

## CITIC Telecom

### Expecting more in 2011

to summarize...

- FY12/10A net profit reached HK\$400m, 6.3% below our estimates
- Stronger-than-expected recovery in voice services traffic and ASP
- Expect CTM to contribute full-year results and CEC to impact on P&L on 2H FY12/11F
- Outlook beyond 2010 remains positive after re-positioning
- Revised target price at HK\$2.94. Maintain Buy.

**What's new?** CITIC Telecom announced its annual results last Friday. Turnover unexpectedly increased 9.2% YoY to HK\$2,966.5m for FY12/10A on stronger-than-expected recovery on voice services. Share of profit in associates, which was mainly driven by acquisition of 20% of Companhia De Telecomunicacoes de Macau, was at HK\$89.0m. Net profit for the period reached a record high at HK\$401.3m, up 8.0% YoY compared to FY12/09A. It was HK\$26.8m below our estimation. In the period, there was a non-cash expense for acquisition of HK\$10.5m and an option expense of around another HK\$10m, which was one of the reasons for a lower actual net profit. Acquisition of China Enterprise Communications (CEC) was approved by shareholders in Nov last year, which may impact on P&L in 2H 2011 by results consolidation.

**Table 1. Actual figure and previous estimates for FY12/10A**

| Year-end Dec (HK\$m)              | our estimates | FY12/10A | Deviation (%) |
|-----------------------------------|---------------|----------|---------------|
| Turnover                          | 2,637.4       | 2,966.5  | 12.5          |
| Profit from operations            | 403.8         | 357.0    | (11.6)        |
| Profit/(loss) share in associates | 87.9          | 89.0     | 1.3           |
| Profit before taxation            | 491.7         | 445.8    | (9.3)         |
| Net profit                        | 428.1         | 401.3    | (6.3)         |
| Total dividend                    | 213.1         | 226.6    | 6.3           |

Source: SBI E2-Capital

**Deviation for turnover due to voice services.** Actual turnover was HK\$329m higher than our estimates, which was contributed by HK\$326m upward surprise by voice services on higher traffic as well as ASP. As we have mentioned, according to Ministry of Industry and Information Technology (MIIT), China outbound calls by fixed line and IP phones were on a down-trend. There was a contraction in voice call volume in 1H and we only expected a slight rebound from the low level in 1H, yet actual recovery was stronger-than-expected. For instance, for 2H alone traffic volume was up 4.5% YoY to 5,315m minutes with ASP as high as HK\$0.21 per minute. Despite the rebound seen in 2H, we believe ASP of voice services is trending down in longer-term.

**Table 2. Business revenue estimates**

| Year-end Dec (HK\$m) | Our estimates | FY12/10A | Deviation |
|----------------------|---------------|----------|-----------|
| Turnover             | 2,637.4       | 2,966.5  | 329.1     |
| Voice services       | 1,579.6       | 1,905.6  | 326.0     |
| SMS services         | 318.6         | 315.7    | (2.9)     |
| Mobile VAS           | 131.6         | 140.6    | 9.0       |
| VPN and others       | 607.7         | 604.6    | (3.1)     |

Source: SBI E2-Capital

|                        |                |
|------------------------|----------------|
| <b>Ticker</b>          | <b>1883 HK</b> |
| <b>Rating</b>          | <b>BUY</b>     |
| Price (HK\$)           | 2.52           |
| Target Price (HK\$)    | 2.94 (+17%)    |
| 12m Price Range (HK\$) | 1.93-2.92      |
| Market cap. (US\$m)    | 770.9          |
| Daily t/o (US\$m)      | 0.9            |
| Free float (%)         | 35.0           |

#### Financial summary

| Year to Dec        | 08A   | 09A   | 10A   | 11F   | 12F   |
|--------------------|-------|-------|-------|-------|-------|
| Turnover (HK\$m)   | 1,358 | 2,717 | 2,966 | 3,242 | 3,516 |
| Net Profit (HK\$m) | 181   | 372   | 401   | 464   | 517   |
| EPS (HK\$)         | 0.168 | 0.188 | 0.168 | 0.195 | 0.210 |
| P/E (x)            | 33.2  | 16.2  | 15.0  | 12.9  | 11.6  |
| P/B (x)            | 4.3   | 3.7   | 3.2   | 2.7   | 2.4   |
| EV/EBITDA (x)      | 10.2  | 9.5   | 10.6  | 9.3   | 7.6   |
| Yield (%)          | 3.3   | 3.8   | 3.8   | 3.9   | 4.2   |
| ROE (%)            | 12.9  | 23.0  | 21.1  | 20.7  | 20.3  |
| ROCE (%)           | 12.9  | 23.0  | 21.1  | 20.7  | 20.3  |
| N. Gear. (%)       | Cash  | Cash  | Cash  | Cash  | Cash  |

Source: SBI/Bloomberg

|                           | 11F   | 12F   | 13F   |
|---------------------------|-------|-------|-------|
| Consensus EPS (HK\$)      | 0.213 | 0.235 | 0.240 |
| Previous earnings (HK\$m) | 577.7 | -     | -     |
| Previous EPS (HK\$)       | 0.242 | -     | -     |

#### Price performance

| Year to Dec              | 1m  | 3m    | 12m   |
|--------------------------|-----|-------|-------|
| Relative to HSI (%)      | 3.2 | (1.8) | (8.5) |
| Actual price changes (%) | 2.9 | (1.2) | 1.6   |



Source: Bloomberg

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**Contribution of acquired business.** During the period, CITIC Telecom acquired 20% of Companhia De Telecomunicacoes de Macau (CTM) in May 2010 and China Enterprise Communications (CEC) in Nov 2010. For CTM, it contributed HK\$21.7m for 2 months in 1H and HK\$67.3m for 6 months in 2H. The management expect growth in Macau should stay strong in 2011 upon its first full year contribution to the company. While for CEC and CPCNet, it was a VPN service provider certified for ISO9001, ISO20000 and ISO27001. ISO27001 is a certification about information security management system. We estimated Leverage on its competitiveness, its CPCNet is to launch cloud services in 2011, preliminary focus on private instead of public, being an extension service on top on its existing data management system. We expect M&A growth would still be the major focus for 2011. The table below shows our impact estimation on P&L in 2011 with respect to both acquisitions made in 2010.

**Table 3. Ex-M&A organic growth assumptions in 2011F**

| HK\$m          | Turnover<br>FY12/10A | Growth<br>rate<br>FY12/11F | Gross<br>margin<br>estimate |
|----------------|----------------------|----------------------------|-----------------------------|
| Voice services | 1,905.6              | 2.7%                       | 20.0%                       |
| SMS services   | 315.7                | 10.0%                      | 35.0%                       |
| Mobile VAS     | 140.6                | 17.5%                      | 80.0%                       |
| VPN and others | 604.6                | 10.0%                      | 35.0%                       |
| <i>Total</i>   | 2,966.5              |                            |                             |

**Table 4. Estimated impact of acquisitions on P&L in 2011F**

| Year-end Dec (HK\$m)       | FY12/11F excl. M&A | CTM contribution | CEC contribution | FY12/11F |
|----------------------------|--------------------|------------------|------------------|----------|
| Turnover                   | 3,135.3            | 0.0              | 107.2            | 3,242.5  |
| Profit from operations     | 360.6              | 0.0              | 18.8             | 379.3    |
| Profit share in associates | 0.0                | 134.5            | 0.0              | 134.5    |
| Net profit                 | 301.1              | 134.5            | 15.7             | 451.3    |

Source: SBI E2-Capital

**Outlook 2011 after re-positioning.** We believe CITIC Telecom would likely re-position itself after changing its name. Its new name and logo are intended to reflect the company's role as key telecom business investment platform overseas for CITIC Group instead of CITIC Pacific (0267 HK). As a platform, the company may leverage on M&A opportunities from CITIC Group. CITIC Group has telecom operations such as telecom licenses, transmission network and content providers, to name a few. For 2011, in addition to M&A growth with respect to CTM and CEC and market growth in voice services, SMS services, data services and mobile VAS, we believe contribution from data centre would gradually be seen beyond 2011 in terms of VPN services. The company currently operates 2 data centres in Admiralty and Central. In Kwai Chung, the company is planning its third data centre. For phase 1, it is up to 35,000 sq feet, schedule to complete next month. While for phase 2, the company tentatively complete another 18,000 sq feet by the end of the year. The management indicated that return on this investment would be double-digit. We would look more closely on the development.

**Table 5. Pro-forma profit and loss**

| Year to Dec (HK\$m)                      | 08A          | 09A          | 10A          | 11F          | 12F          |
|--|--------------|--------------|--------------|--------------|--------------|
| Turnover                                 | 1,358.3      | 2,716.6      | 2,966.5      | 3,242.5      | 3,515.8      |
| Other revenue                            | 10.0         | 5.5          | 3.5          | 0.0          | 0.0          |
| Other net (loss)/gain                    | (11.5)       | 0.5          | (7.0)        | (0.0)        | (0.0)        |
| Network, operations and support expenses | (916.2)      | (1,801.0)    | (2,042.3)    | (2,233.0)    | (2,387.2)    |
| Depreciation and amortization            | (56.7)       | (110.9)      | (113.6)      | (129.7)      | (138.3)      |
| Staff costs                              | (93.8)       | (220.5)      | (262.8)      | (290.2)      | (313.0)      |
| Other operating costs                    | (72.0)       | (141.9)      | (187.2)      | (210.2)      | (227.4)      |
| <b>Profit from operations</b>            | <b>217.9</b> | <b>448.3</b> | <b>357.0</b> | <b>379.3</b> | <b>450.0</b> |
| Finance costs                            | (0.0)        | (0.0)        | (0.2)        | 0.0          | 0.0          |
| Share of profit/(loss) in associates     | (0.9)        | (1.3)        | 89.0         | 134.5        | 141.0        |
| <b>Profit before taxation</b>            | <b>217.0</b> | <b>447.0</b> | <b>445.8</b> | <b>513.8</b> | <b>590.9</b> |
| Income tax                               | (36.0)       | (75.4)       | (44.5)       | (62.6)       | (74.2)       |
| <b>Net Profit</b>                        | <b>181.0</b> | <b>371.5</b> | <b>401.3</b> | <b>451.3</b> | <b>516.7</b> |

Source: SBI E2-Capital

**Maintain BUY with revised target price at HK\$2.94.** The ticker fell to HK\$2.52 after our last update right after announcement of CEC acquisition. Since then, there was no extra M&A deal and organic growth was not especially strong. We revise our net profit estimates to HK\$451.3m for FY12/11F and HK\$516.7m for FY12/12F, taken account into effect of 2010 M&As. Based on 12% WACC, our new target price is HK\$2.94 (from HK\$3.26), representing 15.5x and 13.6x P/E for FY12/11F and FY12/12F. We maintain our BUY rating.

**Table 6. Shareholding structure**

| Shareholder                               | % holding |
|---|-----------|
| CITIC Pacific (0267 HK)                   | 60.6      |
| Matthews International Capital Management | 6.0       |
| Public shareholding                       | 33.4      |
| Total                                     | 100.0     |

Source: HKEx

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**SBI E2-Capital stock ratings:**

**STRONG BUY** : absolute upside of >50% over the next three months

**BUY** : absolute upside of >10% over the next six months

**HOLD** : absolute return of -10% to +10% over the next six months

**SELL** : absolute downside of >10% over the next six months

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