

CITIC Telecom

Results better than expectation

to summarize...

- Interim results better than expectation; FY12/11F results revised up
- Political instability within telecom sector hinders restructuring progress
- Expect minor impact on business fundamentals expect market sentiment
- Outlook stable 2H 2011 onwards on reduced ASP of voice and SMS services
- A higher discount rate suggest further downward revision of TP to HK\$2.67

Interim results better than expectation. CITIC Telecom announced its interim results last Friday. Turnover increased 15.5% YoY to HK\$1,492m for 1H FY12/11A while net profit increased 29.8% to HK\$233.8m partly on increasing contribution from Companhia De Telecomunicacoes de Macau, which was recognized as share of profit of an associate. Positive surprise mainly comes from high voice services ASP at HK\$0.214 per minute compared to HK\$0.161 per minute for 1H FY12/10A. The management indicated that increased ASP was consistent with 2H FY12/10A performance due to higher contribution from emerging markets. Table 1 shows results of 1H this year. Table 2 shows revenue components from voice services, SMS services, mobile VAS and VPN and others while Table 3 shows a further breakdown. Noted that, however, although acquisition of China Enterprise Communications (CEC) was approved by shareholders last year, the impact of which is yet to realize on P&L in 2H this year by results consolidation.

Table 1. Results overview for past 3 interims

Year-end Dec (HK\$m)	1H FY12/10A	2H FY12/10A	1H FY12/11A
Turnover	1,291	1,675	1,492
Profit from operations	187	170	190
Share of profit/(loss) in associates	22	67	77
Profit before taxation	209	237	267
Net profit	180	221	234
EPS (HK\$)	0.086	0.082	0.098
DPS (HK\$)	0.024	0.071	0.024

Table 2. Business revenue estimates

Year-end Dec (HK\$m)	1H FY12/10A	2H FY12/10A	1H FY12/11A
Turnover	1,291.2	1,675.3	1,491.6
Voice services	790.1	1,115.5	924.4
SMS services	151.4	164.4	168.0
Mobile VAS	65.8	74.8	77.1
VPN and others	283.9	320.7	322.1

Table 3. Further breakdown on voice services and SMS services

Year-end Dec (HK\$m)	1H FY12/10A	2H FY12/10A	1H FY12/11A
Voice traffic (m minutes)	4,907	5,315	4,321
Voice ASP (HK\$)	0.161	0.210	0.214
SMS traffic (m messages)	889	963	978
SMS ASP (HK\$ per message)	0.170	0.171	0.172

Source: SBI E2-Capital

Ticker	1883 HK
Rating	BUY
Price (HK\$)	1.37
Target Price (HK\$)	2.67 (+95%)
12m Price Range (HK\$)	1.17-2.92
Market cap. (US\$m)	419.1
Daily t/o (US\$m)	0.4
Free float (%)	35.2

Financial summary

Year to Dec	08A	09A	10A	11F	12F
Turnover (HK\$m)	1,358	2,717	2,966	3,283	3,579
Net Profit (HK\$m)	181	372	401	490	545
EPS (HK\$)	0.168	0.188	0.168	0.205	0.229
P/E (x)	33.2	16.2	15.0	13.0	11.7
P/B (x)	4.3	3.7	3.2	2.8	2.5
EV/EBITDA (x)	10.2	9.5	10.6	9.9	7.9
Yield (%)	3.3	3.8	3.8	3.8	4.2
ROE (%)	12.9	23.0	21.1	21.7	21.1
ROCE (%)	55.2	43.5	36.5	44.3	43.8
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

	11F	12F	13F
Consensus EPS (HK\$)	0.210	0.225	0.240
Previous earnings (HK\$m)	451	504	569
Previous EPS (HK\$)	0.189	0.212	0.221

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(18.7)	(26.8)	(27.8)
Actual price changes (%)	(26.3)	(37.7)	(32.8)



Source: Bloomberg

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Political instability within telecom sector hinders restructuring progress. Former Vice Chairman of China Mobile Zhang Chunjiang (张春江) was arrested in December 2009. He has been sentenced to death (suspended for 2 years) following his conviction for bribery by a Chinese High Court this Jul. In fact, since the exposure of a corruption case at Sichuan Wireless Music Base, a number of high-rank executives of China Mobile were implicated and arrested in 2010, including former general manager of Sichuan Wireless Music Base Li Xiangdong (李向东), former general manager of Sichuan Mobile Li Hua (李华) and former general manager of Chongqing Mobile Shen Changfu (沈长富). While from Mar this year, another round of arrests was seen, involving former Chief Engineer of MIIT Su Jin Sheng (苏金生), deputy general manager of China Mobile's data department Ma Li (马力) and general manager of China Mobile's data department Ye Bing (叶兵). That said, sentiment of telecom industry turned sour quickly again in Q2 this year. Progress of restructuring as key overseas telecom business investment platform of CITIC Group largely pauses at least for 2011 or even 2012.

Table 4. 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

Outlook 2H 2011 onwards on reduced ASP of voice and SMS services. In both 2010 and 2011, major telecom operators in China gradually adjust roaming charges, SMS charges as well as data charges. For instance, in May, China Unicom (0762 HK) lowered roaming charges for over 50 countries, where in some area reduction was as high as 90%. While in Aug, China Mobile (0941 HK) also lowered roaming charges for over 30 countries by as much as 80%. We believe gradual roaming charges reduction is widely expected while financial impact on CITIC Telecom is relatively limited. Since CITIC Telecom pricing shares a small cost proportion to major telecom operators, pressure on margin squeeze is relatively limited for the company, in our view. On the other hand, lowered ASP promotes traffic which should partly offset negative impact of margin squeeze. From 2H this year onwards, 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 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. Phase 1 up to 35,000 sq feet is completed in 1H. 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 shows ex-M&A growth assumptions for 2011F and Table 6 shows estimated impact of acquisitions on P&L for the period.

Table 5. Ex-M&A organic growth assumptions in 2011F

HK\$m	Turnover FY12/10A	Growth rate FY12/11F	Gross margin estimate
Voice services	1,905.6	4.3%	20.0%
SMS services	315.7	10.5%	35.0%
Mobile VAS	140.6	17.3%	80.0%
VPN and others	604.6	29.4%	35.0%
Total	2,966.5		

Table 6. 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	3,176.0	0.0	107.2	3,283.2
Profit from operations	384.0	0.0	18.8	402.8
Profit share in associates	0.0	154.0	0.0	154.0
Net profit	318.6	154.0	15.7	488.3

Source: SBI E2-Capital

Maintain BUY with revised target price at HK\$2.67. The ticker fell to as low as HK\$1.17 after our last update. Base on HK\$1.37 per share and FY12/10A dividend of HK\$0.095 per share, historical dividend yield was 6.9%. We revise net profit for 2011F and 2012F to HK\$489.5m and HK\$545.5m (from HK\$451.3m and HK\$516.7m) on strong performance in voice services as well as VPN business. Based on 13% WACC, our new target price is HK\$2.67 (from HK\$2.94), representing 13.0x and 11.7x P/E for FY12/11F and FY12/12F. We maintain our BUY rating.

Table 7. 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	3,283.2	3,579.3
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)	(2,257.2)	(2,430.4)
Depreciation and amortization	(56.7)	(110.9)	(113.6)	(130.1)	(153.3)
Staff costs	(93.8)	(220.5)	(262.8)	(295.9)	(320.8)
Other operating costs	(72.0)	(141.9)	(187.2)	(198.2)	(216.0)
Profit from operations	217.9	448.3	357.0	401.8	458.8
Finance costs	(0.0)	(0.0)	(0.2)	0.0	0.0
Share of profit/(loss) in associates	(0.9)	(1.3)	89.0	154.0	162.4
Profit before taxation	217.0	447.0	445.8	555.8	621.2
Income tax	(36.0)	(75.4)	(44.5)	(66.3)	(75.7)
Net Profit	181.0	371.5	401.3	489.5	545.5
EPS (HK\$)	0.168	0.188	0.168	0.205	0.229

Table 8. Pro-forma profit and loss (Half-year)

Year to Dec (HK\$m)	1H 2010	2H 2010	1H 2011	2H 2011F
Turnover	1,291.2	1,675.3	1,491.6	1,791.6
Other revenue	2.4	1.1	1.0	0.0
Other net (loss)/gain	(1.9)	(5.1)	(0.0)	(0.0)
Network, operations and support expenses	(851.2)	(1,191.1)	(1,025.2)	(1,231.9)
Depreciation and amortization	(58.4)	(55.2)	(58.5)	(71.7)
Staff costs	(111.1)	(151.7)	(136.2)	(159.6)
Other operating costs	(83.6)	(103.6)	(82.3)	(115.9)
Profit from operations	187.4	169.6	190.3	212.5
Finance costs	0.0	0.0	0.0	0.0
Share of profit/(loss) in associates	21.7	67.3	77.0	77.0
Profit before taxation	209.1	236.6	267.2	289.5
Income tax	(29.0)	(15.5)	(33.3)	(35.1)
Net Profit	180.1	221.2	233.9	254.4

Source: SBI E2-Capital

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