

CITIC Telecom

Transformation to telecom service provider

to summarize...

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2012A top-line in line while net profit was 7.6% below expectation. CITIC Telecom announced 2012A annual results earlier this month. Total revenue was HK\$3,609.8m, which was more or less the same as our estimates. In particular, voice services and SMS services were slightly below expectations partly due to increasing usage of IP based mobile applications. On the other hand, VPN and others revenue were higher than expectation on better-than-expected data business including launch of cloud business. Nevertheless, increased fixed costs on launch of data centre led to smaller-than-expected EBIT while profit from associate was contributed by CTM to be further acquired to 99% stake. Net profit was lower-than-expected at HK\$461.3m. Table 1 shows actual 2012A results and deviations from our estimates. Table 2 shows key P&L items of 2012A and 2011A.

Table 1. Actual 2012A results and deviations from our full year estimates

Year to Dec (HK\$m)	FY12/12A	Full year estimates	Deviation
Total revenue	3,609.8	3,606.2	+0.1%
Voice services	2,079.6	2,136.0	(2.6%)
SMS services	375.5	382.0	(1.7%)
Mobile VAS	202.7	207.2	(2.2%)
VPN and others	952.0	881.0	+8.1%
Profit from operations	348.8	398.8	(12.5%)
Profit from associate	158.3	167.8	(5.7%)
Net profit	461.3	499.3	(7.6%)

Table 2. Selected P&L items of 2012A and 2011A

Year to Dec (HK\$m)	FY12/11A	FY12/12A	YoY
Turnover	3,196.8	3,609.8	+12.9%
Profit from operation	375.4	348.8	(7.1%)
Profit from associate	148.8	158.3	+6.4%
Net profit	458.2	461.3	+0.7%

Source: SBI E2-Capital

Targets to complete acquisition of 79% interest in Macau Telecom by Q3 end.

Last month, CITIC Telecom confirmed VSA of 79% interest in Macau Telecom (CTM) at HK\$9,000.1m. CTM had around 50% market share of Macau mobile business and was the only provider of fixe line and internet service in the area. With another 20% stake acquired in 2010 from CITIC Pacific (0267 HK) through cash and shares issue, upon completion potentially in by Q4 this year, CITIC Telecom will consolidate CTM performance with HK\$4,742.5m revenue and HK\$933.9m net profit in 2012A. The transactions involved buying 51% and 28% stake from Cable & Wireless Communications and Portugal Telecom respectively at 12.2x 2012A P/E. The transaction is subject to government approval.

Ticker	1883 HK
Rating	BUY
Price (HK\$)	2.67
Target Price (HK\$)	3.80 (+42.3%)
12m Price Range (HK\$)	1.25 - 2.87
Market cap. (US\$m)	818.4
Daily t/o (US\$m)	1.9
Free float (%)	39.52%

Financial summary

Year to Dec	11A	12A	13F	14F	15F
Turnover (HK\$m)	3,197	3,610	5,183	9,663	10,439
Net Profit (HK\$m)	458	465	565	1,124	1,224
EPS (HK\$)	0.192	0.194	0.237	0.471	0.513
P/E (x)	13.9	13.8	11.3	5.7	5.2
P/B (x)	2.1	1.9	1.8	2.2	1.9
EV/EBITDA (x)	12.2	11.9	17.2	5.9	5.3
Yield (%)	3.6	3.6	3.6	3.6	3.6
ROE (%)	15.0	14.1	15.7	38.3	35.7
ROCE (%)	11.3	9.8	5.3	12.2	12.2
N. Gear. (%)	Cash	Cash	218.1	110.1	86.3

Source: SBI/Bloomberg

	13F	14F	15F
Consensus EPS (HK\$)	0.270	0.295	-
Previous earnings (HK\$m)	557	622	-
Previous EPS (HK\$)	0.234	0.261	-

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	4.9	45.2	42.8
Actual price changes (%)	5.5	58.9	60.8



Source: Bloomberg

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Transformation towards end-user focused model; income breakdown estimates. Table 3 shows income breakdown estimates before and after acquisition of CTM. As for CTM, the acquisition target, total revenue was HK\$4,742.3m for FY12/12A, including a rough breakdown of 40% handset sales, 30% enterprise and others, 20% mobile excluding handset and 10% fixed line. With HK\$933.6m net profit, net margin was high at 19.7%. While we conservatively assume the acquisition to be completed at end of Q3 in 2013F, with Q4 consolidation, total turnover in 2013F is projected to be HK\$5,182.8m with 76% from existing wholesale business and 24% from CTM retail business. As for 2014F, with full year consolidation, turnover is projected to be HK\$9,662.6m with 56% from CTM. Due to higher profit margin of CTM, CTM may contribute 70%+ bottom-line of the consolidated company in 2014F.

Table 3. Income breakdown estimates before and after further acquisition of CTM

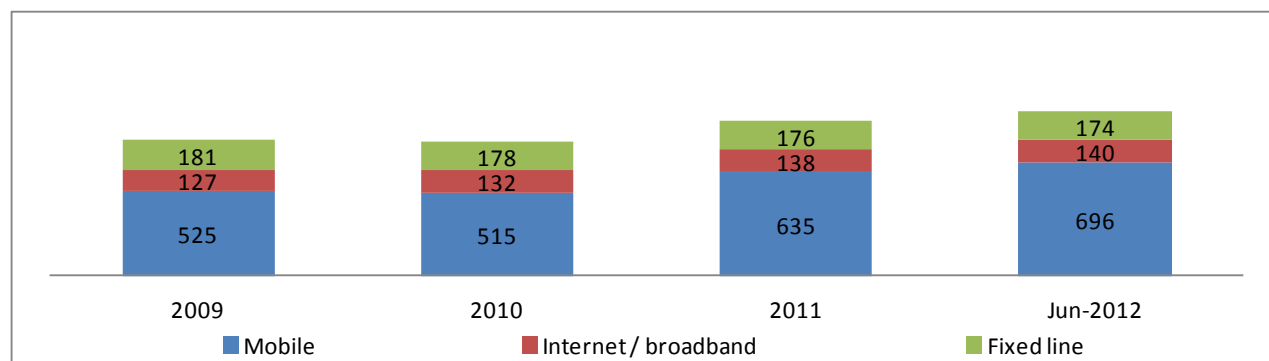
Year to Dec (HK\$m)	CTM in 2012A	Co. in 2012A	2013F, Q4 consolidated	2014F
Total turnover	4,742.3	3,609.8	5,182.8	9,662.6
Wholesale turnover	0.0	3,609.8	3,920.2	4,278.2
voice services	0.0	2,079.6	2,131.5	2,184.8
SMS services	0.0	375.5	413.1	454.4
mobile VAS	0.0	202.7	233.1	268.1
VPN and others	0.0	952.0	1,142.4	1,370.9
CTM turnover	4,742.3	0.0	1,262.6	5,384.3
Mobile excl. handset	948.5	0.0	254.9	1,096.1
Handset	1,896.9	0.0	521.7	2,295.3
Fixed	474.2	0.0	121.5	498.2
Enterprise and others	1,422.7	0.0	364.6	1,494.7
Wholesale turnover as of total	0%	100%	76%	44%
Wholesale ex-CTM net margin	-	8.4%	-	-
CTM turnover as of total	100%	0%	24%	56%
CTM net margin	19.7%	-	-	-

Source: SBI E2-Capital

CTM's dominance in mobile, fixed line, internet & enterprise solutions in Macau. According to information by CTM and Bureau of Telecommunications Regulation (DSRT), CTM is principally engaged in mobile, fixed line and broadband services in Macau. It is also the major supplier of enterprise telecom services to corporate customers in Macau.

- **Mobile.** As of Jun 2012, number of CTM mobile subscribers and total number of mobile subscribers in Macau published by DSRT suggested that CTM captured 47% market share in mobile market. Current mobile services are mainly 2G-GSM and 3G-WCDMA. CTM is one of the three 2G licensees and four 3G licensees.
- **Fixed line.** CTM is currently the only fixed line provider in Macau. Its local and international switched fixed voice and data services rights are non-exclusive until Dec 2016 with automatic extension to Dec 2021.
- **Internet.** CTM is currently the only fixed internet service provider in Macau. According to DSRT, Macau launched 250Mbps (~30MB) FTTH for residential broadband in 2011 and up to 400Mbps (~50MB) direct broadband access to commercial. There were 144,297 broadband subscribers out of 145,120 internet service subscribers by end of 2012. As for broadband internet usage, the number went up from 114.4m hrs for Q4 2010 to 145.4m for Q4 2011 and then to 185.8m for Q4 2012, which was up 27% YoY for both Q4 2012 and Q4 2011.
- **Enterprise solutions.** CTM is the only operator in Macau to offer cross domain and all-round solutions. It is the only operator of mobile virtual network (VPN) in Macau, according to DSRT. The management indicated that they provide surveillance & office securities, network system integration, IT & office appliances as well as e-solutions.

Illustration 1. Number of CTM subscribers



Source: CTM

Gearing to reach 200%+ upon completion; pro forma balance sheet. Table 4 shows our pro forma consolidated balance sheet assuming acquisition completion as of end of 2012A. We assume no fair value change for asset and liabilities of CTM for simplicity. CITIC Telecom secured US\$1.25b with US\$0.2b 1-year loan and US\$1.05b 5-year loan to finance the HK\$9,000.1m (or US\$1.16b) consideration. Thus, upon consolidation, total borrowing and net borrowing of the enlarged group would be HK\$9,949m and HK\$8,366m respectively for 2012A. At HK\$3,438m net equity, net debt-to-equity would be 243% as of 2012A end. Under our assumption of no per share dividend reduction, gearing ratio of the enlarged group would be still at 218% by end of 2013F. As such, we assume CITIC Telecom to look for at least HK\$1,200m equity financing for the short-term loan in 2014F that the ratio could be lowered to 100%-110% by the end of 2014F. Impact of the fund-raising is to be reflected in our balance sheet projection in Table 6 on the next page.

Table 4. Our pro forma balance sheet upon completion of CTM acquisition as of 2012A end

Year to Dec (HK\$m)	CTM in 2012A	Co. in 2012A	Pro forma 2012A
Non current assets			
Property, plant and equipment	864	742	1,606
Intangible assets	6	106	112
Goodwill	0	402	9,155
Interest in an associate	0	1,450	0
Interest in a jointly controlled entity	0	46	46
Non-current other receivables	0	174	174
Deferred tax assets	10	37	48
Other non-current assets	1	0	1
Current assets			
Inventories	120	0	120
Trade and other receivables	385	1,364	1,748
Current tax recoverable	0	4	4
Loans to related parties	801	0	801
Cash and cash equivalents	541	355	1,583
Current liabilities			
Trade and other payables	801	801	1,602
Bank loans	0	100	1,650
Loans from an associate	0	162	162
Current tax payable	130	43	174
Non-current liabilities			
Non-current other payables	0	88	88
Deferred tax liabilities	0	65	65
Bank loans	0	0	8,138
Other non-current liabilities	82	0	82
Net assets	1,715	3,421	3,438
MI	0	(-12)	5

Source: SBI E2-Capital

Maintain BUY with revised TP at HK\$3.80 for 8.1x 2014F P/E and 7.2x EV/EBITDA that reflects full year consolidation of CTM acquisition. CITIC Telecom met our previous target price at HK\$2.63 on positive surprise of the recent acquisition. While the acquisition is still subject to approval, it is estimated to complete this year. On 2012A basis, CITIC Telecom (excluding 20% CTM contribution) and CTM recorded HK\$306.7m and HK\$933.6m respectively. On simple addition, total net profit was HK\$1,240.3m. We estimate 2014F net profit to be HK\$1,123.8m, taken into account HK\$332.0m interest expenses at 4.0% interest rate on HK\$8,299m total borrowing in the year. As such, 2014F P/E would be 5.7x and EV/EBITDA would be 5.9x at HK\$2.67. At our revised target price at HK\$3.80, target P/E and EV/EBITDA would be 8.1x and 7.2x respectively for 2014F, which was comparable to Chinese telecom service providers, in our view. With unchanged dividend per share at HK\$0.096, current price at HK\$2.67 represents dividend yield at 3.6%. Maintain BUY.

Table 5. Profit and loss summary

Year to Dec (HK\$m)	11A	12A	13F	14F	15F
Turnover	3,196.8	3,609.8	5,182.8	9,662.6	10,438.6
Other revenue	1.5	0.5	0.0	0.0	0.0
Other net (loss)/gain	0.2	(6.4)	0.0	0.0	0.0
Network, operations and support expenses	(2,214.4)	(2,527.8)	(3,498.4)	(5,942.5)	(6,419.7)
Depreciation and amortization	(127.1)	(154.3)	(209.4)	(421.6)	(475.5)
Staff costs	(300.2)	(353.0)	(518.3)	(966.3)	(1,043.9)
Other operating costs	(181.4)	(220.0)	(315.8)	(588.8)	(636.1)
Profit from operations	375.5	348.8	640.9	1,743.4	1,863.4
Finance costs	(1.0)	(3.1)	(99.5)	(332.0)	(332.0)
Share of profit/(loss) in associates	148.8	158.3	129.0	0.0	0.0
Profit before taxation	523.7	505.2	670.4	1,411.4	1,531.4
Income tax	(65.4)	(40.2)	(105.7)	(287.7)	(307.5)
Net Profit	458.3	465.0	564.7	1,123.8	1,223.9
EPS (HK\$)	0.192	0.194	0.237	0.471	0.513

Table 6. Balance sheet summary

Year to Dec (HK\$m)	11A	12A	13F	14F	15F
Non current assets					
Property, plant and equipment	669	742	1,614	1,892	2,199
Intangible assets	90	106	112	112	112
Goodwill	364	402	9,117	8,967	8,817
Interest in an associate	1,472	1,450	0	0	0
Other non-current assets	172	258	300	338	386
Current assets					
Inventories	0	0	130	143	158
Trade and other receivables	1,308	1,364	2,059	2,435	2,917
Loans to related parties	0	0	801	801	801
Cash and cash equivalents	257	355	1,719	1,836	2,375
Other current assets	6	4	4	4	4
Current liabilities					
Trade and other payables	852	801	1,725	1,954	2,199
Bank loans	0	100	1,650	0	0
Loans from an associate	123	162	162	162	162
Current tax payable	26	43	174	174	174
Non-current liabilities					
Bank loans	0	0	8,138	8,138	8,138
Other non-current liabilities	157	153	235	235	235
Net assets	3,179	3,421	3,774	5,868	6,863
MI	0	(12)	8	14	20

Source: SBI E2-Capital

Table 7. Valuation of selected telecom service providers in emerging markets

Company	Ticker	Fiscal Year End	Mkt Cap (US\$m)	Historical	P/E (x)			ROE (%)	EV/EBITDA
					1-year fwd	2-year fwd			
CITIC Telecom	1883 HK Equity	12/2012	825.1	13.9	10.0	9.1	14.8	11.86	
China Mobile	941 HK Equity	12/2011	220,989.2	10.9	11.1	11.0	19.6	4.00	
China Telecom	728 HK Equity	12/2011	41,945.7	17.1	17.6	13.9	6.3	3.70	
China Unicom	762 HK Equity	12/2011	35,067.9	42.4	31.9	20.1	2.4	4.36	
Telefonica Brasil	VIV US Equity	12/2011	27,498.2	n.a.	12.3	11.7	10.2	4.54	
PT Telekomunikasi Indonesia	TLK US Equity	12/2011	20,200.3	n.a.	n.a.	n.a.	26.6	5.47	
Philippine Long Distance Telephone	PHI US Equity	12/2011	14,985.6	n.a.	16.6	16.2	26.7	8.01	
PT Indosat Tbk	IIT US Equity	12/2011	3,907.0	n.a.	n.a.	n.a.	7.6	5.72	
Telecom Argentina	TEO US Equity	12/2011	2,905.9	n.a.	5.4	5.5	30.6	5.20	
Magyar Telekom	MYTAY US Equity	12/2011	1,854.0	n.a.	n.a.	n.a.	(0.4)	3.72	
Far EasTone Telecommunications	4904 TT Equity	12/2012	8,116.0	22.6	18.3	16.1	15.1	10.19	

Source: Bloomberg

Table 8. Shareholding structure

Shareholder	% holding%
CITIC Group	60.58%
Matthews International Capital Management	7.02%
Public shareholding	32.40%
Total	100.0

Source: HKEx

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