

CITIC Telecom

Data business expansion pressured margin

to summarize...

- 1H sales generally in line; higher-than-expected voice but lower VPN growth
- Bottom line pressured by fixed expenses related to data centres expansion
- Outlook remains stable for 2H with further organic growth opportunities
- Cloud business rolling out since Q3 2011 extending to 50+ point of presences
- Interim dividend remains at HK\$0.024, alone equivalent to 1.5% of share price
- Maintain BUY with ongoing dividend play with TP slightly lowered to HK\$2.63

1H sales generally in line; higher-than-expected voice but lower VPN growth.

CITIC Telecom announced interim results yesterday. Turnover increased 16.9% YoY to HK\$1,744m, which was 48% of our full year estimates for 2012F. Table 1 shows actual results and contribution to full year estimates. Although total revenue was generally in line with our expectation, contribution of voice services was higher-than-expected while VPN was lower-than-expected. Looking into growth breakdown, voice services and VPN segments together captured 87% total revenue increment during the period. Table 2 shows increments of various selected revenue segments and net profit. Nevertheless, with lower profit margin from voices services and CEC acquired, net profit was merely up 2.1% to HK\$238.8m for 1H FY12/12A.

Table 1. Actual results and contribution to original full year estimates

HK\$m	1H FY12/12A	Full year estimates	1H contribution
Total revenue	1,744.0	3,662.0	48%
Voice services	1,039.1	1,984.6	52%
SMS services	182.7	373.3	49%
Mobile VAS	95.9	207.2	46%
VPN and others	426.3	1,097.0	39%
Profit from associate	75.2	160.4	47%
Net profit	238.8	508.6	47%

Table 2. Increment of selected revenue segments and net profit

HK\$m	1H FY12/11A	1H FY12/12A	YoY
Turnover	1,491.6	1,744.0	252.4
Voice services	924.4	1,039.1	114.7
VPN and others	322.1	426.3	104.2
Net profit	233.9	238.8	4.9

Source: SBI E2-Capital

Interim margin pressured by data centres fixed expenses. CEC was set to reflect its full year performance in 2012 as it consolidated with existing platform. As such, its contribution to bottom line for 1H may be at HK\$25m with addition HK\$20m from organic growth. However, with its new data centre, extra network, operations, support expenses and depreciation amounted to HK\$40m largely offset growth in other area, in our view. Table 3 illustrates impact of various items on net profit.

Table 3. Estimated impact of organic and M&A growth for 1H 2012A

HK\$m	1H 11A	Organic	CEC	Data centre	1H 12A
Turnover	1,491.6	+150	+100	~0	1,744.0
Profit from associates	77.0	(1.7)	0	0	75.2
Net profit	233.9	+20	+25	(40)	238.8

Source: SBI E2-Capital

Ticker	1883 HK
Rating	BUY
Price (HK\$)	1.56
Target Price (HK\$)	2.63 (+68.6%)
12m Price Range (HK\$)	1.25 - 1.96
Market cap. (US\$m)	477.2
Daily t/o (US\$m)	0.25
Free float (%)	39.4

Financial summary

Year to Dec	10A	11A	12F	13F	14F
Turnover (HK\$m)	2,966	3,197	3,606	3,910	4,261
Net Profit (HK\$m)	401	458	499	557	622
EPS (HK\$)	0.179	0.192	0.209	0.234	0.261
P/E (x)	9.1	8.0	7.4	6.6	5.9
P/B (x)	1.6	1.2	1.1	1.0	0.9
EV/EBITDA (x)	7.1	6.8	6.0	4.6	3.5
Yield (%)	6.2	6.2	6.8	7.6	8.5
ROE (%)	17.3	15.0	14.8	14.7	14.7
ROCE (%)	13.4	13.7	15.0	16.5	18.8
N. Gear. (%)	Cash	Cash	Cash	Cash	Cash

Source: SBI/Bloomberg

	12F	13F	14F
Consensus EPS (HK\$)	0.205	0.222	0.238
Previous earnings (HK\$m)	508.7	558.3	615.3
Previous EPS (HK\$)	0.213	0.234	0.258

Price performance

Year to Dec	1m	3m	12m
Relative to HSI (%)	(3.6)	11.8	(2.0)
Actual price changes (%)	1.3	16.7	(2.5)



Source: Bloomberg

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Outlook for 2H 2012. As for 2H this year, the management expects the environment to remain relatively stable despite various challenges such as increasing usage of internet base free text services. For cloud business, CITIC Telecom CPC partnered with VMware (VMW US) and was 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 with 80 potential clients are test-running its system. By end of Jun this year, CITIC Telecom secured 100 customers with 200 potential clients. Table 4 shows foundation of CITIC Telecom cloud business.

Table 4. Cloud business selected items

	By Jun 2012 end
Number of service centres	6
Point of presences	50+
Current number of clients	~100
HK	68%
China	19%
Taiwan	11%
Singapore	2%
Proof-of-concept (POC clients)	~200

Source: SBI E2-Capital

Maintain BUY on ongoing dividend play with revised target price at HK\$2.63 at 13.5% discount rate. CITIC Telecom announced an interim dividend of HK\$0.024. With revised forecast and 50% dividend payout ratio, together with expected final dividend of HK\$0.0757 for 2012F, total dividend yield at HK\$1.56 per share will be 6.39%. We slightly revise down our assumptions as shown in Table 5. Profit forecast for FY12/12F and FY12/13F were lowered to HK\$499.3m and HK\$556.8m respectively (down from HK\$508.7m and HK\$558.3m) to reflect slightly weaker-than-expected VPN performance and impact of service centers fixed expenses in short-term. Our new target price is HK\$2.63 (from HK\$2.81), representing 12.6x and 11.3x P/E for FY12/12F and FY12/13F. Maintain BUY rating.

Table 5. Actual results and contribution to original full year estimates

HK\$m	FY12/11A	Growth rate 12F	New est FY12/12F	Previous est FY12/12F
Voice services	1,939.1	10.2%	2,136.0	1,984.6
SMS services	347.2	10.0%	382.0	373.3
Mobile VAS	176.3	17.5%	207.2	207.2
VPN and others	734.2	20.0%	881.0	1,097.0
Total turnover	3,196.8	12.8%	3,606.2	3,662.0

Table 6. Pro-forma profit and loss

HK\$m	10A	11A	12F	13F	14F
Turnover	2,966.5	3,196.8	3,606.2	3,910.2	4,261.0
Other revenue	3.5	1.5	0.2	0.0	0.0
Other net (loss)/gain	(7.0)	0.2	(1.4)	0.0	0.0
Network, operations and support expenses	(2,042.3)	(2,214.4)	(2,524.3)	(2,698.0)	(2,918.8)
Depreciation and amortization	(113.6)	(127.1)	(141.0)	(157.1)	(174.8)
Staff costs	(262.8)	(300.2)	(342.6)	(371.5)	(404.8)
Other operating costs	(187.2)	(181.4)	(198.3)	(234.6)	(255.7)
Profit from operations	357.0	375.5	398.8	448.9	507.0
Finance costs	(0.2)	(1.0)	(0.7)	0.0	0.0
Share of profit/(loss) in associates	89.0	148.8	167.8	182.0	198.3
Profit before taxation	445.8	523.7	567.0	630.9	705.3
Income tax	(44.5)	(65.4)	(67.7)	(74.1)	(83.7)
Net Profit	401.3	458.3	499.3	556.8	621.6
EPS (HK\$)	0.179	0.192	0.209	0.234	0.261

Source: SBI E2-Capital

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

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