China Film Group
	The Karate Kid		Sony Columbia	China Film Group
Korea	Heavy Paws 2	Beijing Antaeus Films	SBS	Beijing Antaeus Films
Italy	Italy Holiday	Beijing Ciwen Films	Italian Dreams Factory S.R.L	Beijing Ciwen Films

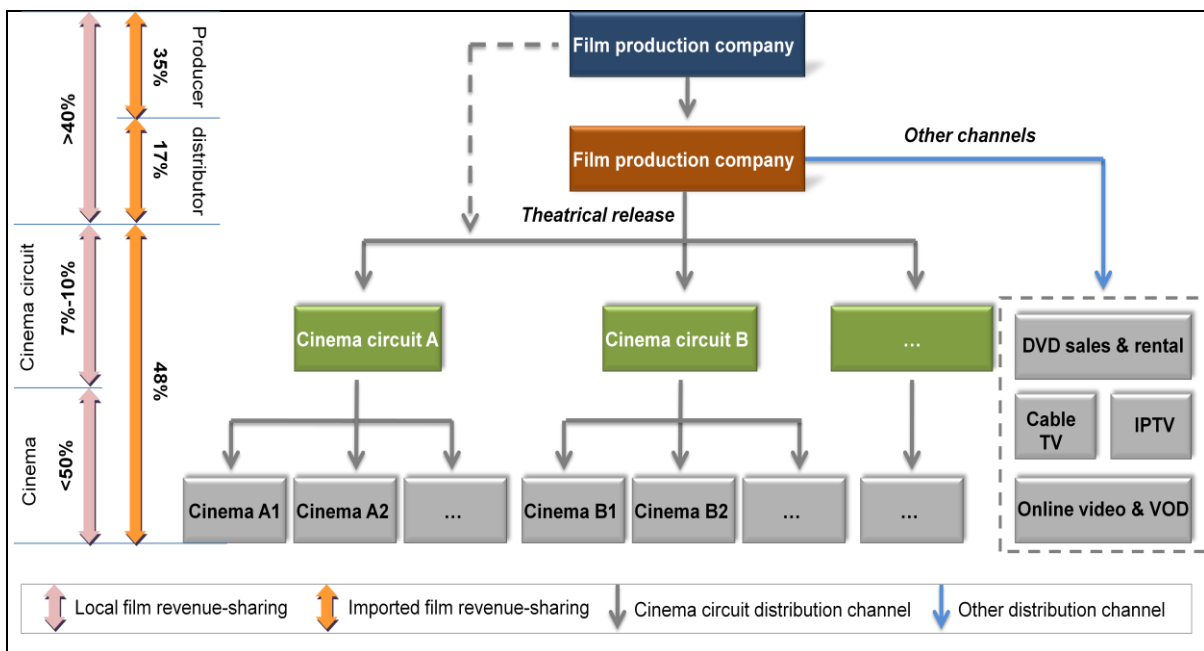
Source: JLJ analysis based on multiple sources

Film Distribution Analysis

Distribution market and structure

- The current China film distribution structure, formed in 2002, is mainly composed of three parts as shown below: 1) production companies; 2) distribution companies; and 3) cinema circuits & cinemas

Chart: China Film Distribution Structure



Source: JLJ analysis based on multiple sources

- The process is as follows: distribution companies receive copies from the production companies, and then distribute to cinema circuits, which are similar to wholesalers and distribute to cinemas screening the films
- Occasionally, production companies would send the film to cinema circuits directly
- There are four distribution models according based on cooperation models:
 - Revenue-sharing:** the most common model adopted by players for imported films and middle & large scale domestic films; players share revenue by proportion
 - Local films: producers and distributors share >40%, cinema circuits take 7%-10%, and cinemas take <50%
 - Imported films: the current proportion for producers, distributors, cinema circuits & cinemas is 35%, 17% and 48% respectively
 - Flat-fee:** distributors pay a one-time fee to buy the copyright from producers and are responsible for the promotion expenses, copy & print fees and transportation fees etc.; distributors do not share box office revenue with producers

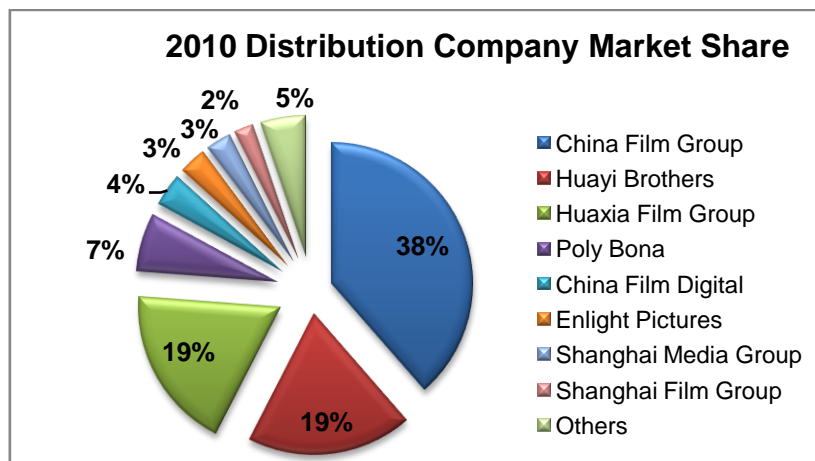
- 3) **Distribution agent:** distributors receive service fees (normally a certain proportion of box office revenues) and get the distribution & exhibition rights; distributors will not be responsible for the promotion, copy & print and transportation
- 4) **Assisted promotion** – unique model in China
 - *China Film Group* and *Huaxia Film Group* are the only two authorized distributors for imported films in China but will sub-contract to other distributors instead of distributing by themselves
 - Normally the two buy film rights with ~US\$ 500,000 and then sub-contract to other distributors, charging management fees and sharing box office revenue
- Marketing & promotion is often important to distributors and to the success of films; common marketing & promotion methods in China include conference, commercial, trailer, premiere, director's/ actor's gossip
- Besides of theatrical release, there are also some other exhibition channels; however they only account for 1/9 of theatrical release market and include:
 - **IPTV (Internet Protocol Television)**
 - Mainly based on TV; users normally need to pay around RMB 3 to RMB 8 (US\$ 0.50 – USD\$ 1.25) for each film viewing
 - China has become the fast-growing region of IPTV; by the end of 2010, there were >8 million IPTV users in China, and it is expected to exceed 12 million in 2011
 - **Online video & VOD**
 - Becoming more popular, Online video & VOD are based on PC and mobile device such as PDA²s and smart phones; some movies are free, and some need users to pay RMB 3-5 (US\$ 0.40- US\$ 0.80) each
 - 9 well-known video websites including *LETV*, *Tencent*, *PPTV*, *PPS*, *Youku*, *Thunder Network*, *Storm Codec*, *Joy.cn* and *Phoenix* have jointly formed *China Film Internet Distribution Alliance* in early of 2011 to promote internet the 2nd largest film distribution channel
 - Mobile VOD is a relatively new distribution channel; with the popularity of iPhone and other smart phones such as Android, more and more distributors stepped into mobile device entertainment market
 - **Cable TV:** subscribers can watch films free through movie channels such as CCTV 6
 - **DVD sales and rentals:** another common way besides of cinemas; however numerous copies of DVDs exist in China
 - It is estimated that China's pirated DVD market reached US\$ 6 billion in 2010, 4 times of box office revenue; however, film players cannot receive income generated from pirated DVDs

² PDA: personal digital assistant

- Pirated DVDs are usually available very quickly, e.g. only four days after the premiere of *Harry Potter and the Deathly Hallows*, pirated DVDs were available in the market
- China's government announced that it would try and control the amount of pirated DVDs on the market; however, there has been limited success in stymieing the availability of pirated DVDs

Key players' analysis

- Distribution market is dominated by several large players such as *China Film Group*, *Huayi Brothers* and *PolyBona*, who involve in production and exhibition businesses as well
- Still a small proportion of them focus on distribution only, e.g. *Huaxia Film Group*; however, two or more distributors will commonly distribute one film jointly
- Foreign players are forbidden to set up WFOE, JV or cooperative distribution companies; however, players from *Hong Kong* and *Macau* can set up 100% owned distribution company
- Distributors can be sorted into four categories: 1) distribute own films only; 2) distribute others' films only; 3), distribute both own and others' films; and 4) distribute digital films only; former three types of distributors distribute both digital and tape films
- Some distributors also have plan to extend distribution business, e.g. *Huayi Brother* is planning to distribute others' films as well
- The following chart indicates key distributors' market share in 2010



Source: JLJ analysis based on multiple sources

- *Huayi Brothers* had a rapid growth in 2010, with 19% market share comparing to 7% in 2009, due to its 3 movies in top 10

- The table below show key distributors of four categories – key players mentioned in production section will not described in detail:

Table: Key film distribution companies

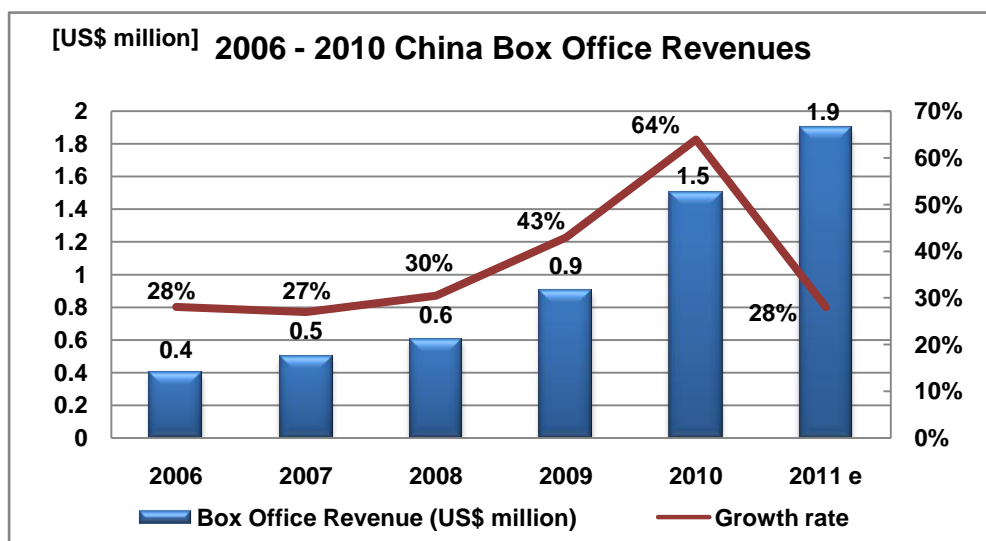
Company	Role on the chain	Films distributed in 2010 ¹
Distribute own films only		
<i>Beijing New Picture</i>	Production + distribution	<ul style="list-style-type: none"> Only one film of box office income over 20 million, i.e. <i>Under the Hawthorn Tree</i> (No.17²)
<i>Huayi Brothers</i>	Production + distribution + exhibition	<ul style="list-style-type: none"> Distributed 7 films solely and jointly Representative films: <i>Aftershock</i> (No.3), <i>If You are the One 2</i> (No.4), <i>Detective D</i> (No.6), <i>Hot Summer Days</i> (No.22) and <i>The Stool Pigeon</i> (No.44) etc.
<i>Orange Sky Golden Harvest</i>	Production + distribution + exhibition	<ul style="list-style-type: none"> Few films distributed, none is in top 62 Representative film: <i>You Deserve To Be Single</i>
Distribute own and others' films		
<i>China Film Group</i>	Production + distribution + exhibition	<ul style="list-style-type: none"> Distributed >44 domestic & imported films solely and jointly Representative films include <i>Avatar</i> (No.1), <i>Let the Bullets Fly</i> (No.2), <i>Aftershock</i> (No.3), <i>If You are the One 2</i> (No.4), <i>Inception</i> (No.5), <i>Ip Man 2</i> (No. 7) etc.
<i>Enlight Pictures</i>	Production + distribution	<ul style="list-style-type: none"> Distributed 3 films solely and jointly Representative films include <i>Legend of the Fist</i> (No. 20), <i>City Under Siege</i> (No. 31), and <i>All's Well, Ends Well 2010</i> (No.37) etc.
<i>PolyBona</i>	Production + distribution + exhibition	<ul style="list-style-type: none"> Distributed 6 films solely and jointly Representative films include <i>Little Big Soldier</i> (No. 14), <i>Just Call Me Nobody</i> (No. 15), <i>Just Another Pandora's Box</i> (No. 21) etc.
<i>Shanghai Film Group</i>	Production + distribution + exhibition	<ul style="list-style-type: none"> Distributed 2 films solely and jointly Representative films include <i>14 Blades</i> (No. 18) and <i>True Legend</i> (No.42)
<i>Shanghai Media Group</i>	Production + distribution +	<ul style="list-style-type: none"> Distributed 5 film solely and jointly Representative films include <i>Pleasant Goat and Big Big Wolf 2</i> (No. 24)
Distribute others' films only		
<i>Huaxia Film Group</i>	Distribution + exhibition	<ul style="list-style-type: none"> State-owned by 19 national film companies including <i>China Film Group</i> Distributed 17 domestic & imported films solely and jointly in 2010 Representative films include <i>Alice in Wonderland</i> (No.8), <i>Harry Potter and the Deathly Hallows</i> (No.9), and <i>Iron Man 2</i> (No.12)
Distribute digital film only		
<i>China Film Digital</i>	Distribution + exhibition	<ul style="list-style-type: none"> Jointly invested by <i>China Film Group</i> and <i>Hualong Film Digital</i> Distributed 4 films in 2010 Representative films include <i>Clash of the Titans</i> (No. 13), <i>Toy Story 3</i> (No.26), <i>Legend of the Guardians</i> (No.53) and <i>Ocean World</i> (No.62)

Source: JLJ analysis based on multiple sources; Note: 1. # of films players distributed and film examples listed in this table indicate those with box office income of over 20 million, total # of films with >20 million income in 2010 = 62; 2. * rank of films in this table is based on box office income among domestic and imported films together

2010 Box Office Review

General overview

- China's box office revenues have been growing at a compound annual growth rate (CAGR) of ~39% from 2006 to 2010
- China's box office market grew sharply in 2010 with >RMB 10 billion (~US\$ 1.5 billion) in revenues, a 64% growth from 2009; and among them, local films accounted for 56%
- China box office revenues are expected to reach US\$ 1.9 billion in 2011
- The chart below illustrates box office revenues and growth rate from 2006-2011:



- In addition to revenues from box offices, revenues generated through movie channels broadcast reached RMB 2 billion (~US\$ 294 million) in 2010
- There are several factors driving box office development: a sound economy, higher-quality films, advanced new technologies, higher average ticket prices and development of new film screens etc.
- Over 300 new cinemas and over 1500 new screens were constructed; total national cinemas exceed 760 and over 6,200 screens by the end of 2010
- Many film players started to set up cinemas in Tier 2 & 3 cities to expand market coverage and gain share
- Capital is not only from film companies, but also other industries, e.g. *Orion*, one of the four biggest food companies from South Korean, invested in *Imega Box* cinema with *Beijing New Film Association* early in 2007
- Foreign players are active in China's cinema market, and many have set up JV cinemas with a minority share (49% share maximum) in most of tier 2 & 3 cities
- Only in several trial cities including *Beijing*, *Shanghai*, *Guangzhou*, *Chengdu*, *Xi'an*, *Wuhan*, and *Nanjing* can they control a cinema with up to 75% share



- However, exceptions are *Hong Kong & Macau* players, which are allowed to set up cinemas 100% wholly owned
- In addition, foreign players are prohibited to be involve in cinema circuits in any form

Overview of key players

- Many large key players with production and distribution business have invested or gradually set up their own cinema circuits and cinemas, such as *Huayi Brothers*
- There were 38 cinema circuits by the end of 2010, with 760 cinemas; however, not all cinemas are owned by cinema circuits
- The following table shows relationships between cinema circuits and cinemas

Table: 2 Different types of cinema circuit in China

Type	Relationship between cinema circuits and cinemas	Representative cinema circuit	Description
Regular Chain	<ul style="list-style-type: none"> - The cinema circuit or its owners provide investment for cinema's construction - The cinema is owned by the cinema circuit 	<i>Wanda Cinema Circuit</i>	<ul style="list-style-type: none"> - The cinema circuit provides film and capitals for cinema construction - The cinemas have the same brand, the same film schedule, and the same management - This type is widely adopted in foreign countries
Franchise	<ul style="list-style-type: none"> - The cinema and its properties do not belong to the cinema circuit, but independent legal entities - The cinema joins a cinema circuit just as a contractor 	<i>China Film Stellar Theater Chain</i> <i>Beijing New Film Association</i>	<ul style="list-style-type: none"> - The cinema circuit is just the film provider - The cinemas have same film schedules, but still have their own brands and management - This type is unique to China

Source: JLJ analysis based on multiple sources

- The following table shows the top 5 cinema circuits by income and their cinemas in 2010

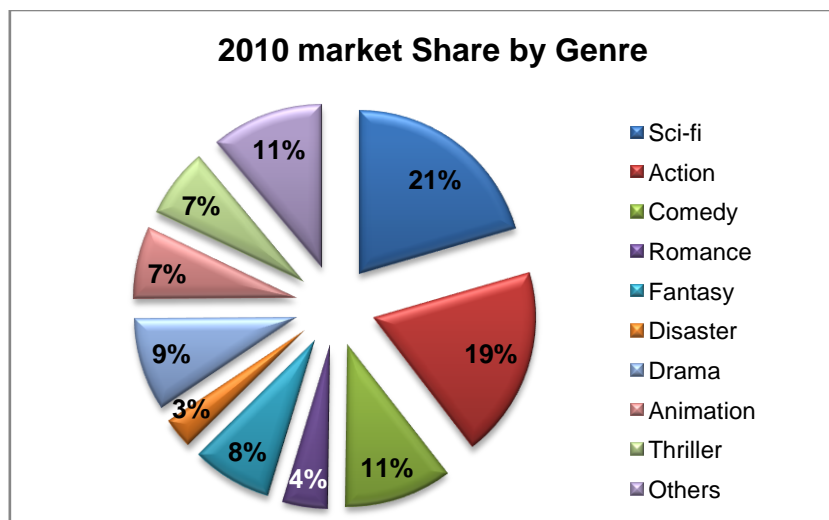
Table: Top-5 cinema circuits & cinemas in 2010 by box office income

Rank	Cinema Circuit	Main investor(s)	Type	Representative cinemas	# of cinema (#of screens)	Box-Office (US\$ M)
1	<i>Wanda International Cinemas</i>	<i>Wanda Group</i>	<i>Regular Chain</i>	<i>Wanda Cinemas</i>	71 (600+)	206
2	<i>China Film Stellar Theater Chain</i>	<i>China Film Group, Stellar Media</i>	Franchise	<i>UME International Cinemas, Golden Harvest Shenzhen Cinemas, Stellar International Cinemas</i>	124 (657)	178
3	<i>Shanghai United Circuit</i>	<i>Shanghai Film Group</i>	Franchise	<i>Studio City Cinema, Jackie Chan Cinema, Yonghua Cinema</i>	125 (483)	158
4	<i>China Film Group South New-Line Corporation</i>	<i>China Film Group, Guangdong Film Company</i>	Franchise	<i>Shenzhen Bona Cinema, Shenzhen Broadway Cinema</i>	94 (312)	140
5	<i>Beijing New Film Association</i>	<i>China Film Group, Beijing Film Company</i>	Franchise	<i>New Dong'an Cinema, Film Association Cinema, Wudaokou Cinema</i>	85 (533)	117

Source: JIJ analysis based on multiple sources

Popular genres

- Sci-fi films were the top performing genres in terms of revenue in 2010, primarily due to the outstanding performance of “Avatar” and “Inception”
- Action and comedy films are also very popular genres; representative films include “Let the Bullets Fly”, “Detective D” and “Ip Man 2”
- Urban romance films are becoming more and more popular in recent years; representative films include “If You are the One 2” and “Eternal Moment” (spring 2011)
- Chinese directors were previously regarded as not being able to product excellent disaster films, however, in 2010 “Aftershock” broke the domestic film box office record and has become the domestic disaster film pioneer
- Below is a breakdown of film genres produced in 2010



Source: JLJ analysis based on multiple sources

Overview of key 2010 films (foreign & domestic)

- At the beginning of 2010, the US produced film “Avatar” was released worldwide; revenues from China were about ~RMB 1.4 billion (US\$ 201 million) and was the highest grossing film of the year
- Although facing fierce competition from *Hollywood* movies, domestically produced films are becoming more successful
- “Aftershock” and “Let the Bullets Fly” are two domestic films that broke the domestic box office record in summer and New Years in 2010
- There were 17 domestically produced films which had box-office revenues exceed RMB 100 million (~US\$ 15 million)

- Sequel is a key word in 2010 China film market. Series like “*If You Are the One*”, “*Ip Man*”, and “*Pleasant Goat, Big Big Wolf*”, all launched their sequels in 2010

Table: Top 10 domestic films & top 10 foreign films in 2010

Rank	Film	Production Company	Release Date	Box-Office Income (million RMB)
Top 10 domestic films				
1	<i>Let the Bullets Fly</i>	Chine Film Group	2010-12-16	664
2	<i>Aftershock</i>	Huayi Bros.	2010-7-22	647
3	<i>If You are the One 2</i>	Huayi Bros.	2010-12-22	473
4	<i>Detective D</i>	Huayi Bros.	2010-9-29	295
5	<i>Ip Man 2</i>	Mandarin Films	2010-4-27	232
6	<i>Sacrifice</i>	Stellar Megamedia	2010-12-4	196
7	<i>Little Big Soldier</i>	Polybona Films	2010-2-14	160
8	<i>Just Call Me Nobody</i>	Polybona Films	2010-12-3	158
9	<i>Under the Hawthorn Tree</i>	Beijing New Picture	2010-9-16	144
10	<i>14 Blades</i>	Shanghai Film Group	2010-2-3	143
Top 10 foreign films				
1	<i>Avatar</i>	20th Century Fox	2010-1-2	1,378
2	<i>Inception</i>	Warner Bros.	2010-9-1	457
3	<i>Alice in Wonderland</i>	Walt Disney Pictures	2010-3-26	226
4	<i>Harry Potter & Deathly Hallows</i>	Warner Bros.	2010-11-19	221
5	<i>The Expendables</i>	Millenium Films	2010-8-20	213
6	<i>Iron Man 2</i>	Paramount Pictures	2010-5-7	176
7	<i>Clash of the Titans</i>	Warner Bros.	2010-4-16	175
8	<i>Prince of Persia</i>	Walt Disney Pictures	2010-5-28	158
9	<i>Resident Evil: Afterlife</i>	Constantin Film	2010-11-16	143
10	<i>Toy Story 3</i>	Walt Disney Pictures	2010-6-16	110

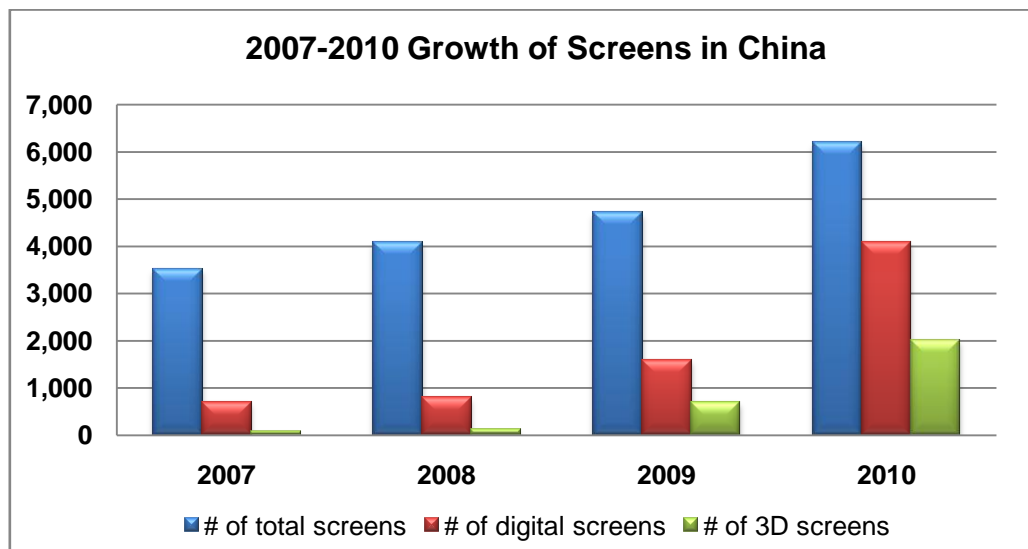
Source: JLJ analysis based on multiple sources

Analysis of new technologies

- With a totally different visual experience, Chinese consumers are willing to pay a premium for *IMAX*³ and *3D* films, which became a very important contributor to box office revenues in 2010; the technology is mostly imported
- In 2010, box office income from *3D/IMAX* imported films accounted for 77% of total revenue from imported films
- Representative *3D/IMAX* imported films include “*Avatar*”, “*Alice in Wonderland*”, “*Toys Story 3*”, “*How to Train Your Dragon*” and “*Inception*”
- In 2010, the number of digital screens rose to ~4,100 (156% increase from 2009), ranking No.2 in the world after the US; the number is expected to increase to 11,800 by 2012

³ IMAX: Image Maximum

- Fast development of digital screens benefit from policies issued on Nov 2009 that cinemas installing digital screens can enjoy up to RMB 50,000 (US\$ ~7,300) subsidies from state film funds
- Box office income from digital films was ~RMB 7 billion (US\$ 1 billion) in 2010, which accounted for 68% of total annual box office
- Many cinemas also accelerate 3D/IMAX screen construction; the number of 3D screens reached 2,020 by the end of 2010 with 190% CAGR since 2007
- Table below shows number of total screens, digital screens and 3D screens from 2007 to 2010



Source: JLJ analysis based on multiple sources

Ticket pricing analysis

- Tickets of films are typically priced based on several key factors:
 - Distribution companies set a minimum price, and based on the minimum price, cinema circuits and cinemas can have some difference from each other
 - Cinema circuits and cinemas will consider the film's quality and running time it will spend to decide price, e.g. cinemas will set higher ticket price for a film of 3-hour than that of a 2-hour film, as 3-hour film will make cinema less showing times per day
 - They will also consider consumption level of local residents; film price in Beijing & Shanghai will definitely higher than that on tier 2 and 3 cities
 - Cinemas also need to add their construction and operating costs into film price
 - Other factors include seasonal effect and screen duration etc.
- In 2010, there were 2.5 billion person-times of tickets sold; thus, the average film ticket price was ~RMB 40 (US\$ 5.90), compared to RMB 31 (US\$ 4.50) in 2009
- The increase of ticket prices are mainly due to the development of 3D/IMAX

movies, which have much higher ticket price than ordinary tickets due to the higher production & construction costs

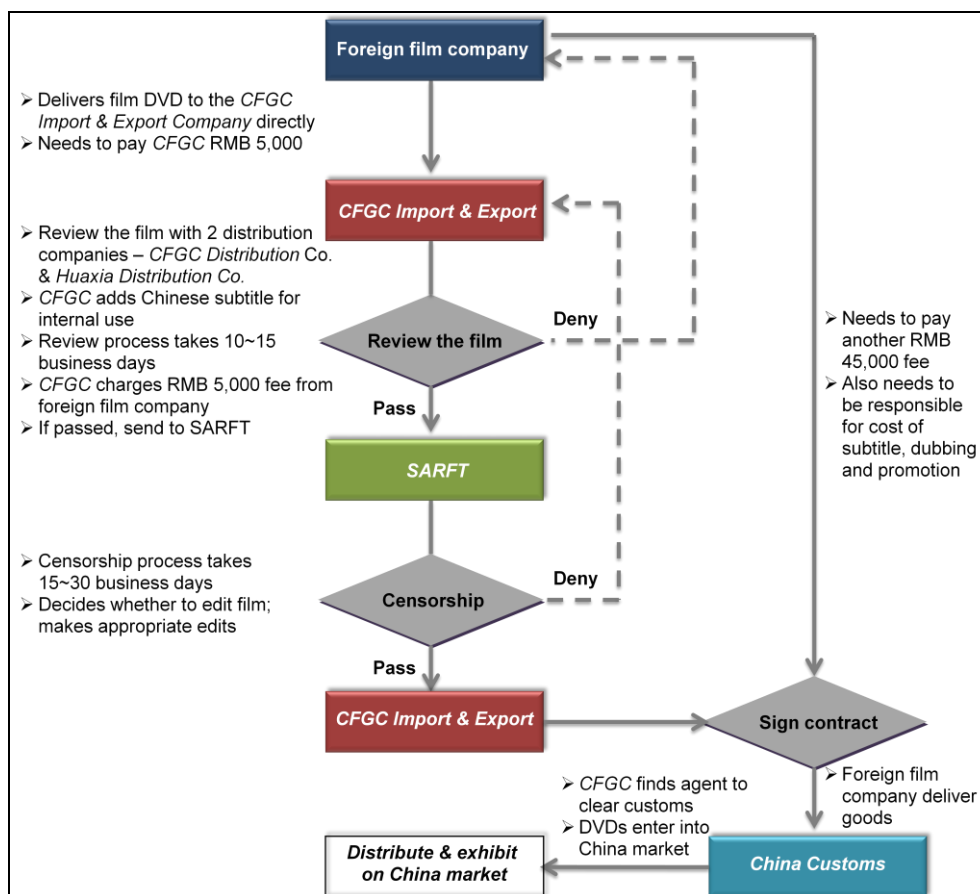
- E.g. in Beijing, the average retail price for an ordinary digital film is ~RMB 60 (US\$ 8.80), but a 3D or IMAX film ticket price is at least RMB 80 (US\$ 12); film of both 3D and IMAX features can be priced at RMB 90 (US\$ 13) or more
- Shanghai and other tier 1 cities have similar retail prices as Beijing; in tier 2 and 3 cities, the retail price for the same film could be up 1/3 of the price of cinemas in tier 1 cities
- Normally, cinemas provide discounted films or other promotions to consumers through different ways, for example:
 - **Student tickets:** apply to students in all level of schools recognized by *Ministry of National Education* (except graduate students); students can get half-price ticket but need to show student ID
 - **Half-price day:** Most of city governments select one day in a week as half-price day; For cities like *Beijing, Dalian* and *Shanghai*, every Tuesday is half-price day
 - **Tickets to group clients:** Sales to group clients like companies, government departments and public organizations; discounted tickets or free tickets are distributed to their crew as extra bonus or allowance
 - **Coupon/gift card:** The cinemas issue coupons or gift cards to public in purpose of attracting more customers
 - **Member card:** consumers bought member card with different value and can enjoy discount and priority to buy tickets without waiting
 - **Group purchase ticket:** group purchasing is new in China but is developing rapidly in recent year; it is convenient and cheaper for consumers
 - There are more than 1,000 group purchase sites in China; one of the site's core businesses is group purchase film ticket
 - Normally, a group purchase film ticket price can be as low as the 60%-80% off its retail price
 - Film tickets are more likely sold in bundles on the group purchase sites, e.g. 2 tickets, 2 drinks and a bag of popcorn in a bundle
 - Group purchase sites and cinemas earn very little (if any) profit by selling cheap tickets; their main intention is to increase popularity from such activities

Import & Export Analysis

Note: HS codes for film and cinematographic goods are HS Code 3706: “Cinematographic film, exposed and developed, whether or not incorporating sound track or consisting only of sound track”; however, because this is not specific enough, this Import Export Analysis is based on data obtained directly from The State Administration of Radio Film and Television (SARFT) instead of China Customs

Procedure of film imports

- Imported films are operated & managed by *China Film Group* according to “*The Measures of Control over Imported Films*”, and supervised by *The State Administration of Radio Film and Television* (“*SARFT*”)
- *China Film Import and Export Company*, subsidiary of *China Film Group*, is the only authorized company with film import rights; any violators will be penalized
- *China Film Group* and *Huaxia Film Group* are the only two authorized distributors for imported films in China but they will sub-contract to other distributors
- Co-produced business with foreign film companies including *Hong Kong*, *Macau* and *Taiwan* regions are all managed by *China Film Co-production Company*, another subsidiary of *China Film Group*
- The general procedure of film import is show as below:



Source: JLJ analysis based on multiple sources including CFGC



- Tariffs are assessed by *China Film Group* according to different type of imported films:
 - For commercial films distributed nationwide, import tariff should be paid when customs is cleared; lowest tariff (that to the most-favored-nation) is 5% and ordinary tariff is 14%
 - For non-commercial films (e.g. education specialized), the import tariff will be exempt

Quota & types of imported films

- The current imported films in China can be divided into three types as shown in the table below; among them, revenue-sharing is the main type:

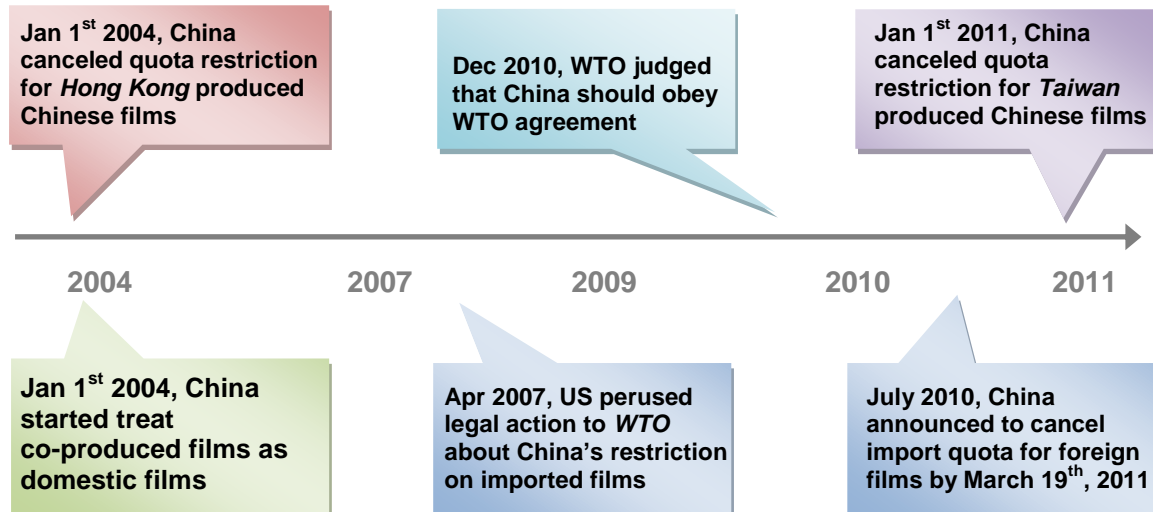
Table: 3 Types of Imported Films in China

Type	Quota (# of films per year)	Introduction
Revenue sharing	20	<ul style="list-style-type: none"> - The main type especially for big-scale films (77% of total imported films by income) - Commonly 15 of the 20 films are imported from US, and the other 5 from other countries - Dominated by Hollywood “Big 6” film companies - Revenue sharing proportion: foreign production company: distribution company: cinema circuit& cinemas = 35%:17%:48% - Simultaneous release with the international market - Examples: <i>Avatar</i>, <i>Inception</i>
Flat-fee	20	<ul style="list-style-type: none"> - ~12% of total imported box office by income - Normally, the distribution company directly buys a bunch of films from a same production company, and pays a lump sum - This type of imported films are not expected to have good box-office; part of them are new films, and part are old films - Not all the 20 films are on show in that year, some may be kept and to be shown the next year - Lag behind the international market - Examples: <i>The Expendables</i>
Special imports	No restriction (7 in total in 2010)	<ul style="list-style-type: none"> - Includes films produced in Hong Kong, Macau and Taiwan in mandarin, special films (3D/IMAX) - Small part of box office (11%) - Those films are either revenue-sharing or flat-fee; and simultaneous release or old films - Some big-scale films are classified into “special imports” just because there is no enough quota for “revenue sharing”

Source: JLJ analysis based on multiple sources; Note: * “Big 6”: *20th Fox*, *Warner Bros.*, *Paramount*, *Sony Columbia*, *Disney* and *Universal*

- *China Film Import & Export Co.* normally discuss with *China Film Distribution Co.* and *Huaxia Film Distribution Co.* to decide which films are revenue-sharing and which are flat-fee
- The decision typically depends on their experience and market outlook of this film
- China had strictly controlled imported entertainment products for many years, but the restriction were gradually loosened, e.g. quota for revenue-sharing films was increased to 20 from 10 in 2004

- Other changes such as canceling quota restrictions for Chinese films from *Taiwan & Hong Kong* as shown below (from 2004 by now):



- Foreign film companies especially those from US were dissatisfied with Chinese regulations on imported films and pursued legal actions in the *WTO*; the *WTO* made judgment in favor of the *US* at the end of 2009
- On July 2010, China announced that they would cancel the import quota for foreign films by March 19, 2011 especially for the revenue-sharing films, which is however still not stated by any official regulations
- The expected changes in terms imported films quantity, distribution and showing time, comparing to the current situations, is shown as below:

Table: Current restrictions on foreign film and possible changes

Item	2010 restrictions	Possible changes
Film import quantity	<ul style="list-style-type: none"> - Annual imported revenue-sharing films: no more than 20 - Annual imported flat-fee films: no more than 20 	<ul style="list-style-type: none"> - The import quota of revenue-sharing films would be increased to 40 or even be canceled - Flat-fee films: will change, but still no more information
Distributor	<ul style="list-style-type: none"> - Currently, only <i>China Film Group</i> and <i>Huaxia Film Group</i> the 2 companies authorized to distribute imported films 	<ul style="list-style-type: none"> - Private film companies would be authorized to distribute foreign films.
Showing time	<ul style="list-style-type: none"> - The annual showing time of foreign films cannot be more than 1/3 of total film showing time. 	<ul style="list-style-type: none"> - No change

Source: JLJ analysis based on multiple sources

Performance of Imported Film in China Market

- China imported 47 foreign films in 2010 including 20 revenue-sharing films, 20 flat-fee films and 7 special imports films
- Among the 20 imported foreign films (revenue-sharing), 16 were from US (80%), and one film each (4 in total) from France, Russia, India and UK
- Total revenue of imported films reached RMB 4.5 billion (US\$ 650 million), accounting for 44% market share
- Of the top 10 grossing films in 2010, 5 were imported and 5 were domestic; however, the 5 imported films have higher box office revenues with RMB 2.5 billion (~US\$ 370 million)
- The table below shows top 10 domestic & imported films in 2010 by box office revenues; all of the imported films on the top 10 list are from the US:

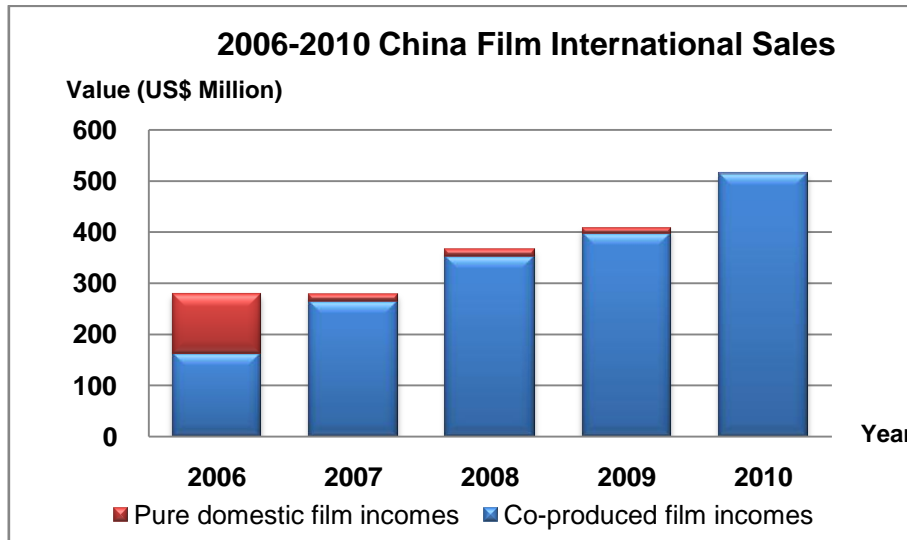
Table: 2010 China box-office Top 10 films (domestic & imported)

Rank	Film name	Film type	Box Office (million RMB)	Production Company	Import Type
1	Avatar	Imported (US)	1,378	20th Fox	Revenue-sharing
2	Let the Bullets Fly	Domestic	664	China Film Group	N/A
3	Aftershock	Domestic	647	Huayi Brothers	N/A
4	If You are the One 2	Domestic	473	Huayi Brothers	N/A
5	Inception	Imported (US)	457	Warner Brothers	Revenue-sharing
6	Detective D	Domestic	295	Huayi Brothers	N/A
7	Ip Man 2	Domestic	232	Mandarin Films	N/A
8	Alice in Wonderland	Imported (US)	226	Disney	Revenue-sharing
9	Harry Potter and the Deathly Hallows	Imported (US)	221	Warner Brothers	Revenue-sharing
10	The Expendables	Imported (US)	213	Millennium Films	Flat-fee

Source: JLJ analysis based on multiple sources

Export analysis

- In 2010, 47 domestic films were exported to more than 60 countries and regions; 46 out the 47 were co-produced films
- Export volume was less compared to 2009; however the value was higher (US\$ 515 million with growth rate of 27%)



Source: JLJ analysis based on multiple sources

- *North America, Pacific Asia and Europe* are still China films' main output areas; *Asia Pacific* was the largest area in 2010 with 60% of the 47 films exported to
- Although there were only 2 films exported to the US, the sales from US reached US\$ 170 million (~1/3 of total exported value), making the US the top 1 country by value
- There were 3 films with international sales over RMB 100 million: *The Karate Kid* (RMB 2.4 billion), *Ip Man 2* (RMB 218 million) and *Astro Boy* (RMB 115 million)
- These 3 films had contributed 76% of total export values; other representative films exported include *14 Blades, Confucius, True Legend and Detective D etc.*
- China's government also encourages the export of films; SARFT had reached an agreement with *Export-Import Bank of China (EIBC)* in August 2010
 - *EIBC* would provide RMB 20 billion (US\$ ~3 billion) or equal foreign currency financing support to domestic film/TV players in the next 5 years to help them/their films be exported
- From the end of 2009, China's central government gave financial awards to qualified exported films according its box office income: 2% of oversea box office income to the films domestically produced, and 1% to co-production films

REGULATORY ANALYSIS

The Chinese legal system is still evolving and laws & regulations tend to undergo frequent, if not constant, change; regional differences also exist and national regulations may differ from what is implemented at the local level

Key government bodies and companies

- All film's production, distribution & exhibition are supervised by *The State Administration of Radio Film and Television* (here after "SARFT")
- SARFT also promotes national cultural industry development and reform, and manages all radio & TV industries related activities besides of film industry
- *China Film Co-production Company*, a subsidiary of *China Film Group*, is the only company authorized by SARFT to manage co-production businesses
- *China Film Import & Export Company*, a subsidiary of *China Film Group*, is the only company authorized to do film import business
- *Huaxia Film Group* and *China Film Distribution Company* of *China Film Group* are the only two companies authorized to distribute imported films, but they normally sub-contract to other distribution companies

The 12th Five-Year Plan (2011-2015)

- The Five-Year Plan is the most important guideline to China's economy and industrial development, which will set up goals and development directions for various sectors every five year
- Normally there will be an "overview Five-Year Plan" and each industry will have its own industrial Five-Year Plan; the film industry, falls under the "*Cultural Industry Five-Year Plan*"
- The overview 12th Five-Year Plan will develop cultural industry as the strategy industry of China, making cultural industrial production value accounts for 5% of GDP from the current 2.5% by 2015
- "*Cultural Industrial 12th Five-Year Plan*" aims to have the annual growth rate of cultural industry reach 15% between 2011-2015
- From the Plan, governments will continue to provide financing and policy supports, e.g. reducing or remission of taxes, bank loan etc.

Guideline on Promoting the Development of the Film Industry

- *State Council Document, No. (2010) 9*

- The guidance was issued by *State Council* on September 2010
- It is considered as the “Film Industry Five-Year Plan” and will make the film industry to become the national strategic industry
- The guideline will promote the production of animation films, documentary films, science/educational films; continue to setup a special fund for outstanding movies
- It will encourage the state-owned movie institutions reform and run by different investors rather than the government, encourage social capital investment and simplify examination & approval procedure
- It will support the construction of digital movie theaters, providing preferential tax policies and allowance etc.

Copyright

- Copyright is a severe problem in China that has bothered film players, especially foreign ones, for many years; it is not the lack of regulations, but the inconsistent enforcement of regulations
- One of the representative copyright problems in film industry is the pirated DVD, which has a huge market in China
 - E.g. only 4 days after the premiere of *Harry Potter and the Deathly Hallows*, pirated DVDs entered into the market
 - It is estimated that China’s pirated DVD market has 4 times of box office revenues, with US\$ 6 billion in 2010, which cannot be shared by film players
- However, Chinese government have taken actions to strengthen copyrights, e.g. from Oct 2010, relevant governments have started special action on fighting against infringement of intellectual property rights and counterfeit goods
- Additionally, some channels have been regulated as well; e.g. 2-3 years ago, all films could be downloaded for free from internet, but recently video websites started to charge fees for new films at ~RMB 5 per film
- On April 2011, “2011 Implementing Plan for National Intellectual Property Strategy” was issued by *State Council* to promote intellectual property protection
 - This is the 3rd year to issue this annual plan, which made by 28 government departments together, and also specified plans were made for each of the 28 departments to execute
 - The 28 departments include *State Copyright Bureau, SARFT, Ministry of Culture, China Customs, the Ministry of Commerce, and Ministry of Science & Technology* etc.
 - This is a comprehensive plan covering copyright, patent ,trademark and other products that serve for almost all industries including agriculture, manufacture and service especially high-tech and creative industry

- Film- relevant regulations about copyright include:
 - Strengthen law efforts on copyright, and promote to establish IPR protection permanent mechanism
 - Further develop “the special action on fighting against infringement of intellectual property rights and counterfeit & shoddy goods”
 - Manage & punish copyright piracy from production to distribution, especially develop special action to network copyright piracy
 - Encourage players to sufficiently utilize the *Shanghai International Film Festival*, and other radio, film & television shows as communication platform for copyright owners

Rating system

- Unlike the US and most European countries, China does not have rating system
- It has been discussed during the past several years; however on May 18, 2011 SARFT clearly stated that China would not take a film rating system at the moment
- SARFT stated that rating system is still not suitable for China’s current film market; however, they will keep improving management, reforming current situation, and trying to develop a system fitting China’s film market and culture

Restriction on legal entity setup for foreign players

- Foreign players are still restricted in film production and distribution legal setup; only co-production and rep. office are allowed, but WFOE and JV are forbidden
- Additionally, foreign players are not allowed to set up cinema circuits
- However, foreign players can set up jointed cinemas (<49% shares) in most of tier 2 & 3 cities; only in several trial cities including *Beijing, Shanghai, Guangzhou, Chengdu, Xi’an, Wuhan, and Nanjing* can they control with up to 75% of share
- *Hong Kong & Macau* players are exceptions which are allowed to set up distribution company & cinemas 100% wholly owned

Other relevant regulations

- The table below details other relevant regulations regarding co-production, imported films and cinemas

Table: Other Relevant Regulations

Regulation	Effect Date	Key Contents
Foreign Investment in Cinemas Tentative Provisions	Jan, 2004; (final supplementary Provisions: Feb, 2006)	<ul style="list-style-type: none"> The provisions was supplemented twice in 2005 and 2006 It regulates that foreign investors should not set up cinema circuits with any forms, and should not set up wholly foreign-owned cinemas either Foreign investors can only have Joint-invested or cooperative cinemas but with 49% shares at most But foreign investors can have 75% shares at most in several trial cities (e.g. Beijing, Shanghai, Guangzhou, Chengdu, Xi'an, Wuhan, Nanjing) The cooperation should be within 30 years From Feb 2006, investors from Hong Kong and Macau can set up cinemas 100% owned by themselves
Regulations on Management of Co-production Films	Aug, 2004	<ul style="list-style-type: none"> Defines 3 types of co-productions: Joint production, assistance production and commission production Chinese part should apply "Chinese-foreign cooperative filmed movies license" from SARFT, then sign the Chinese-foreign cooperative filmed movies contract Contract of co-production film has 2 years validity
Regulations on Administration of Films	Feb, 2002	<ul style="list-style-type: none"> For all co-produced films, Chinese part should apply "Chinese-foreign cooperative filmed movies license" from government, then sign the Chinese-foreign cooperative filmed movies contract SARFT will appoint special company taking film import business Annual domestic films' showing time should be no less than the 2/3 of total
Measures to Strengthen Import of Broadcast Program, TV Program & Films	Mar, 2000	<ul style="list-style-type: none"> All films, TV programs and other files imported by TV stations, radio stations and <i>China Film Group</i> etc. should be supervised & managed by SARFT Companies should apply for "imported film & TV program receipt" from SARFT and then clear customs from China Customs
Measures to Control over Imported Films	Oct, 1981	<ul style="list-style-type: none"> All movies and preview copies import businesses are operated & managed by the <i>China Film Group</i> All co-production businesses & co-production film imports are operated & managed by <i>China Film Group</i> For commercial films distributed national wide, import tariff should be paid when clear customs; lowest tariff (that to the most-favored-nation) is 5% and ordinary tariff is 14% For non-commercial films (e.g. education specialized), the import tariff will be exempted

Source: JLJ analysis based on multiple sources

KEY MARKET DYNAMICS

3D & IMAX films get more and more popular

- 3D and IMAX films have become the major contributor to China's film box-office revenues in 2010; e.g. *Avatar* alone accounted for ~14% of the total box-office revenues
- Among all imported films, revenues of 3D and IMAX films accounted for 77% of the total imported films in 2010
- 3D / IMAX screens growing very fast; the number of 3D screens reached 2,020 by the end of 2010 with 229% average annual growth rate the recent three years
- With totally different visual experience, Chinese consumers are willing to pay a premium for *IMAX*⁴ and 3D films, which will be expected to have a further development in the future

Large players have vertical integration within industrial chain

- To strengthen the competitiveness and take more market share, many large film companies had expanded their businesses to upstream or downstream and cover the overall industrial chain
- E.g. *Huayi Brothers*, besides of production & distribution, had set up its own cinemas from 2010 (3 in total in 2010, will have 11 by end of 2011)
- The market is getting more and more concentrated and dominated by several large players

New financing channel developed & more players choose to go to list

- Asset securitization, a new financing channel was encouraged by government through "*Guideline on Promoting Cultural Industry by Financial Support*", issued on March 2010
- This new financing channel was actually firstly used in May 2011 by the movie *Da Tang Xuan Ji Tu*, raising funds through *Shenzhen Qianhai Financial Asset Exchange*
- With the success of *Huayi Brothers*, more film companies started to look for capitals through listing on stock market of either domestic or overseas
- E.g. *PolyBona* was listed on *NSDAQ* on December 2010 and became the first film company listed overseas
- China's central government also encouraged qualified state-owned and state holding film companies to go to list
- There will be more film companies of either production, distribution or cinema circuits prepare to go to list in 2011 and the next 3 years
- More companies including *China Film Group*, *Shanghai Film Group* and *Enlight Pictures* have plan to go to list in 2011

⁴ IMAX: Image Maximum

Digital films replacing traditional films

- With its lower cost and convenience of copy and transport, digital films have replaced traditional films as the dominant form in the market
- Box office income of digital films was ~RMB 7 billion (US\$ 1 billion) in 2010, which accounted for 68% of total annual box office revenues
- Correspondingly, digital screens also experienced a fast growth; the number of digital screens rose to 4,100 in 2010, 156% increase from 2009 making China No.2 in the world after US
- Fast development of digital screens benefits from policies issued on Nov 2009 that cinemas installing digital screens can enjoy at most RMB 50,000 (US\$ 7300) subsidies from state film funds
- The number of digital screens are expected to reach 11,800 by 2012 with proportion over 85%

Diversified exhibition channels & types of films

- With developing technology, especially the connection of internet, telecom network, and broadcast-TV network, more and more platforms appeared for films exhibition
- Especially paid TV / IPTV, online video on demand which either through PC or mobile phones or TVs
- These channels are also getting regulated, e.g. all films can be downloaded for free from internet around 2-3 years ago, but recently video websites started to charge fees for new films
- In March 2011, 9 well-known video websites including *LETV, Tencent, PPTV, PPS, Youku* have jointly formed *China Film Internet Distribution Alliance* to promote internet the 2nd largest film distribution channel
- Those 9 video websites agreed to have new films released on the same time with the same charge (normally RMB 5 per film)
- Besides, websites such as *Youku, Sina* and *Sohu* started to invest film & TV products, which are called “micro-movie”; those films will be shown on websites and have bring opportunities to many young film producers

Faster development in Tier 2 and 3 cities and Central & Western China

- There were over 300 new cinemas and more than 1,500 screens constructed in 2010; those in Tier 2 and 3 cities and Central & Western China accounted for over 40%
- This was partially driven by digital films, which made cinemas in Tier 2 and 3 cities have the same showing time with those in Tier 1 cities
- Another big reason is that later / new entrants choose to set up cinemas in Tier 2 and 3 cities as they believe there are bigger markets than that in Tier 1 cities which have been taken by large players

More policy supports from governments

- The film industry will be expected to have an even faster development during 2011-2015
- According to the “12th Five-Year Plan”, cultural industrial production value will account for 5% of GDP from the current 2.5% and became the strategic industry
- Governments will continue to provide financing supports, e.g. reducing or remission of taxes, bank loan, and film funds etc.
- The market is also expected to be more open to foreign films; e.g. imported quota of foreign films will be increased to 40 or even canceled, and distribution market will open to private competitors instead of the current 2 state-owned ones

CONSIDERATION FOR ITALIAN PLAYERS

Key opportunities in the China film market

Increasing market with government support

- China's film market will continue to grow in coming years with the aid of government support; film box-office revenues are expected to be US\$ ~2 billion by end of 2011
- “*Cultural Industrial 12th Five-Year Plan*” aims to have the annual growth rate of cultural industry (including film industry) reach 15% during 2011-2015
- The general *12th Five-Year Plan* emphasized to promote cultural industry (including film industry) to be a national pillar industry at the first time
- Central and local governments will continue to provide financial support, e.g. reducing or remission of taxes, bank loan, and film funds etc.
- Besides, the per capita screen number is still much lower than that of developed countries; with economy development, government support and increasing demand, film market of a great potential will have a good development

Import quotas expected to be canceled

- With pressure from the *WTO* and other countries, the imported quota of revenue-sharing foreign films in China is expected to be increased to 40 or canceled all together
- Quotas for flat-fee films will be also increased or canceled in the future, and distribution market will be more opened to private players as well
- This will bring more opportunity to foreign films (esp. for small-sized films) and players (esp. small production companies) from different countries

3D & IMAX will be an area that Italian players can develop

- *3D and IMAX* are growing in the China (as well as global) film market, especially as China film viewers are willing to pay a premium for the visual experience
- Among all imported films, revenues of *3D & IMAX* films accounted for 77% that of total imported films' in 2010
- Number of *3D* screens exceeded 2,000 by the end of 2010 with 190% compound annual growth rate from 2007-2010

Key challenges in the China film market

Strong competition especially from US

- China's film market has a fierce competition and dominated by several large domestic players from production, distribution to exhibition
- Top 3 domestic distribution companies have occupied ~80% market share; cinemas are controlled by domestic companies as well
- Co-production is mainly with players from Hong Kong; imported films are dominated by those from US, which have strong reputation in China market
- 16 out of 20 revenue-sharing were from US in 2010 including all top 5 films

Low awareness of Italian films

- Chinese consumers have low awareness of Italian and other European films, mostly because of strong competition from *US* and cultural difference
- Only 3 out of 20 revenue-sharing films came from Europe in 2010; none of them were from *Italy*
- It will be a challenge for Italian players to face competition from American films as well as to adapt to local consumers' taste

Copyright is still a problem

- Copyright is another obstacle for foreign film production companies to introduce their firms in China
- One of the representative copyright problems in film industry is the pirated DVD, which has a huge market in China
- It is often not the lack of regulations, but the inconsistent enforcement of regulations that allows pirated films to perpetuate in the market
- Italian players can consider protecting themselves through regulations, and also can consider high-tech (e.g. *3D & IMAX*) films with an experience that is not easily reproduced outside of the theater

Restriction on foreign investment

- Although it is allowed to invest in co-production and cinemas, foreign capital is still restricted in setting up wholly owned and JV production and distribution companies
- The restrictions on the film industry exists primarily because the Chinese government does not want to give up controlling and affecting China's media
- Foreign investment is also forbidden to enter in cinema circuits in any form, even in the end of industry chain, e.g. cinemas, foreign investment is still restricted in most of cities (e.g. can only have 49% share at most)
- These restrictions will likely still exist for some time

Practical options for Italian players approaching China market

Italian players can introduce their films into China through direct import, however, they must understand what the local market look like and what kind of films Chinese consumers like, which are probably not able to be found through direct import. Italian players can consider several different ways to approach China market

- The table below summarizes all investment modes and their status

Table: Investment Options for Italian Companies Entering the China Market

Investment Mode	Type of Investment Allowed	Note
Production Company	Forbidden	- Investment in Film production companies will likely still be forbidden in the next 5-10+ years
Co-Production	Allowed	- Three types of co-production opportunities: 1) joint production; 2) assistant production; and 3) commission production - Co-Production likely the highest potential opportunity
Cinema Circuit	Forbidden	- Distribution company and cinema circuit are regarded as the “agent” and “wholesaler” on the industrial chain
Distribution company	Forbidden	- As with production, to control and affect China’s media, China central government will not allow foreign players enter into these two areas either
Cinema	Restricted	- Most lower tier cities (Tier 2 or lower) restrict investment to minority stake Joint Venture (49% maximum) - Tier 1 and some Tier 2 cities allow up to 75% stake in cinemas
Import	Restricted	- Imports of film are limited by quotas set by SARFT; however these quotas are expected to be increased or eliminated
Representative office	Allowed	- Not able to conduct transactions, but can be used as a local area office to develop networks - However, business scope of representative offices are limited

Source: JLJ Analysis on multiple sources

Co-production is priority

- Co-production is probably the best way for Italian players (especially beginners in China market) to get involve in China's film market
- From one side, Italian players engage in the film's production, conduct the process and control cost
- From another side, they can get knowledge on China market and Chinese consumers through their Chinese partners
- In addition, a strong cooperators could have the resources of the whole film industry chain; Italian players can distribute films through their Chinese partners to lower the risk

Set up repetitive office

- Although film WFOE and JV are not allowed in China, there is no restriction on representative office (rep. office)
- Representative office is another good alternative for Italian film players:
 - A representative office is a very low cost solution to set up, and is relatively easy to set up as well as cancel
 - A representative office can be used as a headquarters to execute promotions in China, build relationships and network with local film players (either producer or distributor)
- An example is *Movie Eye Entertainment*, a Japanese film production & distribution company; it set up rep. office in Shanghai in 2002 and then moved to Beijing in 2004
 - Businesses of this rep. office include film planning, production & financing, purchasing excellent films from China & Asia, artists agency, and media development etc.
 - Representative films include *The Longest Night in Shanghai* (2007)

Other investment channels (e.g. cinema investment)

- Instead of direct import, co-production and setting up rep. office, Italian players can also consider other investment channels approaching China market, e.g. cinema investment
- Some new exhibition channels, such as Internet VOD, are developing rapidly and became popular in China; also, some websites started to develop /produce their own films, which are called "micro film" especially produced by young directors
- Italian players can consider invest those kind of channels / websites to get income and as a first step to approach China market

Utilize platforms such as film festivals and cultural communications

- There are some good platforms for Italian players approaching China market, e.g. *Shanghai International Film Festival*, *Beijing International Film Festival* and some other cultural communication

- Italian players and government are also active to promote Italian films through those platforms
- On February 2011, *SIFF* hold a promotion at Berlin, had a good communicate with Cinecitta, Chief of *Italian Film Bureau*, and announced that Italian film “Kiss me again” would be on show in China from March 4th, 2011
- “Italian Film Week-Venice Film in Xi’an” cultural activity was hold in April 2011 in Xi’an of Shaanxi province by local cultural promotion center and Italian Embassy in China to promote excellent films awarded on *Italian Venice Film Festival*

CONCLUSIONS

- China's film market developed fast last year with US\$ 1.5 billion box-office income and 64% growth rate from 2009
- Production volume increased as well however still quite a small proportion of films have chances to be released in theaters
- Market was divided by domestic films and imported in terms of box office revenues, with a 56% : 44% respective earnings in 2010
- The Market is dominated by several large film players which have covered businesses of the whole industrial chain from production, distribution to exhibition
- The industry is still very restricted for foreign players; foreign investment is still restricted in film production, distribution and cinema circuits; co-production and representative offices are allowed, and investment in cinemas is restricted (minority stake in most cases)
- Imported films are dominated by American films by both volume and value; 16 out of 20 revenue-sharing films from US, and top 5 are all from US with ~50% of total imported value in 2010
- 3D/IMAX films are very successful and are expected to continue an upward trend in terms of screens and revenues
- China's film market still have a huge potential and will develop fast in the future; tier 2 and tier 3 cities will become increasingly important as the markets are relatively untapped in terms of high tech cinemas (e.g. 3D/IMAX)
- Government had and will continue to give support to film industry at least in the next five years (2011-2015) through policies and financing support
- There are currently limited opportunities for Italian players; however opportunities do exist, primarily in the coproduction of films (e.g. *Karate Kid*) and cinemas
- However, challenges exist as well, e.g. fierce competition especially from US, Low awareness of Italian films, copyright problem, and restriction on foreign invested legal entity etc.

APPENDIX

Appendix 1. Events/ Film Festival

Shanghai International Film Festival

- *Shanghai International Film Festival*, founded in 1993, is the only class-A international film festival approved by FIAPF⁵ in China
- *Shanghai International Film Festival* is held in every June, and sponsored by both SARFT and Shanghai government
- The 9 days festival in Shanghai is one of the top 9 international class-A film festivals (e.g. Cannes, Moscow, Venice, Berlin, etc.), and the world's fastest growing film festival
- The festival can be divided in four parts:
 - “Golden Goblet” awarding event
 - International films trading market
 - “Golden Goblet” international films forum
 - International films screening events
- In recent years, the festival has pay more efforts on film project capital investment and Asian new actors & directors etc.

Beijing Screenings / Beijing International Film Festival

- *Beijing Screenings*, sponsored by CFGC and CFP⁶, was founded in 1996 and approved by SARFT
- *Beijing Screenings* is a platform for foreign film purchasers and officials of international festivals to preview and purchase China films
- It has become a domestic films’ important bridge to overseas; there have been hundreds domestic films sold to more than 70 countries and regions through *Beijing Screenings*
- After 14 years of growing, *Beijing Screenings* have been moved from each fall to April to coincide with the inaugural *Beijing International Film Festival*, which was firstly hold in 2011
- The total deal volumes of the festival hit RMB 3 billion; deals above RMB 100 million are 80% of total. The co-production film deals are 60% of total

⁵ FIAPF: International Federation of Film Producers Association

⁶ CFP: China Film Promotion International

Appendix 2. Definition of Glossaries

Glossary	Definition
Cinema	<ul style="list-style-type: none"> The actual place where the films are screened and box office revenue goes to Except for the share of box office revenue, a cinema's revenue also includes the sales of concession such as popcorn, drinks and other additional products, as well as derivative commodities of the films, which account for approximately 10-16% of a cinema's total income
Cinema circuits	<ul style="list-style-type: none"> Cinema circuit is a cinema management company that is responsible for communicating with the distribution company to schedule screenings of a film A cinema circuit consists of several cinemas; cinema circuits provide films prints, schedule screenings and manage cinemas under the circuits On a revenue-sharing scheme, cinema circuits obtain prints of the movies Cinema circuits normally schedule screenings of major productions, whereas distributors of medium or low budget films need to strive for support from the cinema circuits to secure screening possibilities
Digital film	<ul style="list-style-type: none"> Digital film refers to films that are filmed, produced, stored with digital technology, with the signals transmitted through satellite, optical fiber, disk, Compact Disks or other forms of physical transmitting forms, then transformed into audio and visual data that conforms to film technology standards, and presented on cinema screens for viewing
Digital screen	<ul style="list-style-type: none"> Digital screens refers to cinema screening rooms installed with digital projectors and can project digital films onto the screens The number of digital screens is a main index used to evaluate a region's capacity of showing digital films
Distribution companies	<ul style="list-style-type: none"> Responsible for setting up and executing marketing and promotional strategies for the films, as well as negotiating with cinema managers on release scales and the number of film prints or opening-day screens Purchase or represent a film's distribution rights, then release the film in the partnering cinema circuits on different forms of partnership Often times the production & distribution of a film is managed by the same company
IMAX film	<ul style="list-style-type: none"> IMAX films are films shot in 70mm film format or produced through computer technology to display images of extra large resolution, to be projected onto IMAX screens
IMAX screen	<ul style="list-style-type: none"> An IMAX screen is a screen to project an IMAX film; a standard IMAX screen is 22 meters wide and 16meters high, but the actual sizes IMAX screens vary in different cinemas and regions
Production companies	<ul style="list-style-type: none"> Companies that engage in film financing, shooting and post-production work of a film project, which includes film production and post-production companies The production company owns the original copyright of a film, and sells within a certain time frame of the copyright to a distribution company or distributor of other channels
Product placement	<ul style="list-style-type: none"> Product placement refers to the placement of a product or its iconic visual image or even its service into the images of a film, TV drama or program Product placement is a marketing and advertisement strategy which aims to give the viewers impression of the product or brand through scene arrangements to let the product or image reappear in the program, thus creating the effect of advertisement

Source: JLJ analysis based on multiple sources