

CITIC Telecom

M&A opportunities to emerge in 2013

to summarize...

- FY12/11A bottom line rose 14.2% YoY, slightly below our estimates
- Data business to contribute as one of first VMware powered providers in China
- Voice and SMS business remains stable
- Asset injection and other M&A less likely in 2012 until CITIC Group IPO
- Revised target price to HK\$2.81 from HK\$2.69. Maintain BUY.

Bottom line for FY12/11A slightly lower than our forecast by 6.4%. CITIC Telecom announced annual results late Feb. Turnover increased 7.8% YoY to HK\$3,196.8m, which was 2.6% lower than our estimates. Looking into its composition, while the performance of voice services and SMS services were in line with expectation, there were slight deviation for newer business segments such as mobile VAS and VPN. While cost structure of CITIC business largely remained the same with stable operating margin at 12%, net profit was reported at HK\$458.2m for FY12/11A, which was 6.4% lower than our expectation. Table 1 shows actual results for FY12/11A and deviations from our estimates. Table 2 shows YoY changes of key financial items. Table 3 shows contribution of CTM and CEC to the company in 2011A. Noted that CEC had only 5 months results consolidated during the period.

Table 1. Actual results and deviation from our estimates

Year-end Dec (HK\$m)	FY12/11A	Our estimates	Deviation
Total revenue	3,196.8	3,283.2	(2.6%)
Voice services	1,939.1	1,987.4	(2.4%)
SMS services	347.2	348.8	(0.0%)
Mobile VAS	176.3	164.9	6.9%
VPN and others	734.2	782.1	(6.1%)
Net profit	458.2	489.5	(6.4%)

Table 2. YoY changes for FY12/11A results

Year to Dec (HK\$m)	10A	11A	YoY
Turnover	2,966.5	3,196.8	7.8%
Profit from operations	357.0	375.5	5.2%
Net Profit	401.3	458.3	14.2%

Table 3. M&A contribution to FY12/11A results breakdown

Year-end Dec (HK\$m)	Ex-M&A	CTM	CEC	FY12/11A
Turnover	~3,046.8	0.0	~150.0	3,196.8
Profit share in associates	0.0	148.8	0.0	148.8
Net profit	~304.4	148.8	~5.0	458.2

Source: SBI E2-Capital

Data business to contribute in 2012. CITIC Telecom CPC partnered with VMware (VMW US) and became one of the first VMware powered cloud service providers in China. VMware workstation itself was first delivered by VMware in 1999 and is now a commonly used cloud platform. By 2011 end, CITIC Telecom secured 21 customers for its cloud segment, of which 7 of them is from existing customers, while 80 potential clients are test-running its system. Table 4 shows typical income sources of its cloud service with current HK\$20k ARPU of 20%+ margin expectation.

Ticker	1883 HK
Rating	BUY
Price (HK\$)	1.77
Target Price (HK\$)	2.81 (+58.8%)
12m Price Range (HK\$)	1.17 - 2.57
Market cap. (US\$m)	529.2
Daily t/o (US\$m)	0.3
Free float (%)	39.4

Financial summary

Year to Dec	09A	10A	11A	12F	13F
Turnover (HK\$m)	2,717	2,966	3,197	3,662	4,005
Net Profit (HK\$m)	372	401	458	509	558
EPS (HK\$)	0.188	0.179	0.192	0.213	0.234
P/E (x)	11.4	10.5	9.2	8.3	7.6
P/B (x)	2.6	1.8	1.4	1.2	1.1
EV/EBITDA (x)	6.3	8.3	7.9	6.1	5.4
Yield (%)	5.4	5.4	5.4	5.8	6.6
ROE (%)	23.0	17.2	15.0	14.7	14.4
ROCE (%)	23.0	17.2	15.0	14.7	14.4
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

	12F	13F	14F
Consensus EPS (HK\$)	0.210	0.230	0.245
Previous earnings (HK\$m)	545.5	569.6	615.3
Previous EPS (HK\$)	0.229	0.239	0.258

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	1.3	(5.0)	(25.1)
Actual price changes (%)	3.0	8.1	(31.9)



Source: Bloomberg

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Table 4. Typical income breakdown for a subscriber of cloud service

	Income breakdown
ARPU	HK\$20,000+
Cloud service	72%
Connectivity and ISP	24%
Security service	4%

Source: SBI E2-Capital

Voice and SMS business remains stable. While data business is expected to grow quickly in future, conventional voice and SMS business may at best remain stable. Over the past 3 years, voice segment experienced volume contraction largely on reduced China-inbound volume from 7,733m minutes in 2009 to 6,362m minutes in 2011. Nevertheless, increased sales contribution of international traffic that boosted ASP compensated volume contraction. As such, annual growth rate of voice revenue in the past 2 years were around 2%. On the other hand, SMS traffic increased considerably which supported high single-digit SMS revenue growth between 2009 and 2011 as SMS ASP was relatively stable.

Table 5. Further breakdown on voice services and SMS services

Year-end Dec (HK\$m)	FY12/09A	FY12/10A	FY12/11A
Voice traffic (m minutes)	10,135	10,221	9,101
Voice ASP (HK\$)	0.170	0.186	0.213
SMS traffic (m messages)	1,565	1,852	1,962
SMS ASP (HK\$ per message)	0.183	0.170	0.177

Source: SBI E2-Capital

Outlook of various segments for 2012 and M&A opportunities. As discussed, while voice and SMS segments are expected to growth at single-digit rate, mobile VAS will may remain strong growth rate on increasing international signalling traffic. Data service is expected to achieve organic growth of 20%, and with 12 months consolidation CEC performance should result in segment growth of 50% for 2012F. Table 5 shows top-line growth and gross margin assumptions for various segments for 2012F. For potential asset injection and further M&A opportunities, we remain conservative on our previous discussion of political instability within telecom sector that delayed restructuring. While as an overseas telecom platform, it is expected that there is major no asset injection time table at least until CITIC Group complete its listing in HK. Nevertheless, in Dec last year, the State Council approved restructuring of CITIC Group. The market expects CITIC Group to list in HK this year and intra-group asset allocation is likely to be clearer by the end of the year. On the other hand, while the market is optimistic on data business, valuation of 3rd party projects offered to CITIC Telecom should be generally too high, which discourages private M&A deals, in our view.

Table 6. Top-line growth and gross margin assumptions for 2012F

HK\$m	Turnover FY12/11A	Growth rate FY12/12F	Gross margin estimate
Voice services	1,939.1	2.3%	15.0%
SMS services	347.2	7.5%	30.0%
Mobile VAS	176.3	17.5%	80.0%
VPN and others	734.2	49.4%	35.0%
<i>Total</i>	3,196.8		

Source: SBI E2-Capital

Maintain BUY with revised target price at HK\$2.81 at 13.5% discount rate. The company announced a final dividend of HK\$0.072. By adding HK\$0.024 interim dividend, total dividend for 2011 was HK\$0.096 per share. At spot price of HK\$1.77, historical dividend yield is 5.4% at 50% dividend payout ratio. While we slightly revise down our profit forecast for FY12/12F and FY12/13F to HK\$508.7m and HK\$558.3m respectively (down from HK\$545.5m and HK\$569.6m), we adjust target price to HK\$2.81 to reflect stronger future growth on data business. Based on our new target price is HK\$2.81 (from HK\$2.67), representing 13.2x and 12.0x P/E for FY12/12F and FY12/13F. We maintain our BUY rating.

Table 7. 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

Table 8. Pro-forma profit and loss

Year to Dec (HK\$m)	09A	10A	11A	12F	13F
Turnover	2,716.6	2,966.5	3,196.8	3,662.0	4,004.6
Other revenue	5.5	3.5	1.5	0.0	0.0
Other net (loss)/gain	0.5	(7.0)	0.2	0.0	0.0
Network, operations and support expenses	(1,801.0)	(2,042.3)	(2,214.4)	(2,509.9)	(2,744.7)
Depreciation and amortization	(110.9)	(113.6)	(127.1)	(165.7)	(173.7)
Staff costs	(220.5)	(262.8)	(300.2)	(347.2)	(400.5)
Other operating costs	(141.9)	(187.2)	(181.4)	(222.1)	(240.3)
Profit from operations	448.3	357.0	375.5	417.1	445.4
Finance costs	(0.0)	(0.2)	(1.0)	0.0	0.0
Share of profit/(loss) in associates	(1.3)	89.0	148.8	160.4	186.4
Profit before taxation	447.0	445.8	523.7	577.5	631.8
Income tax	(75.4)	(44.5)	(65.4)	(68.8)	(73.5)
Net Profit	371.5	401.3	458.3	508.7	558.3
EPS (HK\$)	0.188	0.179	0.192	0.213	0.234

Source: SBI E2-Capital

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