CITIC 1616

Fast Growing platform of CITIC Group

to summarize…

- Interim results generally in line with previous estimates
- Acquisition of China Enterprise Communications (CEC) overall a positive
- Revised CTM contribution and integrate CEC business from 2011 onwards
- Reposition as the key telecommunications investment platform of CITIC Group
- Target revised up to HK$3.26, thanks to contribution of CEC acquisition. Reiterate BUY.

Ticker	**1883 HK**
Rating	**BUY**
Price (HK$)	2.80
Target Price (HK$)	3.26 (+16%)
12m Price Range (HK$)	1.93-3.00
Market cap. (US$m)	855.6
Daily t/o (US$m)	1.1
Free float (%)	35.0

Financial summary

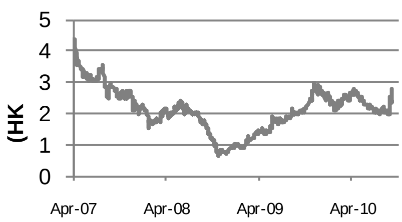
Year to Dec	08A	09A	10F	11F	12F
Turnover (HK$m)	2,486	2,717	2,637	3,011	3,206
Net Profit (HK$m)	332	372	426	578	633
EPS (HK$)	0.168	0.188	0.179	0.242	0.265
P/E (x)	19.4	17.4	18.2	13.5	12.3
P/B (x)	4.2	3.8	3.8	3.0	2.6
EV/EBITDA (x)	11.5	10.4	13.0	10.1	8.7
Yield (%)	2.6	2.9	2.7	3.7	4.1
ROE (%)	23.7	23.0	22.7	25.1	22.8
ROCE (%)	26.9	27.4	21.0	21.8	19.2
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

	10F	11F	12F
Consensus EPS (HK$)	0.195	0.232	0.246
Previous earnings (HK$m)	458.1	556.8	-
Previous EPS (HK$)	0.185	0.234	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	30.9	20.3	34.1
Actual price changes (%)	29.6	30.2	35.3



Source: Bloomberg

Kevin Mak
(852) 2533 3708
kevinmak@sbie2capital.com

Acquires China Enterprise Communications (CEC). In line with our M&A growth hypothesis, CITIC 1616 announced a HK$258m acquisition from its ultimate shareholder CITIC Group and proposed a change in company name to "CITIC Telecom International". The asset to be acquired is 49% equity interest of CEC and 100% of CEC-HK, which is a leading IP-VPN (internet protocol-virtual private network) services provider in China, being one of the few licensees in China. The consideration is to be paid by HK$187.6m in cash, and the company is to assume US$9.1m debt to controlling shareholder. Management indicated that the price-to-sales ratio is 1.55x based on 2009 sales, of which 2009 was the first year CEC-HK (the operation unit) began to make profit of HK$4.5m. Upon completion of the transaction, CITIC 1616 also will be granted a 10-year call option for the additional 45.1% equity interest in CEC.

Valuation for the acquisition at 9.8x P/E for 2010F. For 2009A, sales and net profit of CEC-HK was RMB154.4m and RMB4.5m, which represented a net margin of 2.9% for its first profitable year. With net margin expected to normalize to 15%, potential attributable profit is RMB23m. Since the transaction is to complete most likely in Q4, we ignore synergies and sales growth for 2010. As such, the total consideration of HK$258m is equivalent to 9.8x FY12/10F P/E for CEC-HK based on HK$1.1454 for RMB1. We believe the price for the acquisition is fair in short-term valuation but the acquisition is largely positive for medium to longer term. We expect more synergies to emerge in 2011, which boost a high growth for next year, followed by market growth from 2012 onwards, which is reflected in our revised model. In our view, there is low execution risk as CITIC 1616 has in the past repeatedly demonstrated their ability to merge acquired assets into the fold.

CEC-HK has VPN access in China and limited overlap with existing operations. CITIC 1616 did not own the required license to run VPN business in China. Instead, prior to the acquisition, fully-owned subsidiary CPCNet to own a minority stake in China VPN operations. CPCNet had exposure to the around one-third market share in VPN market in China. Its service fee is 30% to 40% higher than China Unicom and China Telecom, the remaining 2 major operators, due to CITIC 1616's focus on the higher-end market. Upon acquiring CEC, CITIC 1616 owned the required license and lower-to-mid end client base. We believe CEC has reached a critical mass and is supposed to realize cost saving in 2011 upon its merge with CPCNet. From 2012 onwards, we expect CITIC 1616 could realize strong growth with exposure to both high-end and low-end market VPN market in China.

CITIC's repositioning. We believe CITIC 1616 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. 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.

Interim results generally in line with expectation. Revenue decreased 3.2% YoY to HK$1,291.2m for 1H FY12/10A while net profit increased slightly by 1.3% YoY to HK$180.1m. Turnover was 8.1% below our expectation. In the previous report, we downward revised our growth assumptions on voice calls in-and-out of China, yet the actual figure was still weaker than our expectation. As we have mentioned, according to Ministry of Industry and Information Technology (MIIT), China outbound calls by fixed line and IP phones are on a down-trend. There was a contraction in voice call volume in 1H. According to MIIT figure up to Jul, fixed line and IP phone international call was even falling faster at 9.6% YoY to 178m minutes in the month, leading to a downward revision of voice segment performance.

On the other hand, despite a weaker-than-expected turnover, profit from associates was HK$21.7m, largely above our expectation of HK$11.9m. The management attributed this to robust Macau economy and synergies with respect to the acquisition of 20% of Companhia De Telecomunicacoes de Macau (CTM). Actual net profit and dividend payout were close to our estimation for the period.

Table 1. Acutal figure and previous estimates for 1H FY12/10A

Year-end Dec (HK$m)	our estimates	1H FY12/10A	Deviation (%)
Turnover	1,404.8	1,291.2	-8.1
Profit from operations	204.2	187.4	-8.2
Share of profit/(loss) in associates	11.9	21.7	81.7
Profit before taxation	216.2	209.1	-3.3
Net profit	181.6	180.1	-0.8
Dividend	50.8	50.4	-0.8

Source: Company data, SBI E2-Capital

Maintain BUY with revised target price at HK$3.26. The ticker rose to HK$2.80 beyond our target price from HK$2.04 in our last update. We revised our sales estimate to HK$2,637m for FY12/10F and HK$3,011m for FY12/11F (from HK$2,877m for FY12/10F and HK$3,084m for FY12/11F). Net profit estimate is revised down to HK$426.2m for FY12/10F while revised up to HK$577.7m for FY12/11F (from HK$458.1m for FY12/10F and HK$556.8m for FY12/11F). The positive effect of the M&A is actually reflected later, possibly beyond 2011. Based on 12% WACC, our new target price is HK$3.26 (from HK$2.68). We maintain our BUY rating.

Table 3. Pro-forma profit and loss

Year to Dec (HK$m)	**08A**	**09A**	**10F**	**11F**	**12F**
Turnover	1,358.3	2,716.6	2,637.4	3,010.5	3,205.7
Other revenue	10.0	5.5	7.0	9.0	11.5
Other net (loss)/gain	(11.5)	0.5	(8.7)	(14.0)	(14.9)
Network, operations and support expenses	(916.2)	(1,801.0)	(1,738.7)	(1,988.2)	(2,113.9)
Depreciation and amortization	(56.7)	(110.9)	(118.7)	(123.7)	(137.2)
Staff costs	(93.8)	(220.5)	(225.5)	(232.3)	(247.3)
Other operating costs	(72.0)	(141.9)	(150.9)	(149.5)	(159.1)
Profit from operations	**217.9**	**448.3**	**401.9**	**511.8**	**544.7**
Finance costs	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Share of profit/(loss) in associates	(0.9)	(1.3)	87.9	150.7	160.5
Profit before taxation	**217.0**	**447.0**	**489.8**	**662.6**	**705.2**
Income tax	(36.0)	(75.4)	(63.6)	(84.9)	(72.5)
Net Profit	**181.0**	**371.5**	**426.2**	**577.7**	**632.7**

Source: Company data, SBI E2-Capital