

Company Note

CITIC Telecom 1883 HK

Termination of Coverage

- ❑ *Terminate coverage due to material change in investment thesis*
- ❑ *Completed acquisition of CTM in 1H FY12/13*
- ❑ *Transformed from an asset-light to an asset-intensive business model*
- ❑ *May shift the focus to gearing down in the near term*

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Stock Data (1883 HK)

Rating	Not Rated
Price (HK\$)	2.06
Target Price (HK\$)	n.a.
12m Price Range (HK\$)	1.307-2.86
Market cap. (HK\$m)	6,826.1
Daily t/o (HK\$)	10,803,446.8
Free float (%)	40.0
<i>Source: Bloomberg</i>	

What's New. CITIC Telecom (1883 HK) completed the acquisition of 79% equity interest in Macau Telecom (CTM) from Cable & Wireless Communication (CWC) and Portugal Telecom on 20 Jun 2013. After the completion, CITIC Telecom holds 99% stake in CTM, thus making CTM a subsidiary of the group. The group recently published the interim results for 1H FY12/13 with consolidation of CTM's performances. The group also reclassified their business segments by subsidiary companies (CT, CPC and CTM, representing their hubbing, data and telecom services respectively), instead of by services provided as before.

For the first half of the year, CITIC Telecom reported a turnover of HK\$1,881.3m, up 7.9% YoY. CTM contributed HK\$135.4m to the top-line. Excluding such, CITIC Telecom's revenue from original business amounted to HK\$1,745.9m, up 0.1% YoY. The mentioned acquisition also constituted a deemed disposal of CTM's equity, generating a HK\$1,115.4m other net gain. Profit attributable to shareholders amounted to HK\$794.6m, growing 232.5% YoY. Excluding the gain from deemed disposal, CITIC Telecom would have recorded a net loss of HK\$320.8m.

Table 1: Selected Income Statement Items

HK\$m	1H FY12/12A	Growth (%)	1H FY12/13A	Growth (%)
Revenue	1,744.0	<i>16.9</i>	1,881.3	<i>7.9</i>
CT	1,344.3		1,164.2	<i>(13.4)</i>
CPC	399.7		581.7	<i>45.5</i>
CTM	-		135.4	<i>n.a.</i>
Other revenue and net income	(1.2)	<i>n.a.</i>	1,133.6	<i>n.a.</i>
Profit from associates and JV	76.4	<i>(0.8)</i>	79.5	<i>4.1</i>
Profit from operation	197.1	<i>3.6</i>	920.6	<i>367.2</i>
Net profit	238.8	<i>2.1</i>	794.1	<i>232.5</i>
<i>Net profit margin (%)</i>	<i>13.7</i>		<i>42.2</i>	

Source: Bloomberg

What we missed. The acquisition of CTM was completed earlier than we expected (3Q FY12/13). As of 30 Jun 2013, CITIC Telecom had HK\$1,527.1m of cash and HK\$8,512.8m of debt, constituting a net debt to equity ratio of 54.0%. We missed the post-acquisition net gearing due to: 1) stronger cash position after the equity fundraising in Apr 2013; and 2) asset revaluation from the consolidation of CTM's financial accounts.

As for business performances, CT (i.e. the hubbing services) contributed HK\$1,164.2m of revenue and HK\$50.9m of adjusted EBITDA. This is mainly due to a 19.7% YoY decline in voice services sub-segment to HK\$834.7m, as compared to our forecast of HK\$1,065.8m. On the other hand, CPC, the group's VPN and other data businesses, surprised us positively by revenue growth of 45.5% YoY.

Table 2: Comparison with our pro forma estimate under previous segmental classification

HK\$m	1H FY12/13A	Growth (%)	Our estimate	Deviation(%)
Revenue	1,881.3	7.9	2,113.4	(11.0)
Voice services	834.7	(19.7)	1,065.8	(21.7)
SMS services	199.1	9.0	206.5	(3.6)
Mobile VAS	107.1	11.7	116.6	(8.1)
VPN and others	605.0	41.9	571.2	5.9
CTM	135.4	n.a.	153.3	(11.7)
Profit from operation	920.6	367.2	265.3	-71.2
Net profit	794.1	232.5	171.8	-78.4
Net profit margin (%)	42.2		8.1	
Core profit from operation*	(194.8)	n.a.	265.3	n.a.
Core net profit*	(321.3)	n.a.	171.8	n.a.
Core net profit margin (%)	n.a.		8.1	

*excluding deemed disposal of CTM

Source: Bloomberg

Our view. CITIC Telecom's hubbing service is being hurt by a 24.7% YoY reduction in voice service traffic handled and we expect the depreciation to continue, though may be at a slower pace. In the meantime, data business segment is showing a good prospect, but the segment only contributed 14.6% of revenue in 1H FY12/13, assuming CTM contributed for the entire period. It would be hard for the segment to bring about strong growth in the group level.

The business focus for CITIC Telecom has become CTM, whose segmental revenue dropped 2.7% YoY in 1H FY12/13. The weakened performance was mainly due to the decline in handsets sell, reflecting a stabilization of the smartphone market. At status quo, we do not foresee a material deterioration going forward. However, while we like CTM's monopoly in broadband services and about 46% market share in mobile market in Macau, already high penetration of such services have limited the room for further expansion. We are also wary of the government opening up the telecommunications sector to more competition by issuing new licenses. 4G services in Macau can be a good catalyst, but it is still in planning stage for now.

Moving ahead. CITIC Telecom has geared up substantially after the acquisition. The gearing up for the CTM acquisitions has compromised the group's financial position and limited CITIC Telecom's dividend payout. With the cash-strong nature of the group's business, we expect CITIC Telecom to gradually pay down their debts in the near future.

CITIC Telecom has completed the transition from an asset-light services provider to an asset-intensive telecom operator. Given also the constraints on dividend and M&A prospect, the investment thesis of the group has changed materially. As a result, we have decided to terminate our coverage on the company. Our last call was BUY with target price of HK\$3.80.

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